



SHIVAJI UNIVERSITY, KOLHAPUR

CENTRE FOR DISTANCE EDUCATION

M. Com. Part-II

Advanced Accountancy

(Taxation / Costing)

(Academic Year 2021-22 onwards)

Semester-III : Paper-V (DSE-A5)

Semester-IV : Paper-VII (DSE-A7)

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Shivaji University,
Kolhapur. (Maharashtra)
First Edition 2022

Prescribed for **M. Com. Part-II**

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Copies : 1,000

Published by:

Dr. V. N. Shinde

Ag. Registrar,
Shivaji University,
Kolhapur-416 004.

Printed by :

Shri. B. P. Patil

Superintendent,
Shivaji University Press,
Kolhapur-416 004

ISBN- 978-93-92887-46-8

★ Further information about the Centre for Distance Education & Shivaji University may be obtained from the University Office at Vidyanagar, Kolhapur-416 004, India.

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Preface

It gives us immense pleasure to bring forward this Self Instructional Material of Advanced Accountancy (Taxation/Costing) for the students of M.Com. Part-II. In the first section unit 1 gives the basic concepts and definitions about of income tax. The second unit focusses on computation of income and tax liability in respect of various entities. In the third unit, provisions regarding clubbing of income, set off and carry forward of losses have been discussed. Fourth unit gives the introduction to GST.

The second section starts with cost accounting in which first unit is introductory including elements of cost. The second unit elaborates the concepts as well as problems and solutions of job costing and contract costing. The third unit describes process costing and service costing alongwith examples. Fourth unit describes the need, reasons and also the manner of preparation of reconciliation of cost and financial accounts.

We are thankful to all the authors who have tried to incorporate the latest developments. We are also thankful to the office bearers of Centre for Distance Education and Shivaji University, Kolhapur.

Though utmost care is taken for incorporating the relevant matter, we also welcome the suggestions from students, teachers and others who find this book useful.

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INDEX

Unit No.	Topic	Page No.
Semester-III		
1	Definitions, Exemptions and Deductions	1
2	Computation of Taxable Income and Tax Liability	33
3	Clubbing of Income, Set off & Carry Forward of Losses	81
4	Introduction to GST	119
Semester-IV		
1	Introduction and Element of Cost	183
2	Job and Contract Costing	244
3	Process Costing and Service Costing	288
3	Reconciliation of Cost and Financial Accounts	333

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

Definitions, Exemptions and Deductions

Index :

- 1.0 Objectives
- 1.1 Introduction
- 1.2 Presentation of Subject Matter
 - 1.2.1 Important Definitions
 - 1.2.2 Exempted Income/Tax Free Income Under Section 10
 - 1.2.3 Deduction from Gross Total Income Under Chapter VIA
- Check Your Progress
- 1.3 Summary
- 1.4 Terms to Remember
- 1.5 Answers to check your progress
- 1.6 Exercise
- 1.7 References for Further Study

1.0 Objectives

After Studying this unit you will be able to:

- Understand - Important Terms that are used in Income Tax Act 1961.
- Concept of exemptions under section 10 of Income Tax Act 1961.
- Deductions to be allowed From Income of an assessee.
- Explain - Important definitions given under section 2 and 3 of the Income Tax Act 1961, various incomes which are not considered while calculating Gross Total Income and various deductions which allowed under chapter VI A of Income Tax Act 1961.
- Find Relationship between Income and Tax Liability of an assessee

1.1 Introduction:

Importance of Income Tax has increased in the present days as it has become a main source of revenue to the Government. Income Tax is a direct tax and has an immense impact on the tax payers. Provisions in the Income Tax Act are simplified and logically arranged to simplify the tax process and to prevent avoidance and evasion of Tax. The Finance Act is passed every year to prescribe the rates of tax applicable to the particular assessment year.

For levy of tax first of all the taxable income of a person is determined. All five heads of income are considered while calculating its Gross Total Income and after allowing deductions from gross total income, taxable income is found out.

Section-I

1.2 Presentation of Subject Matter

1.2.2 Important Definitions

(I) Important Definitions / Concepts Under Income Tax Act -1961

- **Person [Section 2(31)] : Person includes:**

- (i) An Individual;
 - (ii) A Hindu Undivided Family (HUF);
 - (iii) A Company;
 - (iv) A Firm;
 - (v) An Association of Person (AOP) or Body of Individuals (BOI), whether incorporated or not;
 - (vi) A local authority;
 - (vii) Every artificial juridical person not falling within any of the preceding sub-clauses.
- a) An individual means a natural person *i.e.* a human being. It includes a male, female, minor child. However, the income of minor is now generally included in the income of a parent. Sometimes the minor is himself liable to tax on income earned by him. Since minor is not competent to contract, his income shall be taxable through his legal guardian.

- b) A Hindu undivided family has not been defined under the tax laws. However, as per the Hindu law, it means a family which consist of all person lineally descended from a common ancestor including their wives and daughters. For detailed discussion refer Chapter 14.
- c) A firm shall have the meaning assigned to it in the Indian partnership Act, 1932 and shall include a limited liability partnership as defined in the Limited Liability Partnership Act, 2008.
- d) Association of persons: The Income –tax Act does not define an association of persons (AOP). In the absence of any definition, the words must be construed in their plain ordinary meaning.

Association of persons means two or more persons who join for a common purpose with a view to earn an income. It need not be on the basis of a contract. Therefore, if two or more persons join hands to carry on a business but do not constitute a partnership, they may be assessed as an Association of Person (AOP).

- e) Body of individuals (BOI) means a conglomeration of individuals who carry on some activity with the objective of earning some income. It would consist only of individuals. Entities like companies or firms cannot be members of a body of individuals. Normally, income- tax shall not be payable by an assessee in respect of the receipt of share of income by him from BOI/AOP if the tax has already been paid by such BOI/AOP.

- **Distinction between AOP and BOI**

1. An AOP may consist of non- individual but a BOI has to consist of individuals only. If two or more persons (like firm, company, HUF, individual etc.) join together, it is called an AOP. But if only individuals join together then it is called a BOI. For example, where X, ABC Ltd. and PQ & Co. (A firm) join together for a particular venture then they may be referred to as a body of individuals.
 2. An AOP implies a voluntary getting together for a common desire or combined will to engage in an income producing activities, whereas a BOI may not have such common desire or will.
- f) *A local authority: The expression local authority means:*

- i. Village Panchayat; or
 - ii. Municipality; or
 - iii. Municipal Committee and district Board, legally entitled to, or entrusted by the Government with, the control or management of a Municipal or local funds; or
 - iv. Cantonment Board.
- g) Artificial juridical person are entities which are not natural person but are separate entities in the eyes of law. Though they may not be sued directly in a court of law but they can be sued through persons managing them.

- **Assessment year [Section 2(9)]:**

Assessment year means the period of 12 months commencing on the first day of April every year. It is, therefore, the period from 1st of April to 31st of March, for example, the assessment year 2020-21 will commence on 1.4.2020 and will end on 31.3.2021. The tax is levied, in each assessment year, with respect to or on the total income earned by the assessee in the previous year.

- **Previous year [Section 3]:**

According to section 3, previous year means the financial year immediately preceding the assessment year. Financial year means a year which starts on 1st April and ends on 31st March.

1. Income- tax is payable on the income earned during the previous year and it is assessed in the immediately succeeding financial year which is called an assessment year. Therefore, the income earned during the previous year 1.4.2019 to 31.3.2020 will be assessed or charged to tax in the year 2020-21.
2. All assesses are required to follow a uniform previous year *i.e.* the financial year (1st April to 31st March) as their previous year. Previous year, for Income Tax purpose, will be financial year which ends on 31st of march although the assessee can close his books of account on any other date *e.g.* an assessee may maintain books of account on calendar year basis but his previous year, for Income Tax purpose, will be financial year and not the calendar year.

- **Assessee [Section 2(7)]:**

Assessee means a person by whom any other sum of money is payable under this Act and includes the following:

- i. Every person in respect of whom any proceeding under the Income-tax Act has been taken:
 - a) for the assessment of his income or the income of any other person in respect of which he is assessable; or
 - b) to determine the loss sustained by him or by such other person; or
 - c) to determine the amount of refund due to him or to such other person.
- ii. A person who is deemed to be an assessee under any provision of this Act *i.e.* a person who is treated as an assessee. This would include the legal representative of a deceased person or the legal guardian of minor if minor is taxable separately.
- iii. Every person who is deemed to be an assessee in default under any provision of this Act. A person is said to be an assessee in default if he fails to comply with the duties imposed upon him under the Income-tax Act. For example: a person, paying interest to another person, is responsible for deducting tax at source on this amount and to deposit the tax with the Government. If he fails in either of these duties *i.e.*, if he does not deduct the tax, or deduct the tax but does not deposit it with the Government, he shall be deemed to be an assessee in default.

- **Income [Section 2(24)]:** Income includes:

- i. profits and gains;
- ii. dividend;
- iii. voluntary contribution received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such religious purpose or by an association or institution referred to in section 10(21), 10(23) or 10(23C) (*iv*), (*v*), (*vi*) and (*via*) or by a electoral trust;
- iv. the value of any perquisite or profit in lieu of salary taxable under section 17(2) and (3);

- v. any special allowance or benefit, other than perquisite included under *(iv)* above, specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit;
- vi. any allowance granted to the assessee either to meet the personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living;
- vii. the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;
- viii. the value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee mentioned in clause *(iii)* or clause *(iv)* of sub-section (1) of section 160 or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee (such person being hereafter in this sub-clauses referred to as the ‘beneficiary’) and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary;
- ix. any sum chargeable to income-tax under section 28*(ii)*, *(iii)*, *(iiia)*, *(iiib)* and *(iiic)* or section 41 or section 59;
- x. the value of any benefit or perquisite taxable under section 28*(iv)*;
- xi. any sum chargeable to Income-tax under section 28*(v)*;
- xii. any capital gains chargeable under section 45;
- xiii. the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society;
- (xiiia)* the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its member;

- xiv. any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort of from gambling or betting of any form or nature whatsoever;
- xv. any sum received by the assessee from his employees as contribution to any provident fund or superannuation fund or any fund set up under the provisions of the employees State Insurance Act, 1948 or any other fund for the welfare;
- xvi. any sum received under a Key-man Insurance Policy including the sum allocated by way of bonus on such policy;
- xvii. any sum referred to in section 28(vi) (See Chapter 6);
- xviii. any sum referred to in section 56(2)(vii) i.e. gift of money and property exceeding Rs.50,000 (See Chapter 8);
- xix. the value of property referred to in section 56(2)(viii).
- xx. where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares. [Section 56(2) (viib)].

1.2.2 Exempted Income/Tax Free Income Under Section 10

Every income is taxable under income tax law, whether it is received in cash or in kind, whether it is capital or revenue income, but still some incomes are given exemption from tax. In this section we will study those incomes which are exempt from tax.

- **AGRICULTURAL INCOME**

As per section 10(1), agricultural income is exempt from tax if it comes within the definition of “agricultural income” as given in section 2(1A). In some cases, however, agricultural income is taken into consideration to find out tax on non-agricultural income.

- **RECEIPTS BY A MEMBER FROM A HINDU UNDIVIDED FAMILY**

As per section 10(2), any sum received by an individual as a member of a Hindu undivided family either out of income of the family or out of income of estate

belonging to the family is exempt from tax. Such receipts are not chargeable to tax in the hands of an individual member even if tax is not paid or payable by the family on its total income.

- **SHARE OF PROFIT FROM PARTNERSHIP FIRM**

As per section 10(2A), share of profit received by partners from a firm is not taxable in the hand of partners.

- **LEAVE TRAVEL CONCESSION**

As per section 10(5), the amount exempt under section 10(5) is the value of any travel concession or assistance received or due to the assessee from his employer for himself and his family in connection with his proceeding on leave to any place in India. The amount exempt can in no case exceed the expenditure actually incurred for the purpose of such travel. Only two journeys in a block of four years is exempt. Exemption is available in respect of travel fare only and also with respect to the shortest route.

- **FOREIGN ALLOWANCE**

As per section 10(7), any allowance paid or allowed outside India by the Government to an Indian citizen for rendering service outside India is wholly exempt from tax.

- **TAX ON PERQUISITE PAID BY EMPLOYER**

As per section 10(10CC), the amount of tax actually paid by an employer, at his option, on non-monetary perquisites on behalf of an employee, is not taxable in the hands of the employee. Such tax paid by the employer shall not be treated as an allowable expenditure in the hands of the employer under section 40.

- **AMOUNT PAID ON LIFE INSURANCE POLICIES**

As per section 10(10D), any sum received on life insurance policy (including bonus) is not chargeable to tax. Exemption is, however, not available in respect of the amount received on the following policies –

- a. any sum received under section 80DD (3) or 80DDA (3);
- b. any sum received under a Key-man insurance policy;

- c. any sum received under an insurance policy (issued after March 31, 2003) in respect of which the premium payable for any of the years during the term of policy, exceeds 20 per cent of the actual sum assured.

In respect of (c) (*supra*) the following points should be noted –

1. Any sum received under such policy on the death of a person shall continue to be exempt.
2. The value of any premiums agreed to be returned or of any benefit by way of bonus or otherwise, over and above the sum actually assured, which is received under the policy by any person, shall not be taken into account for the purpose of calculating the actual capital sum assured under this clause.

- **EDUCATIONAL SCHOLARSHIPS**

As per section 10(16), scholarship granted to meet the cost education is exempt from tax. In order to avail the exemption it is not necessary that the Government should finance scholarship.

- **DAILY ALLOWNCES OF MEMBERS OF PARLIAMENT**

Clause (17) of section 10 provides exemption to Members of Parliament and State Legislature in respect of the following allowances:

- a) Daily allowance- Entire amount is exempt
- b) Any other allowance received by a member of parliament under - Entire amount is exempt the Members of parliament (Constitution Allowance) Rules, 1986
- c) all allowances received by any person by reason of his membership – up to Rs.2000 p.m. in of any state Legislature or any committee thereof aggregate

- **FAMILY PENSION RECEIEVED BY MEMBERS OF ARMED FORCES**

As per section 10(19), family pension received by the widow (or children or nominated heirs) of a member of the armed forces (including Para - military forces) of the Union is not chargeable to tax from the assessment year 2005-06, if death is occurred in such circumstances given below—

- a. acts of violence or kidnapping or attacks by terrorists or anti-social elements;
- b. action against extremists or anti-social elements;
- c. enemy action in the international war;
- d. action during deployment with a peace keeping mission abroad;
- e. border skirmishes;
- f. laying or clearance of mines including enemy mines as also mine sweeping operations;
- g. explosions of mines while laying operationally oriented mine-fields or lifting or negotiation mine-fields laid by the enemy or own forces in operational areas near international borders or the line of control;
- h. in the aid of civil power in dealing with natural calamities and rescue operations; and
- i. in the aid of civil power in quelling agitation or riots or revolts by demonstrators.

- **INCOME OF MINOR :**

As per section 10(32), in case the income of an individual includes the income of his minor child in terms of section 64(1A), such individual shall be entitled to exemption of Rs. 1,500 in respect of each minor child if the income of such minor as includible under section (641A) exceeds that amount. Where, however, the income of any minor so includible is less than Rs. 1,500, the aforesaid exemption shall be restricted to the income so included in the total income of the individual.

- **DIVIDENDS AND INTEREST ON UNITS :**

As per section 10(34)/ (35), the following income is not chargeable to tax –

- a. any income by way of dividend referred to in section 115-O [*i.e.*, dividend, not being covered by section 2(22) (e), from a domestic company];
- b. any income in respect of units of mutual fund;

- c. income from units received by a unit holder of UTI [*i.e.*, from the administrator of the specified undertaking as defined in Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002];
- d. income in respect of units from the specified company.

- **CAPITAL GAIN ON COMPULSORY ACQUISITION OF URBAN AGRICULTURAL LAND**

As per section 10(37), in the case of an individual/Hindu undivided family, capital gain arising on transfer by way of compulsory acquisition of urban agricultural land is not chargeable to tax from the assessment year 2005-06 if such compensation is received after March 31, 2004 and the agricultural land was used by the assessee (or by any of his parents) for agricultural purposes during 2 years immediately prior to transfer.

- **LONG-TERM CAPITAL GAINS ON TRANSFER OF EQUITY SHARES/UNITS IN CASES COVERED BY SECURITIES TRANSACTION TAX**

As per section 10(38), Long-term capital gains arising on transfer of equity shares or unit of equity oriented mutual fund is not chargeable to tax from the assessment year 2005-06 if such a transaction is covered by securities transaction tax.

The securities transaction tax is applicable if equity shares or units of equity-oriented mutual fund are transferred on or after October 1, 2004 in a recognized stock exchange in India (or units are transferred to the mutual fund). If the securities transaction tax is applicable, long-term capital gain is not chargeable to tax; short-term capital gain is taxable @ 10 per cent (plus SC and EC). If income is shown as business income, the taxpayer can claim rebate under section 88E.

1.2.3 DEDUCTION FROM GROSS TOTAL INCOME UNDER CHAPTER VIA

- **Basics**

Sec 80A General Rules for deduction to be made in computing total income

Sec 80AB Deduction pertaining to specified incomes

Sec 80AC Deduction not to be allowed unless return if income is furnished.

- **Deduction pertaining to investment**

80C investment in provident fund, life insurance, equity shares

80CCC Contribution to pension funds

80CCD Contribution to a notified pension scheme

80CCE Limit on deduction

80CCF Subscription to long term infrastructure bonds

- **Deduction pertaining to medical treatment and expenses**

80D Health insurance and contribution to Central Government Health Scheme

80DD Maintenance of a dependant person with disability

80DDB Medical treatment

80U Individual with disability

- **Deduction pertaining to certain contributions**

80G Donation to certain funds, Charitable Institution, etc

80GGA Donation for Scientific Research or Rural Development

80GGB Contribution to Political Parties by Companies

80GGC Contribution to Political Parties

- **Deduction pertaining to expenditure**

80E Payment towards Interest on Education Loan

80GG Payment towards Rent

- **Deduction pertaining to Industrial Undertakings**

80IA Deduction in respect of profit and gains by undertaking or enterprises engaged in infrastructure development etc

80IAB Deduction in respect of profit and gains by undertaking or enterprises engaged in development of special Economic Zone

80IB Deduction in respect of profit and gains by undertakings other than infrastructural Development Undertaking

80IC Deduction in respect of certain undertakings or enterprises in certain Special Economic Zone

80ID Deduction in respect of profit and gains from business of Hotels and Convention Centers in specified Areas

80IE Deduction in respect of undertaking in North Eastern States

● **Deduction pertaining to Specified Business**

80JJA Deduction in respect of profit and gains from business of collecting and processing of bio-degradable waste

80JJAA Deduction in respect of employment of New Workman

80LA Deduction in respect of certain Income of Offshore Banking Units and International Financial Center

80P Deduction in respect of income of Co-Operative Societies

● **Deduction pertaining of certain Incomes**

80QQB Deduction in respect of Royalty Income etc., of authors of certain books other than text books

80RRB Deduction in respect of Royalty on Patents

“DEDUCTIONS” for the purpose of this chapter refers to deductions available from gross total income. A set of specific deductions considering various socio economic factors have been provided under this chapter. As a learner of the subject, try to understand the logical reasoning behind each and every deduction, this would help you to appreciate the provisions. One of the main reason for such high saving ratio, apart from the conservative nature of the Indian population, is the tax incentives which are made available to promote long term saving. This and many more incentives are being offered for various classes of person to promote social and economic causes. The total set of deductions available can be broadly categorized as;

S/No	Category	Section	Classification as per Act
1	Basics	80A,80AB,80AC	Deduction pertaining to certain payments

2	Deduction pertaining to investments	80C,80CCC, 80CCD, 80CCE,80CCF	Deduction pertaining to certain payments 80U is classified under “other deductions”
3	Deduction pertaining to medical treatment and expenses	80D, 80DD, 80DDB, 80U	
4	Deduction pertaining to certain contribution	80G, 80GGA, 80GGB, 80GGC	
5	Deduction pertaining to expenditure	80E, 80GG	
6	Deduction pertaining to industrial undertakings	80IA, 80IAB,80IB,80IC, 80ID,80IE	“Deduction pertaining to certain incomes”
7	Deduction pertaining to specified businesses	80JJA,80JJAA,80LA, 80P	
8	Deduction pertaining to certain Incomes	80QQB, 80RRB	

Let us now look into each of these deductions in some details.

- **General rules for deduction to be made in computing total income-Sec 80A**

- 1 Deduction cannot exceed gross total income:**

Deduction u/s 80C to 80U shall be allowed against the gross total income of an assessee. Aggregate of deductions under this chapter cannot exceed the gross total income of an assessee.

- 2 No deduction in the case of members of AOP and BOI if allowed to an AOP/BOI :**

Where a deduction has been allowed under this chapter for an AOP or BOI, no deduction for the same payment / income shall be made in computing the total income of a member of the AOP or BOI in relation to the share of such member in the income of the AOP or BOI.

3 Specific provisions for assessee claiming deduction u/s 10A, 10AA, 10B, 10BA or u/s 80IA to 80RRB (“Deduction pertaining to certain incomes”) - sec 80IA(7) to(11)

● **Deduction pertaining to investment**

This set of section consists of tax incentives available for making certain specified investments. The benefits of investment incentives are however restricted only to individual or HUF assesses. Deduction for investment is contained in the following section:

Section	Eligible assessee	Description
80C	Individual or HUF	Investment in provident fund, life insurance, equity shares etc
80CCC	Individual	Contribution to pension funds
80CCD	Individual	Contribution to a notified pension funds
80CCE	NA	Limit on deduction u/s 80C, 80CCC and 80CCD
80CCF	Individual or HUF	Subscription to long term infrastructure bonds

Let us now look into each of these section in some detail

● **Contribution to pension funds - Sec 80CCC**

Particulars	Provisions
Eligible assessee	individual assessee only
Eligible investment	Contribution to a contract of any annuity plan of LIC or any other approved insurer for receiving pension from a fund set up by LIC or any other insurer referred u/s 10(23AAB)
Quantum of deduction	Amount invested or Rs. 1.5 lakhs whichever is less
Consideration on maturity closure/ Sec	The following amounts received from the fund shall be chargeable to tax in the year of receipts as income of the

80CCC (2)	<p>assessee / nominee:</p> <ul style="list-style-type: none"> ● Any amount on surrender of the annuity plan either whether in whole or in part ● Pension received from the annuity plan
Conditions	<p>- Investment has to be made out of income chargeable to tax</p> <p>Deduction is available only on payment basis</p> <p>Where a deduction has been allowed under this section, no deduction shall be allowed u/s 80C for the same contribution</p>

● **Contribution to a notified pension scheme - Sec 80CCD**

Particulars	Provisions	
Eligible assessee	All Individual assesses	
Eligible investment	Contribution to a pension scheme notified by the Central Government	
Quantum of deduction	In case of employee assesses:	In case any other individual assessee.
	<p>A:Contribution by employee:</p> <p>Lower of actual contribution or 10% of salary for the previous year.</p>	Lower of actual contribution:
	<p>B: Contribution by employer:</p> <p>Lower of actual contribution or 10% of salary for the previous year.</p>	or 10% of gross total income for the previous year
Consideration on maturity/ closure- Sec	The following amounts received from the fund shall be chargeable to taxation in the year of receipt as income of	

80CCD(3)	<p>the assessee/ nominee:</p> <ul style="list-style-type: none"> ● Any amount on closure or opting out of pension scheme ● Pension received from the annuity plan <p><i>No income shall however arise u/s 80CCD (3) if the amount received is used for purchasing an annuity plan in the same previous year.</i></p>
Conditions	Deduction is available only on payment basis

The additional deduction of Rs. 50,000 under section 80CCD (1B) is available to assessee over and above the benefit of Rs. 1.50 lakh

- **Limit on deduction u/s 80C, 80CCC and 80CCD - 80CCE**

Aggregate deduction u/s 80C, 80CCC and 80CCD cannot exceed
Rs. 1.5 lakhs + 50,000 U/S 80CCD(1B)

- **Deduction pertaining to medical treatment and expenses**

Here, we shall look at deduction which are available for various expenses pertaining to medical treatment, insurance and maintenance. These deduction can be broadly classified as:

Section	Eligible	Description
80D	Individual or HUF	Health insurance and contribution to Central Government Health Scheme
80DD	Resident Individual and HUF	Maintenance of a dependant person with disability
80DDB	Resident Individual and HUF	Medical treatment etc
80U	Resident Individual	Individual with disability

Let us now look into each of these sections in some detail.

- **Health insurance and contribution to central Government Health Scheme- Sec 80D**

Eligible assessee - Individual and HUF

Eligible expenditure - Medical insurance premium, contribution to Central Government Health and payment for preventive health check up

Quantum of deduction - In the case of an individual

For family : Rs 25,000

For parents : Rs 25,000

In the case of HUF : Rs 25,000

Additional deduction of Rs 5,000 is available where the payment is made for the benefit of a senior citizen-

Maximum deduction under this section is Rs. 50,000

- **Condition** - Payment shall be made by any mode other than cash.

Payment shall be made out of income chargeable to tax.

Family means Spouse and Dependent Children

In case of HUF policy can be taken on any member of the HUF

- **Maintenance of a dependant person with disability - Sec 80DD**

Eligible assessee - Resident Individual and Resident HUF

- **Eligible expenditure** -

1 Medical treatment, training and rehabilitation of a **dependant** suffering from permanent physical disability **OR**

2 Amount deposited in an approved scheme of LIC/UTI for the benefit of the dependant relative.

- **Quantum of deduction** - Fixed Deduction of Rs 75,000 irrespective of actual expenditure incurred /amount deposited

In case of sever disability (80% or more) deduction enhanced to Rs 1,25,000.

- **Conditions** - Disability to be certified by a medical authority and a copy of the same to be furnished with ITR.

Relative is not dependant on any other person and does not claim deduction u/s 80U.

Where the dependant relative pre deceases the assessee, any amount received from the scheme shall be treated as income of the assessee in the year of such receipt.

Where condition of disability is temporary and requires reassessment after a specified period, the certificate shall be valid for the period starting from the assessment year relevant to the previous year during which the certificate was issued and ending with the assessment year relevant to the previous year during which the validity of the certificate expires

- **Medical treatment etc - 80DDB :**

Eligible assessee - Resident Individual and resident HUF

Eligible expenditure - In case of an individual, amount paid for medical Treatment of specified diseases for self or dependant. In case of HUF amount paid for medical treatment of specified diseases for any member of HUF

- **Quantum of deduction** - Rs 40,000 or actual expenditure whichever is less

For senior citizens Rs 1,00,000 or actual whichever is less

- **Conditions** - Certificate by a specified medical authority to be filed with the ITR . Any reimbursement from employer or insurance company should be reduced from the amount of deduction

Specified diseases include neurological / Cancer/ AIDS/ Renal failure/ Hemophilia/ Thalassaemia

Dependent means spouse, children, parents, brothers and sisters of the individual or any of them.

- **Specified Diseases means**

1 Neurological Diseases i.e. (a) Dementia (b) Dystonia Musculoram Deformans, (c) Motor Neuron Disease, (d) Ataxia, (e) Chorea, (f) Hemiballismus, (g) Aphasia (h) Parkinsons Disease - Where it is certified to be 40% and above.

2 Malignant Cancer

3 Full Blown Acquired Immuno Deficiency Syndrome (AIDS)

- 4 Chronic Renal Failure
- 5 Haemophilia
- 6 Thalassaemia

● **Deductions pertaining to certain contributions**

The deductions discussed under this classification relate to incentives given to the assessee in respect of contributing towards specified causes and institutions. The provisions are aimed to provide an incentive to person to make active contributions for social and welfare causes. These deductions are provide under the following section

Section	Eligible assessee	Description
80G	All Assesseees	Donations to Certain Funds, charitable Institutions, etc.
80GGA	Assessee without business income	Donations for Scientific Research or Rural Development
80GGB	Indian Company	Contribution to Political Parties by Companies
80GGC	Any Assessee except Local Authority	Contribution to Political Parties

● **Donations to Certain Funds, Charitable Institutions, etc. - Sec 80G**

Eligible assessee - All Assesseees

Eligible Contributions - Donations in money made to specified institutions / funds. List of donations are discussed later

- **Quantum of deduction** - Deductions are generally available on the following basis based on the type of donation made.
 1. Eligible for 100% deductions without qualifying limits
 2. Eligible for 50% deductions without qualifying limits
 3. Eligible for 100% deductions with qualifying limits
 4. Eligible for 50% deductions with qualifying limits

Maximum Deduction in respect of the aggregate Donations made where qualifying limit is applicable is restricted to 10% of adjusted gross Total Income. Other Donations are allowed to the extent paid.

Determination of Adjusted Gross Total Income is discussed below

- **Conditions** - Donations in kind is not considered for this section
Approval once granted u/s. 80G (5) (vi) shall continue to be valid to perpetuity
- **Donations eligible for 100% deduction without qualifying limits :**
 1. National Defense Fund set up by Central Government
 2. Prime Minister's National Relief Fund
 3. Prime Minister's Armenia Earthquake Relief Fund
 4. Africa (Public Contributions India) Fund
 5. National Foundation For Communal Harmony
 6. Approved University/Educational Institution Of National Eminence
 7. Maharashtra CM's Earthquake Relief Fund
 8. Any fund set up by State Govt. of Gujarat, exclusively for providing relief to victims of earthquake in Gujarat
 9. Zila Saksharata Samiti
 10. National /State Blood Transfusion Council
 11. Fund set up by State Govt. to provide medical relief to the poor
 12. Army Central Welfare Fund / Indian Naval Benevolent Fund/ Air Force Central Welfare Fund
 13. Andhra Pradesh CM's Cyclone Relief Fund, 1996
 14. National Illness Assistance Fund
 15. Chief Minister's Relief Fund or Lt Governor's Relief Fund
 16. National Sports Fund set up by Central Govt.
 17. National Cultural Fund set up by the Central Govt.

18. Fund For Technology Development and Application, set up by the Central Govt.
 19. National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities
- **Donations eligible for 50% deduction without qualifying limits**
 1. Jawaharlal Nehru Memorial Fund
 2. PM's Drought Relief Fund
 3. National Children's Fund
 4. Indira Gandhi Memorial Trust
 5. Rajiv Gandhi Foundation
 - **Donations eligible for 100% deduction WITH qualifying limits**
 1. Donation to Govt. or any approved local authority or association for **promoting family planning**
 2. Donation by a **company assessee**, to Indian Olympic Association or to any such other similar association notified by Central Govt. for the development infrastructure for sports and games or the sponsorship of sports and games in India.
 - **Donation eligible for 50% WITH qualifying limits**
 1. Govt. or any approved local authority / institution or association to be utilized for any charitable purpose other than family planning
 2. Any other fund fulfilling the conditions of 80G(5)
 3. To any authority constituted in India by or under any law for satisfying the need for housing accommodation or for the purpose of planning development or improvement of cities, towns and villages or both
 4. Corporation promoting the interests of minority community
 5. Notified mosque, temple, church, gurudwara or other place notified by the Central Govt. to be of historic, artistic importance
 - **Donation for Scientific Research or Rural Development - Sec 80GGA**

Eligible assessee - Assessee not having any Business or Professional Income

Eligible Contribution - Contribution to any *approved research association / University, College or Other Institution which has as its object, the undertaking of scientific research in social science or statistical research*

Contribution to an Association engaged in *Rural development or eradication of poverty-*

Quantum of deduction - 100% of Sum Paid

Conditions - NA

- **Contributions to Political Parties by Companies - Sec 80GGB**

Eligible assessee - Indian Company

Eligible Contributions - Contribution to a political party or an electoral trust

Quantum of deduction - 100% of Sum Paid

Conditions - Political Party means a political party registered under section 29A of the Representation of the people Act, 1951

- **Payment towards Interest on Education Loan - Sec 80E**

Eligible assessee - Individual assessee

Eligible expenditure - Any Sum paid by the individual in the previous year by way of interest on educational loan.

Quantum of deduction - 100% of Sum Paid

Conditions - Loan should have been taken from any financial institution or any approved charitable institution

Loan must have been taken for pursuing higher education of self or relatives

Deduction shall be allowed for 8 assessment year starting from the assessment year in which the assessee starts paying the interest on loan or until the interest thereon is paid in full, whichever is earlier

1 Higher education means any course of study pursued after passing the Senior Secondary examination or its equivalent from any school, board or university recognized by the central Government or State Government or Local Authority

2 Relative means the spouse and children of the individual or the student for whom the individual is the legal guardian

3 Principal component of education loan repaid shall not qualify for any deduction.

● **Deduction in respect of profit and gains by undertakings or enterprises engaged in development of Special Economic Zone - Sec 80IAB**

Eligible assessee - Undertaking or enterprise engaged in development of Special Economic Zone notified on or after 01.04.2005 under the Special Economic Zones Act, 2005

Eligible Income - Profits and gains derived by above undertakings or enterprises

Quantum of deduction - 100% of profits and gains derived by such business for any 10 consecutive assessment year out of 15 years beginning with the year in which the Special Economic Zone has been notified by the government.

Conditions - Profits and Gains of eligible business for the purpose of section 80IAB shall be computed as if such eligible business were the only source of income of the assessee during the previous year

Accounts to be mandatorily audited. Refer Para 11.1 for further conditions under section 80IA

Existing Developers of Special Economic Zones will get deduction only for the un-expired period of 10 consecutive assessment years

Where a Developer who develops SEZ on or after 01.04.2005 transfers the operation and maintenance of SEZ to another Developer, the deduction shall be allowed to such transferee Developer for the remaining period in the 10 consecutive assessment years as if no transfer had taken place.

● **Deduction pertaining to Specified Business :**

This set of deductions consists of tax incentives available to certain business units. These deductions have been given in order to promote certain types of business keeping the larger interest of the nation. Deduction against income of such business is contained in the following section:

Section	Eligible assessee	Description
80JJA	All Assesseees in business of	Deduction in respects of profits and

	conversion of bio degradable waste into productive resources	processing of bio degradable waste
80JJAA	Indian Company	Deduction in respect of Employment of New Workmen
80LA	Offshore Banking Units and International Financial Centre	Deduction in respect of Certain Income of Offshore Banking Units and International Financial Centre
80P	Co Operative Societies	Deduction in respect of income of Co-Operative Societies

- **Deductions to be made in Computing Total Income Summarized Provisions**

Basic rules of deductions(80A/AB/AC) - Deductions cannot exceeds GTI, Deductions not allowed to members if allowed to AOP/BOI, Deduction allowed only when claimed by the assessee, Assessee's duty to place relevant material

- **Deduction in respect of life insurance premium, Contribution to Provident fund, etc 80C-**

Life Insurance : individual, spouse, child, for policy issued after 1.4.2012 premium allowed 10% and before 1.4.2012 premium allowed 20% of capital sum assured for policy issued on or after 1.4.2013 in case the person insured is a person with disability or suffering from specified ailment or disease premium allowed - 15% of capital sum assured.

RPF/SPF: only to individual

RPF: Individual, spouse, child

National saving certificate : Principal amount plus interest both deemed to be invested

Tuition fees : For 2 children, Not towards development fees/donation, At time of admission or thereafter, Full time education

- **Residential house property:**

installment of self Finance by authority engaged in construction/ownership, Co Operative Society , Bank, Govt., LIC, National housing bank, any co. where he is

substantially interested, Employer, Expenses(stamp duty, registration fees etc.) for transfer of such house property included

- **Others :**

ULIP of UTI, Approved Superannuation fund, Notified Deposit Scheme of PSU/authority by law for development of housing projects or development of cities/towns/village, investment in Debentures and equity shares of public company, Sum deposited in Scheduled bank/post office for 5 years in term deposit, Bonds of NABARD, saving in senior citizens saving scheme

- **Deduction in respect of contribution to pension funds (80CCC):**

For Annuity plan of LIC or any other insurer & for receiving pension from LIC or any other insurer

- **Deduction in respect of contribution to notified pension scheme of Central Government (80CCD):**

Employer and employee contribution not exceeding 10% of salary in each case, Limited to 10% of GTI

- **Limit on deductions under sections 80C, 80CCC & 80CCD (80CCE):**

The aggregate amount is excluding employers contribution to pension scheme

- **Deduction in respect of investment made in an equity saving scheme (notified) (80CCG):**

Acquisition of listed equity shares or units of equity oriented fund for 3 years (lock in period), GTI of assessee shall not exceed Rs.12,00,000, If the assessee fails to comply with condition, the deduction allowed shall deemed to be the income of that previous year

- **Deduction in respect of medical insurance premia, Payment on health check up (From A.Y.2013-2014) Contribution to Central Govt. Health Scheme or other similar scheme (80D):**

For medi- claim insurance of spouse, child, dependent parents. HUF any member, For Health Check up of spouse, child dependent parents, For Govt. Scheme only individual, Not paid in cash

- **Deduction in respect of dependant who is a person with disability (80DD):**

Deduction in respect of medical treatment, etc. (80DDB):

Need to furnish a certificate from Govt. hospital doctor, Amount received from insurance company to be deducted from Rs. 40,000/60,000

- **Deduction for interest paid on loan taken for pursuing higher education (80E):**

For a period of 8 yrs from the year he starts paying interest, Self, Spouse, child

- **Deduction in respect of interest on loan sanctioned during financial year 2013-2014 for acquiring residential house (80EE):**

The loan is sanctioned by the financial institution during the period beginning on 1.4.2013 and ending on 31.3.2014, the amount of loan sanctioned for acquisition of the residential house property does not exceed Rs.25,00,000, the value of the residential house property does not exceed Rs.40,00,000, the assessee does not own any residential house property on the date of sanction of the loan.

- **Deduction in respect of donation to certain funds, charitable institutions, etc. (80G):**

Donation in kind do not qualify and if more than Rs. 10,000 payment should not be made in cash, Calculation of Adjusted GTI

- **Deduction in respect of rent paid (80GG):**

Individual, spouse, minor child or a HUF of which of he is member should not own house at a place of residence or the place of work, If assessee (individual) owns any residential house property at any other place then such property should not be assessed as self occupied in the hands of the assessee u/h house property.

- **Deduction in respect of certain donations for scientific research or rural development, etc. (80GGA):**

For scientific research, Research in social sciences or statistical research, PSU or local authority for eligible project, Rural development or urban poverty eradication

Deduction in respect of contributions given by companies to political parties (80GGB):

Political party, Electoral trust

Deduction in respect of contributions given by any person to political parties (80GGC):

Political party, Electoral trust

Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development etc. (80-IA):

It is up to assessee to choose any consecutive 10years, out of first 15/20 years of operations

Deduction in respect of profits and gains of an undertaking or a enterprise engaged in development of Special Economic Zone (80-IAB):

Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development, etc. (80-IB):

Deduction in respect of certain undertakings or enterprises in certain special category States (80-IC):

Specified Area include Export processing zone, industrial estate, Software park, Theme Park, Himachal Pradesh and Uttarakhand

Deduction in respect of profits and gains from business of hotels in specified area or world heritage site and convention centers in specified area (80-ID):

Special provisions in respect certain undertakings in North Eastern States (80-IE):

From 1.4.2007 to 1.4.2017, For manufacturing eligible article, substantial expansion to manufacture, carry any eligible business

Deduction in respect of profits and gains from business of collecting and processing of bio degradable waste (80JJA):

Deduction in respect of employment of new workmen (80JJAA):

Deduction in respect of certain incomes of Offshore Banking Units (80LA):

Deduction in respect of income of co-operative societies (80P):

Deduction in respect of royalty income, etc. of authors of certain books other than text books (80QQB):

Book for literary, artistic or scientific in nature, Derived by him in due course of his profession

Deduction in respect of royalty on patents (80RRB):

Deduction in respect of interest on deposits in saving accounts (80TTA):

Saving account with bank, co-operative bank or post office

Deduction in the case of a person with disability (80U):

Deduction available for the person himself.

Check Your Progress

a) Choose correct alternative from given below:

- 1) In case of a partner, the share of profits from the firm shall be-
 - a) Fully Taxable
 - b) Fully Exempt
 - c) Included is the total income of the partner and relief of Income Tax U/S 86 shall be allowed..
 - d) None of the above
- 2) Casual income received by the assessee is
 - a) Fully Exempt
 - b) Exempt upto Rs. 5,000
 - c) Fully Taxable
 - d) None of the above
- 3) Daily allowance received by a member of Parliament is
 - a) Exempt
 - b) Taxable
 - c) Included in total income for rate purpose
 - d) None of the above
- 4) Deductions U/S 80C in respect of life insurance premium, contribution to P.F. etc is allowed to
 - a) Any assessee
 - b) Individual assessee only
 - c) Individual of H.U.F.
 - d) Individual of HUF who is resident in India
- 5) The payment for health insurance premium U/S 80D should be paid

1.4 Terms to Remember

Exemption : An amount of income not included while calculating taxable income of assessee.

Deduction : An allowance / expenditure incurred during the year deducted from gross total income of the assessee.

Assessee : Every person in respect of whom tax or any other sum is payable under the act.

Assessment year : Period of 12 months commencing from 1st day of April every year and ending on 31st March.

Previous Year : Financial year immediately preceding the assessment year.

1.5 Answers to check your progress

- a) 1 – b, 2 – c, 3 – a, 4 – c, 5 – c
- b) 1 – Individual, 2 - 10,000 Rs., 3 – Taxable, 4 – exempt, 5 - 1,500 per minor child.
- c) 1 – False, 2 – False, 3 – True, 4 – True, 5. – False.

1.6 Exercise

a) Long Questions :

1. Explain any four exemptions u/s. 10 of Income Tax Act.
2. What is the difference between exemption and deduction? Explain with examples.
3. Write a note on any four deductions under Chapter VI A.

b) Short Answer Questions.

1. Explain the term 'Person'
2. What do you mean by 'Income' ?
3. What are sources of income ?
4. What is the provision relating to deduction u/s. 80C ?
5. What do you mean by 'Agricultural Income'. ?

1.7 References for Further Study

Manoharan, T. N. - Income Tax.

Singhania, V.K. - Student's Guide to Income Tax

Bare Act - Income Tax Act, Finance (No. 2) Act.

ICAI, New Delhi - Study Material on Income Tax.



Unit 2

Computation of Taxable Income and Tax Liability

Structure :

- 2.0 Objectives
- 2.1 Introduction
- 2.2 Presentation of Subject Matter
 - 2.2.1 Individual – Computation of taxable income and Tax liability
 - 2.2.2 HUF – Computation of taxable income and Tax liability
 - 2.2.3 Firm – Computation of taxable income and Tax liability
 - 2.2.4 AOP – Computation of taxable income and Tax liability
 - 2.2.5 Company – Computation of taxable income and Tax liability
- 2.3 Summary
- 2.4 Terms to Remember
- 2.5 Answers to Check Your Progress
- 2.6 Exercise
- 2.7 References for Further Study

2.0 Objective:

After studying this unit, students will be able to understand –

To understand theory and practical computation of incomes of assesses of various kinds such as individuals, Hindu Undivided Family, Firm and Association of Persons

2.1 Introduction :

This chapter deals with computation of income and tax liability in respect of different types of assessee.

An individual means a human being including male, female, minor, major or a person of unsound mind. The assessment of individual refers to the computation of the total income of an individual for income tax purpose. The procedure of such computation

includes following steps.

- (1) Ascertain the income of an individual as per the provisions in the Act under the various heads such as salaries, income from house property, profits and gains of business or profession, capital gains and income from other sources. The residential status of an individual should be taken into consideration while computing such income under various heads.
- (2) The proper effect should be given to the unabsorbed losses and allowances brought forward from the earlier years.
- (3) The gross total income should be calculated by editing the incomes of an individual from all the heads.
- (4) The deductions under section 80 CCC to 80 U, (if any), should be claimed from the gross total income. The balance represents to total taxable income of an individual.
- (5) Finally, tax liability on total taxable income should be computed by taking into consideration the rebates u/s 88 and relief's u/s 89 and advance tax, if any, paid by him.

✦ **Points to be remembered :**

While computing the total income of an individual assessee the following points also should be remembered:

(1) Income as a member of Hindu Undivided Family :

A share received by an individual as a member of HUF is exempt from tax u/s 10 (2) even though HUF has not paid any tax on its income.

(2) Income received as a partner of a firm :

The share in the profits of a firm (which is assessed as a firm) received by an individual as a partner is exempt from tax. But, the remuneration in the form of a salary, bonus, commission or any interest received by him from the firm in the capacity of working partner is taxable as income from business. No standard deduction can be claimed by him in respect of such salary income.

(3) Income received as a member of AOP or BOI :

A share received by an individual as a member of 'Association of Persons' or

'Body of Individuals' is dealt with as under u/s 67 (A).

- (a) In case the total income of the association or body is taxable at maximum marginal rates or at any higher rate the share received by member from its income will not be included.
- (b) In case the total income of association or body is taxable at the usual rates the share of a member is included in his total income. However, he is entitled for a rebate of tax at an average rate on such income.
- (c) In case the total income of association or body is not liable for tax, the share of member in such income is included in his total income. But, he is not entitled for a rebate of tax.

(4) Dividend received as a member of domestic company :

It is exempt from tax u/s 10 (33) hence not included in his individual income.

(5) Dividend received as a member of cooperative institution :

It is included in the individual income of a member.

2.2 Presentation of Subject Matter

2.2.1 Computation of Income & tax Liability - Individual

✦ Pro-forma of computation of taxable income of individual

Legal Status :

Previous year :

Residential Status :

Assessment year:

Particulars	Rs.	Rs.
I Income from salary		X X
II Income from house property :		
a) Self occupied	X X	
b) Letout	X X	X X
III Income from business or profession		X X
IV Capital gains		X X
V Income from other sources:		X X
Gross Total income (Total I to V)		XX
Less : Deductions under Chapter VI A		
(1) u/s 80 CCC to 80 U		X X
Total taxable income		X X
A) Tax payable		X X
B) Add : Education cess at 4% on tax		X X
Total Tax Payable		X X

✦ Illustrations

Illustration 1 :

Mr. Ramprasad, who is an employer of a company at Pune (Population exceeds 30 lakhs) furnishes the following particulars of his income.

- (1) Basic salary Rs. 30,000 per month.
- (2) Dearness Allowance Rs. 5,000 per month (not eligible for retirement benefits)
- (3) Bonus Rs. 1,00,000 p.a.
- (4) Commission fixed Rs. 2,50,000

- (5) Employees contribution to Recognized Provident Fund Rs. 50,000 to which employer contributes a matching sum.
- (6) Interest credited to Provident Fund at 10% p.a. Rs. 60,000.
- (7) Entertainment Allowance Rs. 6000 per month (He was receiving from the company Rs. 3,000 per month prior to 1.4.1955).
- (8) He was provided with a rent free accommodation of fair rent of Rs. 2,00,000 per year. The cost of furniture provided amounted to Rs. 1,00,000.

Mr. Ramprasad is the owner of a house property of the Municipal value of Rs. 18,000. It has been let out at Rs. 2,000 per month. Municipal taxes amount to 10% of the municipal value and 30% of the municipal taxes are borne by the tenant. The house remained vacant for two months during the year.

Besides he has received Rs. 65,000 as interest on bank deposits. His investments and expenditure during the year were :

Payment of LIC Premium on own life Rs. 30,000. Donation to Prime Minister's National Relief Fund Rs. 50,000. Professional tax Rs. 2,000 p.m. Medi-claim insurance premium for family Rs. 12,000.

Compute his total income for the A.Y. 2020 – 21.

Solution :

Computation of the total income of Mr. Ramprasad

Legal Status: Individual

Previous year : 2020-21

Residential Status : Resident

Assessment year : 2021-22

Particulars	Rs.	Rs.	Rs.
I Income from Salary			
Basic Salary		3,60,000	
Dearness Allowance		60,000	
Bonus		1,00,000	
Commission		2,50,000	
Annual Accretion to RPF Employers contribution	50,000		
Less : 12% of salary (Rs. 36,000)	43,200	6,800	

Interest exceeding 9.5% (i.e. 60,000 x .5/10)			
Entertainment Allowance @ Rs. 6,000 p.m.		72,000	
Rent free furnished accommodation (W.N.1)		1,27,300	
Gross Salary		9,79,100	
Less : 1) Standard Deduction u/s 16 (i)		(50,000)	
2) Professional Tax u/s 16 (iii)		(2,400)	9,05,100
II Income from House Property (Let Out)			
Gross Annual Value :			
(a) Municipal Value	18,000		
(b) Fair rent		
(c) Rental Value	24,000		
Annual Lettable Value [Higher of (a) and (b) above]	18,000		
(e) Gross Annual Value [Higher of (c) and (d) above]	24,000		
Less : Vacancy period rent	4,000	20,000	
Less : Municipal Taxes paid by owner (70% of Rs. 1,800)		(1,260)	
Annual Value		18,740	
Less : Deductions u/s 24			
(i) Standard Deduction (30% of Annual Value)		(5,622)	13,118
III Income from other sources			
Interest on Bank Deposits (Fixed Deposits)		65,000	
Interest on Savings Deposits		5,000	70,000
Gross Total Income			9,88,218
Less : Deductions u/s 80			
(1) LIC, RPF etc. u/s 80 (C)		80,000	
(2) Donations u/s 80 (G)		50,000	
(3) Medi-claim u/s 80 (D)		12,000	
(4) Interest on SB A/c u/s 80 (TTA)		5,000	1,47,000
Total Taxable Income			8,41,218

Working Note :

- 1) Valuation of rent free furnished accommodation at Ahemadabad (Population exceeds 25 lakh)

Salary :	Rs.	15% of salary of Rs. 7,82,000 i.e.	1,17,300
Basic	3,60,000	Add 10% of cost of Furniture	10,000
DA (if enters)	Nil	Value of furnished house	1,27,300
Bonus	1,00,000	(F.R.V. not to be considered for the	
Commission	1,50,000	valuation of accommodation)	
Taxable Ent. Allow.	72,000		
	7,82,000		

- 2) Deduction for entertainment allowance u/s 16 (ii) : cannot be claimed as assessee is non government employee. Until P.Y. 2000-01 non govt. employees were eligible for this deduction. And while computing this deduction the entertainment allowance received prior to 1.4.1955 was one of the limits.
- 3) Assessee can claim Deduction u/s 80 (C) in respect of his contribution to RPF & payment of LIC Premium.
- 4) DA does not enter retirement benefit and commission is fixed (i.e. not based on turnover) hence not included in salary for the purpose of calculation of RPF

Illustration 2 :

Mr. Rajmani is employed with M/s Expressions Pvt. Ltd., Mapusa. From the following information pertaining to the year ending 31st March, 2020, compute his total income :

	Rs.
Basic salary (after TDS and own contribution to Recognized PF)	6,00,000
Tax deducted at source	80,000
Bonus	1,00,000
Employer's contribution to recognized PF (Employee also contributes an equal amount)	90,000
Entertainment Allowance	95,000
House Rent Allowance	60,000

Mr. Rajmani was in continuous service with the same employer since 5th July, 2008. He also received entertainment allowance @ Rs. 4,000 per month for 2008 – 09 and @ Rs. 5,000 per month after 2018 – 19.

He is also the owner of a residential house property, which he has let out to his friend Murlidhar for annual rent of Rs. 48,000. The fair rent is Rs. 50,000 and Municipal valuation Rs. 45,000. He incurred the following expenses in connection with the said property during the previous year 2018 – 19..

- (i) Municipal taxes @ 10%
- (ii) Repairs and white wash due but not paid Rs. 5,000.
- (iii) Insurance premium paid Rs. 4,000
- (iv) Ground rent due but not paid Rs. 1,000
- (v) Interest paid on capital borrowed by his late father for constructing this property Rs. 10,500.
- (vi) Salary to rent collector Rs. 3,000.

Mr. Rajmani donated Rs. 8,000 to Goa University and spent Rs. 5,500 on medical treatment of his dependent son who is permanently physically handicapped. He paid a rent of Rs. 10,000 per month for a house where he stays and professional tax of Rs. 2,500 p.m.

Solution :

Computation of the total taxable income of Mr. Rajmani for A.Y. 2020-21

Particulars		Rs.	Rs.	Rs.
I	Income from Salary			
	Basic pay (Net)	6,00,000		
II	Add : (1) Tax deducted at source	80,000		
	(2) Contribution to RPF	90,000	7,70,000	
	Bonus		1,00,000	
	Employers' contribution to RPF			
	Exceeding 12% of salary Rs. 7,70,000			Nil
	Entertainment Allowance			95,000

House Rent Allowance	60,000		
Less : Exempt u/s (13 A) (W.N.1)	43,000	17,000	
Gross Salary		9,82,000	
Less : 1) Standard Deduction u/s 16 (i)	50,000		
2) Professional Tax u/s 16 (iii)	30,000		
3) Entertainment Allowance (W.N.2)	Nil	80,000	9,02,000
III Income from House Property (Let Out)			
Gross Annual Value :			
(a) Municipal Value	45,000		
(b) Fair rent Value	50,000		
(c) Annual Rental Value	48,000		
(d) Annual Letable Value [Higher of (a) and (b) above]	50,000		
(e) Gross Annual Value [Higher of (c) and (d) above]		50,000	
Less : Municipal Taxes paid 10% of M.V.		4,500	
Annual Value		45,500	
Less : Deductions u/s 24			
Standard Deduction (30% of Annual Value)	13,650		
Insurance premium paid	Nil		
Ground Rent due	Nil		
Interest on Housing Loan	1,500	24,150	21,350
Gross Total Income			9,23,350
Less : (1) Deduction for RPF Contribution u/s 80 (c)		90,000	
2) Deduction for handicapped dependent u/s 80 (DD)		50,000	
3) Deduction for donation u/s 80 (G)		8,000	1,48,000
Total Taxable Income			7,75,350

Working Notes :**1) Exemption for House Rent Allowance u/s 10(13A)**

Salary		a) Actual HRA received	60,000
Basic	7,70,000	b) Rent paid	1,20,000
D.A. (if enters)	Nil	Less : 10% of salary	77,000
	7,70,000		43,000
Rent paid	1,20,000	c) 40% of salary whichever is less is exempt i.e.	3,08,000 43,000

Notes: 1.) Deduction for Entertainment Allowance u/s 16 (ii) As the assessee is non govt. employee he cannot claim deduction in respect of entertainment allowance. Entertainment allowance received by him during 2003-04 or 2004-05 are of no relevance to him for calculation of deduction u/s 16 (ii)

- 1) If the handicapped dependent is severely handicapped (i.e. 80% or more) the deduction u/s 80(D) is increased to Rs.75,000 instead of Rs. 50,000.
- 2) Interest on capital borrowed for construction of father is deductible u/s 24. But after expenses such as white wash expenses, repairs, rent collection charges, insurance etc. are not deductible.

Illustration 3 :

Mr. Babu of Bangalore submits the following trading and profit and loss account for the year ending 31-3-2020 :

Particulars	Rs.	Particulars	Rs.
To Opening Stock	6,00,000	By Sales	42,00,000
To Purchases	38,00,000	By closing Stock	8,00,000
To Freight	1,50,000		
To Gross Profit c/d	4,50,000		
	50,00,000		50,00,000
To Salaries & Wages	1,48,000	By Gross Profit b/d	4,50,000
To Rent and taxes	38,000	By Dividend from Co-op Society	20,000
To Income tax	6,000		

To Household expenses	42,000	By Rent from Building	
To Postage and telegram	4,000	Let out	48,000
To Donation	5,000		
To Audit Fees	2,000		
To Provision for bad debts	6,800		
To Bad Debts	4,200		
To Miscellaneous Expenses	6,000		
To Depreciation	5,000		
To Net Profit	2,51,000		
	5,18,000		5,18,000

The following information is available :

- (a) He is also an employee in a cinema company and receives salary of Rs. 2,60,000 during the year and paid professional tax @ Rs. 1000 p.m.
- (b) Purchases include Rs. 50,000 being advance to suppliers in March, 2019 against goods to be delivered in April, 2020.
- (c) Rent and taxes include Rs. 23,000 being municipal taxes paid for the building let out.
- (d) Donation is paid to the Indian Naval Benevolent Fund.
- (e) Miscellaneous expenses include Rs. 4,000 being purchase of books for the employment.
- (f) Depreciation allowable as per rules is Rs. 4,000. Compute his total income for the A.Y. 2020 – 21.

Solution :

Computation of the total income of Mr. Babu for A.Y. 2020-21

Particulars	Rs.	Rs.	Rs.
I Income from Salary			
Gross Salary		26,00,000	
Less : Standard Deduction	50,000		
Professional Tax u/s 16 (iii)	12,000	62,000	25,38,000
II Income from House Property			
Gross Annual Value – Rent		48,000	
Less : Municipal Taxes paid		23,000	
Annual Value		25,000	
Less : Standard Deduction (30%) of annual value		7,500	17,500
III Income from business:			
Net Profit		2,51,000	
Add : Inadmissible expenses:			
Advances included in	50,000		
Purchases Income Tax	6,000		
Household expenses	42,000		
Donation	5,000		
Provision for bad debts Books for employment	6,800		
Depreciation	5,000		
Municipal Taxes	23,000	1,41,800	
		3,92,800	
Less : Inadmissible incomes :			
Dividend from co-operative society	20,000		
Rent from buildings (let out)	48,000	68,000	
		3,24,800	
Less : Depreciation as per rules		4,000	3,20,800
IV Income from other sources :			
Dividend from co-operative society			20,000

Gross Total Income		28,96,300
Less : Deduction for donations u/s 80 G		5,000
Total Taxable Income		28,91,300

Note : (1) Advance for purchase is inadmissible because it is not actual purchase.

Illustration 4

The following is the summary of cash transactions of Dr. V. Kumar for the previous year ending 31-3-202X :

Particulars	Rs.	Particulars	Rs.
Opening balance	2,43,500	Rent of hospital	2,60,000
Consultation fees	15,00,000	Staff salary	2,80,000
Rent from house property	2,40,000	Cost of medicines	2,50,000
Visiting fees	4,80,000	Surgical equipments	3,00,000
Sale of medicines	7,80,000	Income Tax	60,000
Gifts	3,00,000	Medical books	80,000
Pathological fees	4,00,000	Magazines	40,000
Interest on National Def.	40,000	General expenses	80,000
Gold Bond		Household expenses	14,20,000
Interest on Bank S. B. Account	30,000	Municipal taxes	20,000
Dividend from Indian Company	80,000	Repairs	40,000
Lottary Income (Net)	3,50,000	Fire Insurance	6,000
		Wealth Tax	1,40,000
		Deposits in post office	3,00,000
		Car expenses	40,000
		Donations	1,80,000
		Charity	10,000
		Laboratory expenses	60,000
		Collection charges	5,000
		Closing balance	8,72,500
	44,43,500		44,43,500

Other information :

- (a) Municipal taxes, fire insurance and repairs are in connection with house property let out.
- (b) On 31-3-2020 there was a stock of medicines of Rs. 50,000
- (c) Gifts include Rs. 80,000 from father-in-law and the balance from patients
- (d) Depreciation as per rules Rs. 1,00,000 on all blocks of assets including on books and the portion applicable on car.
- (e) Magazines of Rs. 20,000 only were related to profession.
- (f) Household expenses included Rs. 20,000 payment made by cheque on “mediclaim” scheme and Rs. 1,20,000 paid to ‘Jeevan Suraksha’ Policy of LIC.
- (g) One-fourth of car expenses were related to personal use.
- (h) Collection charges Rs. 1,000 for dividend and Rs. 4,000 for house property.
- (i) Donations were given to National Blood Transfusion Council. Compute his total income for the assessment year 2020 – 21.

Solution :

Computation of the total income of Dr. V. Kumar for A.Y. 2020-21

Particulars	Rs.	Rs.	Rs.
I Income from profession:			
Allowable profession incomes :			
Consultation fees	15,00,000		
Visiting fees	4,80,000		
Sale of medicines	7,80,000		
Gifts from patients (30,000 – 8,000)	2,20,000		
Pathological test fees	4,00,000	33,80,000	
Less : Allowable deductions :			
Rent of hospital	2,60,000		
Staff Salary	2,80,000		
Cost of medicines (25,000 – 5,000)	2,00,000		
Magazines of profession	20,000		

General expenses	80,000		
Laboratory expenses	60,000		
Depreciation	1,00,000		
Car expenses (4,000 x $\frac{3}{4}$ office)	30,000	10,30,000	2,35,000
II Income from house property (Let out)			
Gross Annual Value – Rent		2,40,000	
Less : Municipal taxes paid		20,000	
Annual Value		2,20,000	
Less : Standard deduction (30% of A.V.)	66,000		
Fire Insurance	-	66,000	1,54,000
III Income from other sources:			
Interest on Govt. Securities		40,000	
Interest on post office S.B. Account	30,000		
Less : Exempt u/s 10 (15)	30,000	Nil	
Dividend from Indian Company	80,000		
Less : Exempt u/s 10 (34)	80,000	Nil	
Lottery Income (3,50,000 x 100/70)		5,00,000	
			5,40,000
Gross Total Income			30,44,000
Less : (1) Deduction for Jeevan Suraksha Plan u/s 80 C		1,00,000	
(2) Deduction in respect of medi-claim u/s 80 D		20,000	
(3) Deduction in respect of Donations u/s 80 G		1,80,000	3,20,000
Total Taxable Income			27,24,000

Illustration 5 :

Mr. Jagadish Khurana a salaried employee in Mumbai obtains the following emoluments from this employer during the previous year ending 31, 20XX.

Basic salary	4,80,000
Bonus	1,30,000
Commission (fixed)	1,48,000
House rent allowance	1,20,000

Employer's contribution towards recognised provident fund Rs. 62,400

During the previous year, the employer has provided a laptop computer for using it for official and private purpose. Ownership is not transferred. Further the employer provided club facility for official use.

He owns a house property which is used by him for his own residence. Municipal valuation of the house property is Rs.1,20,000. He makes the following expenditure in respect of house property

Municipal taxes : Rs. 13,000; repairs : Rs. 11,000; interest on capital borrowed to pay municipal tax : Rs. 3,150; and insurance : Rs. 1600

Besides, he has received Rs. 1.59,000 as interest from deposit in saving bank account. He has received different gifts from A-Rs. 25,000 on October 1, 20XX and from B Rs.26,000 on March 1, 20XX. During the previous year, he makes the following expenditure and investments:

Contribution towards recognised provident fund Rs. 1,40,000

Payments of insurance premium on own life policy (sum assured: Rs. 60,000)
Rs.14,000

Donation to the National Defence Fund Rs. 3,200

Determine the net Taxable Income and Tax Liability of Mr. Jagadish Khurana for the assessment year 202X-2X under old and new tax regime.

Solution:**Statement of Taxable Income and Tax Liability of Mr. Jagadish Khurana for A.Y.202X- 2X**

Particulars	Rs.	Rs.
Income from salary (see note 1)		8,32,000
Income from house property (see note 2)		Nil
Income from other sources :		
Bank interest on deposits in saving account	1,59,000	
Gift received on October 1, 20XX received on amount (Rs. 25,000 + Rs. 26,000; as the aggregate amount Exceed Rs. 50,000 it is taxable)	51,000	2,10,000
Gross total income		10,42,800
Less: deduction under section 80C to 80 U		
U/S 80C (contribution to RPF and insurance premium)	1,50,000	
U/S 80G in respect of donation to national defense fund (i.e., 100% of Rs. 3,200)	3,200	
U/s 80 TTA in respect on deposits I saving bank account	10,000	1,63,000
Net income		8,79,420
Tax (see note 3)		88,420
Add : Surcharge (not applicable)		nil
Tax and surcharge		88,420
Add : health and education cess (4% of tax and surcharge)		3,537
Normal tax liability		91,957

NOTES :

	Rs.	Rs.
1. Computation of Income from Salary		
Basic Salary		4,80,000
Bonus		1,30,000
Commission		1,48,000
House rent allowance	1,20,000	

Less : exempt from tax being the least of :		
(a) (being 50% of salary, i.e. Rs. 4,80,000) Rs. 2,40,000		
(b) (being the house rent allowance) Rs. 1,20,000		
(c) being excess of rent paid (i.e. nil) minus 10% of salary Nil	Nil	1,20,000
being the least, is exempt from tax amount taxable		
Employer's contribution in excess of 12% of salary (i.e. Rs. 62,400 – Rs. 57,600)		4,800
Gross salary		8,82,800
Less : standard deduction		50,000
Income from salary		8,32,800

The perquisites in respect of use of computer and club facility are not chargeable to tax

(2) COMPUTATION OF INCOME FROM HOUSE PROPERTY –

Since house is used for the purpose of own residence, nothing would be chargeable to tax under section 23(2)(a). Interest on capital borrowed to pay municipal tax is not deductible.

(3) Computation of Tax: *10,92,600

Particulars		Old Regime
Taxable Income (Rs)		8,79,600
Computation of Tax	Rate %	Tax (Rs)
First Rs. 2,50,000	Nil	Nil
Next Rs. 2,50,000	5	12,500
Next Rs. 3,79,600	20	75,920
Total		88,420
Particulars		New Regime
Taxable Income (Rs.) 8,79,600 + 50,000 + 1,63,200)		10,92,600
Computation of Tax	Rate %	Tax (Rs)
First Rs. 2,50,000	Nil	Nil
Next Rs. 2,50,000	5	12,500

Next Rs. 2,50,000	10	25,000
Next Rs. 2,50,000	15	37,500
Next Rs. 92,600	20	18,520
Total		93,520

2.2.2 Computation of income and tax liability- Hindu Undivided Family (HUF)

Hindu undivided family (H.U.F.) is treated as a separate entity in the course of income tax assessment under the Hindu Law, the term Hindu Undivided Family refers to *a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters*. There should be two or more persons whether male or female to constitute a H.U.F. The relation of a H.U.F does not arise from a contract but from status.

1) Hindu Coparcenaries :

A Hindu joint family consists of two types of members :

(i) Members entitled for maintenance only:

The female members of family are entitled only for maintenance out of the family property but they do not enjoy right to enforce partition.

(ii) Coparcenaries :

The sons, grand sons and great grand sons of the holder of the property for the time being, who are entitled to demand their shares on a partition of the family are called coparcenary.

2) Two schools according to Hindu Law :

According to Hindu Law the Hindu Undivided Families are governed by two schools viz. Mitakshara and Dayabhanga.

(i) *Mitakshara* :

It applies to whole of India except West Bengal and Assam and some part of Orissa. Under this school of law, each son acquires, by birth an equal interest in his father's ancestral property by mere birth and has right to demand partition. However, the self acquired property of the father remains his personal property.

(ii) *Dayabhanga* :

It applies to West Bengal and Assam and some parts of Orissa. Under this school of law a son does not acquire any interest by birth in an ancestral property. He

acquires such interest only after the death of his father. Hence the son enjoys the right to demand partition only after the death of father. In view of this, the father enjoys an absolute right to dispose of the property of the family according to his desire. Thus there is no coparcener in Dayabhanga school of law, till the death of father. After the death of father the sons became coparceners in respect of property left by father and income arising therefrom is taxable as income of Hindu Undivided Family.

1) **Jain & Sikh Undivided Families :**

Jain and Sikh families are treated as Hindu Undivided Families for the purpose of the income tax act though they are not governed by Hindu Law.

Assessment of Hindu Undivided Family:

Conditions Income of a joint Hindu family is assessed for tax as Hindu Undivided Family if the following conditions are fulfilled :

(i) *There is a coparcener ship :*

It should be noted that once a joint family income is assessed as H.U.F it continues to be assessed as such in the subsequent assessment years till the partition is claimed by coparceners.

(ii) *There is joint family property :*

The joint family property consists of ancestral property, property acquired with the aid of ancestral property and property transferred by its members to H.U.F. Ancestral property means the property inherited by a man from any of his three immediate male ancestors i.e. father, grand father and great grand father.

Allowable expenses of H.U.F (Some critical items) :

(i) *Salary paid to members of the family :*

Any genuine and reasonable salary paid by H.U.F to its members for the services rendered to earn an income is allowable deduction in computing the taxable income of H.U.F. Similarly any remuneration paid to Karta of family is allowable as deduction if there is an agreement to that effect.

(ii) *Fees and remuneration as director or partner :*

In the case the funds of H.U.F are invested in a company or a firm the remuneration or fees received by any of its members as a director or a partner is

treated as income of family. But if such fees or remuneration is earned essentially for services rendered by the member in personal capacity it is treated as personal income of the member.

✦ **Income not allowable as H.U.F Income :**

The following incomes are not treated as H.U.F income.

(a) *Income of members in personal capacity :*

Any income earned by the members of H.U.F in their personal capacity are taxable in the hands of such individual members. They are not treated as H.U.F income.

(b) *Income from self acquired property of father :*

It is taxable as an individual income of father and not treated as income of H.U.F.

(c) *Profit of members of family :*

The profit earned by an individual member of the family is treated as his individual income even if he has borrowed the capital for such business from H.U.F.

(d) *Profits of members of H.U.F from firm :*

The profits earned by members of H.U.F from partnership business are treated as their personal income & not the income of H.U.F.

(e) *Income from ancestral property under Dayabhanga law :*

Where Dayabhanga law is applicable the income from ancestral property is taxable as an individual member of father and not of H.U.F

(f) *Income from impartible estate :*

Income from impartible estate is taxable in the hands of individual member holding such estate.

(g) *Income from converted self acquired property :*

The income from self acquired property converted (or transferred without adequate consideration) after 31st December, 1969 into joint family property is not taxable in the hand of H.U.F.

(h) *Income from funds given to wife and daughter of Karta :*

Any income from the amount allocated to wife of Karta and unmarried daughters for marriage expenses at the time of partition is not includible in income of H.U.F.

(i) *Income from Stridhan* :

As 'Shridhan' is an absolute property of a women the income arising therefrom to any female member of H.U.F is treated as her personal income & not of H.U.F.

✦ **INCOMES ALLOWABLE AS H.U.F. INCOMES (Critical items):**

(a) **Income from partnership firm** :

Incomes received from a partnership firm by Karta or any other member H.U.F by investing the funds of family as capital will be treated as under:

(i) *Share in profits* :

The share in profits received by the H.U.F from firm is treated as income of H.U.F from business but as it is exempt from tax u/s 10(2A) it is not included in its taxable income.

(ii) *Interest on capital* :

The interest on capital invested received from such firm is taxable in the hands of H.U.F as income from business u/s 28

(iii) *Remuneration from firm* :

Any remuneration received (in the form of salary, bonus, commission etc.) by the Karta or other member as working partner from such firm is also taxable as business income in the hands of H.U.F. However, the reasonable remuneration payable to him as per the agreement is also deductible from such income received from firm.

(b) **Income from Investments** :

If the funds of the family are invested in some securities such as shares, debentures, government bonds etc. the income arising from such securities will be treated as income of H.U.F.

(c) **Income from H.U.F business & property** :

Normally, all incomes arising from the business carried by H.U.F and assets and property owned by it is treated as H.U.F income

✦ **Partition of H.U.F** :

There are two kinds of partition of H.U.F viz.

(a) Total partition and (b) Partial partition :

Total partition means the physical division of the entire property of the family and the members. After such partition joint Hindu family ceases its existence.

Partial partition, on the other hand, means separation of few members from joint family. After such separation the family continues its existence with the remaining members and the property.

In case of total partition the assessing officer issues the notice to all the members of the family and conducts the enquiry and finally the date of partition. The family is assessed as H.U.F till such date whereas in case of partial partition the family is continued to be assessed as such even after the date of partition.

✦ **Clubbing and adjustment of losses :**

Income belonging to some other person, may be clubbed and taxed as income of H.U.F u/s 60 to 63 Eg. Any income transferred by H.U.F without transferring an asset is clubbed with the income of H.U.F. Similarly, income of an asset transferred under revocable transfer by family is clubbed with the income of H.U.F and taxable in its hands.

Losses of current year as well as preceding years are set off u/s 70 to 80 of the Act.

The total income of family from five heads after aforesaid adjustments will be the Gross Total Income of H.U.F.

✦ **Deduction from Gross Total Income :**

From the Gross Total Income of H.U.F the following deduction can be claimed under chapter VI A: 80 (C), 80 D, 80 DD, 80 DDB, 80 G, 80 GGA, 80 GGC, 80 I, 80 IA, 80 IB, 80 JJA.

✦ **Tax Rates & Rebate :**

A H.U.F is taxable at the rates applicable to individuals or Association of Person or artificial juridical person.

ILLUSTRATIONS

Illustration 1 :

From the following details furnished by Mr. Mahesh, Karta of Hindu Undivided Family compute total income for the assessment year 2020 – 21 :

	Rs.
Profit from business	60,000
Salary received by a member of the family from his services in a college	1,00,000
LIC Premium on life of family member paid by Karta	2,000
Directors fees received by the Karta	6,570
Annual rental value of the property let out	12,000
Municipal taxes paid	600
Interest on bank deposit	450
Donation to Veershaiv college (approved one)	60,000
Marriage expenses of daughter of Karta	10,000

The family has sold on 1.12.2019 its open site for Rs. 5,35,000 which was purchased on 1.6.2008 for Rs. 15,000. The cost inflation index for the financial years 2007–08 and 2019-20 were 129 and 280 respectively.

Solution :

Computation of total income of H.U.F for A. Y. 2020 – 21

Particulars	Rs.	Rs.
I Income from house property (let out) :		
Gross annual value (rent received)	12,000	
Less : Municipal Taxes Paid	600	
Annual Value	11,400	
Less : Standard deduction (30% A.V.)	3,420	7,980
II) Income from Business		
Profit from business		60,000

III) Capital gains :		
Sale proceeds of open site	5,35,000	
Less : Indexed cost of acquisition (15,000 x 280/129)	32,558	5,02,442
IV) Income from other sources :		
Interest on bank deposits		450
Gross total Income		5,70,872
Less : Deduction under chapter VIA :		
Donation to Veershair College u/s 80G (W. Note 1)	28,444	
For LIC premium u/s 80 C	2,000	30,444
Total taxable income		5,40,428

Working Notes :

1) Computation of deduction u/s 80 G	Rs.
Donation approved to Veershaiv college (approved)	60,000
Qualifying amount should not exceed 10% of adjusted Gross Total Income of Rs. 5,68,872 [i.e. G.T.I	
Rs. 5,70,872 – 2000 80C) i.e.	56,887
Deduction is 50% of qualifying Amount of Rs. 56,887 i.e.	<u>28,444</u>

Illustration 2 :

A Hindu Undivided Family consists of Amar and his two younger brother's Avinash and Arvind. From the following particulars compute the total income of the family for the assessment year 2020-21 :

- (a) Interest on government securities held out of family funds Rs. 6,000.
- (b) The family owns a house property consisting of the identical units, the actual value of them being Rs. 20,000. Municipal tax paid is at 10% of the municipal value. One unit is occupied by the family for its own residence and the other one is let out at a rent of Rs. 800 per month. Let out portion remained vacant for one month during the year.

- (c) Profit from family business managed by the Karta is Rs. 1,00,000 before deducting Rs. 15,000 paid to him as salary but after charging speculation loss of Rs. 5,000.
- (d) On 1.3.2019 the family sold its shares for Rs. 85,820 which were purchased by it on 1.10.2021 for Rs. 40,000. The selling expenses of the same amounted to Rs. 500. The cost inflation index for the financial year 2001-02 and 2019- 20 were 100 and 280 respectively.
- (e) Avinash received salary of Rs. 24,000 by working in a private company.
- (f) The family spent Rs. 15,000 on medical treatment of a specified disease of a member of the family and paid Rs. 5,000 as donation to National Blood Transfusion Council and paid a premium of Rs. 6,000 on Life Insurance Policy of Members of Family.

Solution :

Computation of total taxable income of H.U.F for A. Y. 2020-21

Particulars	Rs.	Rs.	Rs.
I Income from house property:			
(A) Half portion – Let out			
Gross Annual value			
(a) Municipal value (1/2 x 20,000)	10,000		
(b) Rent received @ Rs. 800 p.m.	9,600		
(c) Gross Annual Value			
[Higher of (a) and (b) above	10,000		
Less : Vacancy Period Rent not adjustable as MV is higher	Nil	10,000	
Less : Municipal tax @ 10% of M.V.		1,000	
Annual value		9,000	
Less : Standard deduction (30% of A. value)		2,700	
Income from let out unit		6,300	
(B) Income from half portion self occupied			

Annual value	Nil	6,300
II Income from business :		
Profit from family business	1,00,000	
Add : Speculation loss wrongly debited	5,000	
	1,05,000	
Less : Salary to Karta	15,000	90,000
III Capital gains :		
Sale proceeds of shares	95,000	
Less : Selling expenses	500	
Net sales proceeds	94,500	
Less: Indexed cost of acquisition (40,000 x 280/100)	1,12,000	
Long term capital loss carried forward	-17,500	--
IV) Income from other sources :		
Interest on government securities		6,000
Gross total income		1,02,300
Less : Deductions under Chapter VI A :		
(1) Medical treatment of specified disease of members u/s 80(DD B)	15,000	
(2) Donations u/s 80 (G)	5,000	
(3) LIC Premium u/s 80 (c)	6,000	
(4) Interest on S. B. A/c u/s 80 (TTA)	6,000	32,000
Total Taxable Income		76,300

Notes :

- (1) Salary received by Mr. Avinash is his individual income
- (2) Donation to Blood Transfusion Council is 100% deductible. It has no upper ceiling too.
- (3) Speculation loss of Rs. 5,000 cannot be set off against any other income except speculation profit

- (4) A reasonable and genuine salary payment to Karta paid in the interest of business of H.U.F is allowable deduction.
- (5) Capital loss of Rs.(-)17,500 cannot be set off against any other income hence carried forward.

Illustration 3 :

A Hindu undivided family consisting of three members X, Y and Z of whom X is Karta. From the profit and loss account of the family and the information given below compute its total income for the assessment year 2020 – 21.

Expenditure	Rs.	Income	Rs.
Salaries	45,000	Gross Profit	1,16,550
Office rent	6,000	Rent from house property	9,000
General expenses	9,000	Interest on 7% Saving	15,000
Interest on loan	4,500	Bonds 2002	
Income tax	15,000	Profit from smuggling	7,950
Advertisement	3,000	Profit on sale of building	18,000
Bad debts	1,500	(Bought on 1.1.1995)	
Provision for bad debts	3,000		
Fire insurance	300		
Municipal taxes	900		
Household expenses	23,550		
Donation	3,000		
Depreciation	5,250		
Net profit	46,500		
	1,66,500		1,66,500

Additional Information :

- (a) Salaries include Rs. 9,000 paid to X who is looking after the affairs of the family business and Rs. 6,000 paid to Y who is working as accountant.
- (b) General expenses include Rs. 2,000 paid as tips to police and Rs. 1,000 a penalty both relating to smuggling business.
- (c) Donations paid are related to an approved institution.

- (d) Depreciation allowable on other block of assets amounts to Rs. 5,000.
- (e) Fire insurance and municipal taxes are relating to house property let out.
- (f) Building (a block of assets) of written down value of Rs. 80,000 is sold for Rs. 98,000 during the year.

Solution:

Computation of total taxable income of H.U.F for A.Y. 2020 – 21.

Particulars	Rs.	Rs.	Rs.
I Income from business:			
Net profit as per P & L A/c		46,500	
Add : Expenses disallowed :			
Penalty (in general expenses)	1,000		
Income Tax	15,000		
Provision for bad debts	3,000		
Fire insurance	300		
Municipal taxes	900		
Household expenses	23,550		
Donation	3,000		
Depreciation	5,250	52,000	
Less : Incomes taxable under other heads :		98,500	
Rent from house property	9,000		
Interest on 7% Saving Bonds 2002	15,000		
Profit on sale of building	18,000	42,000	
		56,500	
Less : Depreciation as per rules		5,000	51,500
II Income form house property (Let out) :			
Gross Annual Value (Rent)		9,000	
Less : Municipal taxes paid		900	
Annual value		8,100	
Less : Standard deduction (30% A. Value)	2,430		

Fire insurance	Nil	2,430	5,670
III Capital gains (short term) :			
Sale proceeds of buildings		98,000	
Less : Written down value		80,000	18,000
Gross Total Income			75,170
Less : Deductions under chapter VI A			
Donation u/s 80 (G) (50% of Rs. 3,000)			1,500
Total taxable income :			73,670

Notes :

- (1) Salaries of members of H.U.F Mr. X and Mr. Y are allowable deduction being reasonable & in the interest of business.
- (2) Tips paid to police in respect of smuggling business are allowable deduction but the penalty paid is disallowed.
- (3) Interest on 7% Saving Bonds 2002 is exempt from tax u/s 10(15).

2.2.3 Computation of income and tax liability - Firm

Indian partnership Act, 1932 (section 4) defines partnership as “a relationship between persons who have agreed to share the profits of a business carried by all or any of them acting for all”. Persons who have entered into partnership with one another are called individually “partners” and collectively a “firm”. Under section 2(23) of Indian Income Tax Act, ‘firm’, ‘partner’ and ‘partnership’ have the meanings respectively assigned to them in the Indian partnership act, but the expression ‘partner’ shall also include any minor person who, has been admitted to the benefit of partnership. In case a minor is to be admitted to the benefits of the partnership there must be at least two adults to form a legal partnership. An individual or a company or a trust can become a partner but H.U.F or firm cannot become a partner in a firm.

+ Assessment of Firm (sec. 184) :

The salient features of the scheme introduced from the assessment year 1993 –94 for the taxation of firms are as under :

- (a) The firm will be taxed as a separate entity. There will be no distinction between registered and unregistered firms.

- (b) The share of the partner in the income of the firm will be exempt u/s 10 (2A) in computing the individual income of partner.
- (c) Remuneration to partners in the form of salary, bonus, commission or by whatever name called will be allowed as a deduction in computing the income of firm subject to certain restrictions.
- (d) The firm paying interest on funds employed by partners can claim deduction in respect of such interest paid upto a maximum of 12% p.a.
- (e) The income of the firm will be taxed at a flat rate of 35%.
- (f) The partnership firms will be assessed in two ways :
 - (i) Partnership firm assessed as such (PFAS)
 - (ii) Partnership firm assessed as association of persons (PF AOP)

(I) Partnership Firm Assessed as Such (PFAS):

In order to avail the status of PFAS a firm should satisfy the following five conditions :

- 1) A firm must be evidenced by an instrument (such as partnership)
- 2) Individual share of partners should be specified in instrument.
- 3) A certified copy of instrument should be submitted along with the first return of income of firm.
- 4) Revised instrument must be furnished with the returns whenever there are changes in constitution or profit sharing ratio.
- 5) There should not be any failures as mentioned in section 144 which are :
 - (a) Failure of firm to submit its return of income even after receiving notice.
 - (b) Failure to comply with all the terms of notice u/s 142(1) requiring the firm to produce specified accounts, documents or information or to get the accounts audited.
 - (c) Failure to comply with all the terms of notice u/s 143(2) requiring an attendance before assessing officer or the production of evidence in support of return filed.

Once a firm is assessed as a PFAS by fulfilling the aforesaid conditions, it will be

assessed as PFAS for every subsequent year unless there is a change in constitution or profit sharing ratio.

II) Partnership Firm assessed as association of persons (PFAOP) sec. 184 & 185

A firm is assessed as an association of persons if :

- (a) It does not comply with the provisions specified u/s 184 (referred above)
- (b) It commits failures referred in section 144 (referred above)

If the firm is assessed as association of persons a different provisions of the Act will be applicable to it.

+ Computation of total income of firm:

The total income of a firm shall be computed under the various heads of income in usual manner keeping in view the residential status of firm. However, while computing the income from business or profession the following important points should be carefully considered.

- 1) Interest to partner : Interest paid to partners exceeding 12% p.a. is disallowed.
- 2) Remuneration to partners : The remuneration paid to partners in the form of salary, bonus, commission etc is allowed as deduction if :
 - (i) It is paid only to a working partner.
 - (ii) It is authorised by the partnership deed.
 - (iii) It does not pertain to period prior to partnership deed.
 - (iv) It does not exceed permissible limits.

(1) *Remuneration allowable to working partners u/s 40(b) :*

Book profit	Maximum amount deductible in respect of remuneration to partners u/s 40 (b) with effect from the assessment year 2010-11
If book profit is negative	Rs. 1,50,000
In case book profit is positive-	
a) On first 3 lakh of book profit	Rs. 1,50,000 or 90 percent of book profit, whichever is more
b) On balance of the book profit	At 60 percent of book profit

Note :

- 1) **'Book profit'** refers to the net profit shown in the Profit & Loss A/c in the manner indicated u/s 28 to 44D of the Act before debiting the remuneration to partners.
- 2) **'Profession U/s 44 AA'** : Includes legal, medical, engineering, architectural profession, or profession of accountancy or technical consultancy or interior decoration or any other profession notified by Board.
- 3) **Rent to Partners** : Rent paid to partner of the firm who is the owner of premises is allowable deduction after considering the above points. The profits & gains of firm from business and profession are computed in usual manner given under chapter 'Income from business or profession'.

+ Deduction from Gross Total Income :

In order to ascertain total taxable income of the firm the following deductions can be claimed under chapter VIA from the gross total income of the firm :

80G, 80GGA, 80HHB, 80HHBA, 80HHC, 80HHC 80HHD, 80HHE, 80HHF, 80I, 80IA, 80IB, 80JJA and 80O.

However the deduction in respect of long term capital gains are not allowed from the aforesaid sections.

+ Computation of incomes of partner :

The individual income of partners of a firm are computed under different heads as per the provisions of the Act. In computing the incomes of a partner from the firm, however, the following points should be carefully considered.

(a) Remuneration from the firm :

Any salary, bonus, commission or remuneration by whatever name called receivable or received by partner from the firm as per the provisions of partnership deed [but not exceeding provisions u/s 40 (b)] is taxable in the hands of the partner as 'profits and gains from business or profession' u/s 28(v). Hence the partner can claim deduction in respect of any expenses incurred by him wholly and exclusively for the purpose of earning such income. Such remuneration received from the firm is not taxable under the head 'Income from salary' because partner of the firm is not an

employee of the firm. Secondly, the standard deduction u/s 16(i) cannot be claimed by the partner in respect of such remuneration.

(b) Interest from the firm :

Any interest received by a partner as per the provisions of the partnership deed not exceeding 12% p.a. is shown as income from business or profession in the computation of income of the partner.

(c) Rent from the firm :

Any rent received by the partner for the premises let out to the firm shall be shown under the head 'Income from houseproperty'.

(d) Perquisites from the firm :

Any perquisites in the form of rent free accommodation, free gas, electricity etc. provided to the partner are disallowed in the hands of the firm. As a result, they are not assessable in the hands of the partner to prevent double taxation.

(e) Share in profits of the firm :

The share received by the partner from the profits of the firm is exempt u/s 10(2A)

(f) Deduction allowable :

From the income of the partner from firm chargeable under the heads 'Profit and Gains of Business' the following deductions can be claimed.

- (i) Interest on funds borrowed for investment in firm.
- (ii) Interest paid to firm on deficit capital, if any, on failure to maintain minimumrequired capital.
- (iii) Incidental expenses to earn remuneration from firm.

Format for computation of Total Income of Firm

Particulars	Rs.	Rs.
I Income from business / profession :		
Net profit as per profit & loss A/c		x x x
Add : Inadmissible expenses debited to P & L A/c		
Payments to retiring partners	x x x	
Interest paid to partners exceeding 12%	x x x	
Excess depreciation debited	x x x	
Partnership deed, stamp paper, fees	x x x	
Loss of cash at partners residence	x x x	
Private loans irrecoverable	x x x	
Expenses chargeable under other heads	x x x	
Capital expenditure	x x x	
Loss of stock by fire, theft etc.	x x x	
Fines & penalties	x x x	
Donations & charity	x x x	
Personal expenses of partners	x x x	
Income tax or wealth tax	x x x	
Provisions for bad debts	x x x	
Provisions for income tax	x x x	
Loss on sale of capital assets	x x x	
Gift tax or estate duty	x x x	
Preliminary expenses	x x x	
Payments in excess of Rs. 20,000 (not made by cheque)	x x x	x x x
Less : Incomes chargeable under other heads or exempt :		
Rent from house property	x x x	
Income from investments	x x x	
Interest on bank deposits	x x x	
Bad debts recovered previously allowed		

Incomes chargeable under the head		
Incomes from other sources	X X X	
Refunds of taxes	X X X	X X X
Add : Remuneration of partners in the form of salary, Bonus, Commission etc. (if debited to P & F A/c)		X X X
BOOK PROFIT		X X X
Less : Remuneration allowable to working partners u/s 40 (b) (W. Note 1)		X X X
Income from business or profession		X X X
II) Income taxable under the other heads (to be computed as per Provisions of Act)		X X X
Gross Total Income		X X X
Less : Deduction allowable u/s 80 G to 80 GGA		X X X
Total Taxable income		X X X

Working Note :

1) Remuneration allowable to working partners u/s 40 (b):

Book profit	Maximum amount deductible in respect of remuneration to partners u/s 40 (b) with effect from the assessment year 2010-11
If book profit is negative	Rs. 1,50,000
In case book profit is positive-	
a) On first 3 lakh of book profit	Rs. 1,50,000 or 90 percent of book profit, whichever is more
b) On balance of the book profit	At 60 percent of book profit

Illustrations :

Illustration 1 :

A and B are the working partners in a firm sharing profits and losses in the ratio 3:2. The profit and loss account of the firm showed a net profit of Rs. 56,000 for the year ending 31-3-2019 after charging the following :

- (a) Interest on capital at 20%: A Rs. 7,500 and B Rs. 2,500
- (b) Salary of partners: A Rs. 80,000 and B Rs. 80,000.

Compute the income of the firm for the assessment year 2020 – 21

Solution :

Computation of total income for A. Y. 2020 – 21

Particulars	Rs.	Rs.
(i) <i>If Professional Firm :</i>		
Net profit as per profit & loss A/c		56,000
<i>Add : Excess interest disallowed :</i>		
On capital of A @ 8% (i.e. 7,500 x 8/20)	3,000	
On capital of B @ 8% (i.e. 2500 x 8/20)	1,000	4,000
		60,000
<i>Add : Salary to partners debited to P & L A/c :</i>		
A	80,000	
B	80,000	1,60,000
Book Profit		2,20,000
<i>Less : Salary allowable to working partners :</i>		
(a) Salary actually paid to A & B	1,60,000	
OR		
(b) Salary allowable u/s 40 (b)		
90% on first Rs. 2,20,000	1,98,000	
whichever is less i.e.		1,60,000
Taxable Income from Business		60,000

Illustration 2 :

X Y and Z are the partners in a firm sharing profits and losses in the ratio of 1:2:3. The profit & Loss account of the firm showed a net profit of Rs. 40,000 for the year ending 31.3.2020 after charging the following :

Salary of Rs. 30,000 and Rs. 20,000 to X and Y respectively. Interest on capital calculated at the rate of 15% p.a. of Rs. 1,250 and Rs. 7,500 and Rs. 6,250 to X, Y and Z respectively. Bonus for Z of Rs. 15,000; commission of Rs. 5,000; Rs. 12,500 and Rs. 17,500 to X, Y and Z respectively.

Z had borrowed money for his capital investments in the firm and had paid interest of Rs. 37,500 separately to the lender.

X and Y are the working partners in the firm.

Compute the total income of the firm and the taxable income of the three partners from the firm for the assessment year 2020 – 21.

Solution :**Computation of total income of firm for A. Y. 2020 – 21**

Particulars	Rs.	Rs.
Net profit as per profit & loss A/c		40,000
<i>Add</i> : Excess interest (over 12%) disallowed :		
X (1,250 x 3/15)	250	
Y (7,500 x 3/15)	1,500	
Z (6,250 x 3/15)	1,250	3,000
<i>Add</i> : Remuneration to partners (debited to P & L A/c):		43,000
Salary to X	30,000	
to Y	20,000	
Bonus to Z	15,000	
Commission to X	5,000	
Y	12,500	
Z	17,500	1,00,000
Book Profit		1,43,000
<i>Less</i> : Salary allowable to working partners X & Y:		

(a) Actual salary & commission paid to X & Y (50,000 + 17,500)	67,500	
OR		
(b) Salary allowable u/s 40 (b) 90% on first Rs. 1,28,700 (book profit) 1,28,700 whichever is less	1,28,700	67,500
Total income of firm		75,500

	X	Y	Z
Salary	30,000	20,000	--
Interest on capital @ 12%	1,000	6,000	5,000
Share in profits (exempt u/s 10 (2 A))	--	--	--
Commission	5,000	12,500	--
Total income from firm	36,000	38,500	5,000

Note : Interest on loan taken for capital investment in the firm by Mr. Z is allowable deduction from his individual taxable income.

Illustration 3 :

A, B and C are the partners in a firm sharing profits and losses in the ratio of 4:3:3. The following is the profit and loss account of the firm for the year ending 31.3.2020 :

Particulars	Rs.	Particulars	Rs.
Salaries	35,000	Gross Profit	2,40,000
Rent	5,000	Profit on sale of car	21,000
Miscellaneous expenses	10,000	Bad debts recovered	5,000
Car expenses	6,000	(previously taxed)	
Advertisement	5,000	Interest on bank deposits	5,000
Income tax	25,000	Dividend from Indian Co.	10,000
Loss of cash kept at the residence of partner	13,000		
Donations	2,000		

Commission partner A		20,000	
Salary to partners :			
B	30,000		
C	<u>15,000</u>	45,000	
Interest on capital :			
A	6,000		
B	3,750		
C	<u>5,200</u>	15,000	
Depreciation		20,000	
Net profit transferred :			
A	32,000		
B	24,000		
C	<u>24,000</u>	80,000	
		2,81,000	2,81,000

Additional information :

- a) Miscellaneous expenses paid for the private expenses of partner B Rs. 5,000
- b) Advertisement includes Rs. 2,000 which is not related to business
- c) 1/3 of car expenses relate to personal use of the partners.
- d) Donations are paid to municipal corporation for promoting family planning.
- e) Depreciation allowable as per the rules is Rs.15,000 (for business).
- f) Rate of interest charged on capital is at 15%p.a.
- g) A and B were the working partners.
- h) The car purchased on 1.2.2009 for Rs. 1,10,000 was sold on 31.12.2016 for Rs. 61,000 and its written down value as on 1.4.2019 was Rs. 40,000 and it was the only asset in that block of assets.

Compute the total income of the firm for a. Y. 2020 – 21

Solution :**Computation of the total income of the firm for A. Y. 2020– 21**

Particulars	Rs.	Rs.
(i) Income from business :		
Net profit as per P & L A/c		80,000
Add : <i>Inadmissible expenses</i> :		
Private expenses of partner B	5,000	
Car expenses (1/3 rd personal)	2,000	
Advertisement not related to business	2,000	
Income tax	25,000	
Loss of cash at residence of partner	13,000	
Donations	2,000	
Interest on capital (exceeding 12%) (15,000 x 3/15)	3,000	
Depreciation (20,000 – 15,000) in excess	5,000	57,000
		1,37,000
Less : <i>Incomes taxable under other heads</i> :		
But debts (previously disallowed)	5,000	
Profit on sale of car	21,000	
Interest on bank deposits	5,000	
Dividend from Indian Co.	10,000	41,000
		96,000
Add : <i>Remuneration to partners (debited to P & L A/c)</i> :		
Salary to B & C	45,000	
Commission to A	20,000	65,000
Book profits		1,61,000
Less : <i>Salary allowable to working partners A & B</i> :		
(a) Actual remuneration (salary & commission) paid to A & B (30,000 + 20,000)	50,000	
OR		
(b) Salary allowable u/s 40 (b) :		

90% of first Rs. 1,61,000 (book profit)	1,44,900	
Whichever is less of (a) & (b) above i.e.		50,000
Income from Business		1,11,000
II) Short term capital gains (on sale of car)		21,000
III) Income from other sources :		
Interest on bank deposit	5,000	
Dividend from Indian Co	Nil	5,000
Gross Total Income		1,37,000
Less : Deduction under chapter VI A		
(1) Deduction for donations u/s 80 (G)		
(not exceeding 10% of adjusted G. T. I of Rs. 1,47,000)	2,000	2,000
Total taxable income		1,35,000

Notes :

- (1) Bad debts recovered previously taxed are exempt since they were taxed earlier.
- (2) Profit on sale of car is short term capital gain as car is depreciable asset.

2.2.4 Computation of income and tax liability – Association of Persons

When two or more persons come together to protect their common interest or perform a joint business activity, it is called association of persons, provided it is not a Firm or Hindu Undivided Family, Company or a local authority. The basic conditions for Association Of Persons (AOP) are :

- (i) There should be a joint venture,
- (ii) The aim of such joint venture is to earn a revenue, and
- (iii) It should not be a firm or H.U.F. or Company or local authority.

The association of persons (AOP) is also called Body of Individuals (BOI).

In case of co-owners of the property if their shares are not definite and ascertainable, they will be as an association of persons.

In case a partnership firm fails to fulfil the conditions laid down in section 184 for any assessment year, it shall be assessed as an association of persons for that assessment year.

✦ **Computation of share of a member u/s 67 A. :**

A) Where shares of members of A.O.P or B.O.I. are known :

The income of members shall be computed as under –

- (1) Any interest, salary, commission or other remuneration paid to members is deducted from the total income of A.O.P. and the remaining balance is apportioned among the members.
- (2) If the balance apportioned among the members as above is profit the interest, salary, commission or other remuneration of members is added to their respective shares in profit.

But, if the balance apportioned among the members is loss the interest, salary, commission or other remuneration of members is adjusted suitably to the share in loss of respective members.

- (3) The different kinds of income of members of A.O.P. as ascertained in the above two steps is to be shown under proper heads of income.
- (4) The interest paid on funds borrowed by member for the purpose of making investment in the association is deducted from his share in the income from business or profession. In case the net share of a member in the income of A.O.P. is a loss, it cannot be set off from his individual income.

✦ **Computation of total income of A.O.P. :**

The total income of A.O.P. from various sources is computed under different heads as per the provisions of income tax. But, the salary, interest, bonus, commission or other remuneration to members is not allowed as deduction there from.

✦ **Exemption to members in respect of share from A.O.P. :**

The share of income received by member from A.O.P. is treated as under:

- (1) If A.O.P. is taxed at the maximum marginal rate or any higher rate, the share of member from AOP is exempt from tax while computing his total income.
- (2) If AOP is not subject to any income tax, the share of member from AOP is taxable in his individual hands.

- (3) If AOP has paid tax at normal rates, the share received by member from AOP is included in his individual income but, he is entitled for a rebate of tax at an average rate thereon.

B) *Where share of members of AOP or BOI are unknown :*

In case the shares of members of AOP in the whole or any part of income of such AOP are indeterminate or unknown the tax is charged on its total income at the maximum marginal rate. But, if the total income of any member of AOP is chargeable to tax at a rate higher than maximum marginal rate, the tax shall be charged on its total income at such higher rate.

On discontinuance of the business or profession carried on by AOP, there is no bar to continue the proceedings already instituted or to initiate any proceedings for assessment purposes. The AOP shall be treated as in existence until such proceedings are finalized.

2.2.5 Computation of income and tax liability - Company

Company is a separate form of organisation with own identity. As per section 2(17), company means an Indian Company, body corporate, association / institution declared as company.

+ Computation of taxable income of Companies :

Companies have to adopt a specific procedure for computation of taxable income and tax liability. The deductions under chapter VI A in respect of companies are not the same as they are for individuals / HUFs the tax liability of company is based on its book profit for this purpose profit and loss Account is required to be adjusted with the help of following points.

- Income tax paid or payable and provision for the same.
- amount transferred to reserve in any name
- provisions made for meeting liabilities
- dividend paid or payable
- expenditure on exempted income u/s. 10 and 11
- amount of provision for deferred tax
- unallowed depreciation

- income exempt from tax, but credit to P & LA/c
- unabsorbed depreciation
- profit of sick unit

As per these adjustments, the taxable profit is to be calculated.

Illustration :

Adarsh Textiles Ltd., has given the following details

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
Stores	10,50,000	Sales	70,34,000
Salaries & Wages	19,40,00	Closing stock	7,21,000
General Exp.	11,60,000	Dividend	51,000
Donation	25,000	Transfer fees	18,000
Office Exp.	10,000		
Audit fees	5,000		
Depreciations	5,55,000		
Legal charges	25,000		
Income tax	70,000		
Net Profit	29,84,000		
	78,24,000		78,24,000

1. Legal charges include Rs. 500 for personal case of director.
2. Dep. as per rules is Rs. 6,05,000/- computation of taxable Income of Adarsh Textile Ltd.

Net Profit as per P & L	Rs.	29,84,000
Add : Disallowed Expenses		
Donation	Rs.	25,000
Income Tax	Rs.	70,000
Legal Charges	Rs.	5,000
Depreciation	Rs.	<u>5,55,000</u>

	Rs.	36,39,000
Less : Allowable Expenses & Income		
Depreciation	Rs.	6,05,000
Dividend	Rs.	51,000
	Rs.	<u>6,56,000</u>
Taxable Income	Rs.	<u><u>29,83,000</u></u>

Check your progress

A) Fill in the blanks with appropriate alternatives -

- i) HUF stands for
 - a) Hindu family
 - b) Hindu Undivided family
 - c) Hindu United family
 - d) None of these
- ii) Deduction in respect of life insurance premium is available for
 - a) an individual
 - b) a firm
 - c) a company
 - d) AOP
- iii) Company means and includes
 - a) Indian company
 - b) foreign company operating in India
 - c) Holding Company
 - d) All of these
- iv) Which of the following expenses is disallowed for book profit ?
 - a) Salary & wages
 - b) Income tax
 - c) Depreciation
 - d) Conveyance
- v) Dividend received is taxed as income from
 - a) business or profession
 - b) Capital gain
 - c) other sources
 - d) house property

B) State whether the following statements are true or false

- i) Book profit and net profit are one and the same.
- ii) Donation is allowable expenditure for individual.
- iii) Company is required to pay tax at a flat rate.
- iv) Individual and HUF are treated similarly for taxation purpose.
- v) Partners salary is a disallowed expenditure for partnership firm.

2.3 Summary :

Total taxable income is calculated as per the respective type / category of person. Individual, firm, AOP, Company have to calculate their income considering applicable I exemptions and deductions of the respective entity. The tax liability depends upon total taxable income. Provisions of deduction Particularly the subsections of section 80 have to be carefully applied for computation of taxable income. For example, section 80C deductions are mostly applicable to individual / huf, but not applicable for company / firm.

2.4 Terms to Remember :

1. **Company** – A company registered under Indian Companies Act.
2. **Firm** – A partnership firm registered under Indian Partnership Act.
3. **AOP** – An Association of Persons formed voluntarily for specific objectives.
4. **Book Profit** – Profit shown in the profit and loss account is adjusted with referencedisallowed expenses and exempted income.

2.5 Answers to Check Your Progress

- A) 1. b 2. a 3. d 4. b 5. c
B) 1. False 2. False 3. True 4. True 5. False

2.6 Exercise

1. What are the features of taxable income of a firm.
2. Briefly explain the provisions of taxable income in respect of company.
3. Explain the features of computation of income of an individual and HUF.
4. From the following details, compute the total taxable income of best Footwears Pvt. Ltd.

Particulars	Rs.	Particulars	Rs.
Opening stock	1,35,000	Sales	17,00,000
Opening stock	10,11,000	Closing stock	4,09,000
Purchases	6,000	Dividend received	21,000
Salaries	2,40,000		

Office Expenses	67,500		
Depreciation	1,56,000		
Travelling	47,000		
Donation	11,000		
Income tax	40,000		
Interest on bank loan	75,500		
Commission sales	17,000		
Net Profit	3,24,000		
	21,30,000		21,30,000

Additional information -

- Depreciation as per T.I. Rules is Rs. 1,65,000/-
- Salary includes Rs. 2,000/- paid to an employee for personal work of director of company.
- Travelling includes Rs. 7,000/- paid for personal tour of company's chairman.

Compute the total taxable income of Best Footwares Pvt. Ltd., Write Short Notes on the following –

- Book Profit
- Association of Person
- Deduction in respect of partners salary
- Director's Remuneration.

2.7 References for Further Study:

1. Singhania V. K. – Students Guide to Income Tax
2. Manoharan T. N. – Income Tax
3. Herekar P.M. – A Simple Approach to Income Tax
4. Kulkarni S. S. – Income Tax
5. Pagare, Dinkar – Direct Tax Laws
6. Kadkol , M. B. – Income Tax – Law and Practice.



Unit 3

Clubbing of Income, Set off & Carry Forward of Losses

(Section 56 to 59)

Structure :

- 3.0 Objectives
- 3.1 Introduction
- 3.2 Presentation of Subject Matter
 - 3.2.1 Clubbing of income
 - 3.2.2 Set off and carry forward of losses
 - 3.2.3 E-filing of returns
 - 3.2.4 Online payment of tax
- 3.3 Summary
- 3.4 Terms to Remember
- 3.5 Answers to Check your progress
- 3.6 Exercise
- 3.7 References for Further Study

3.0 Objectives :

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

- + Meaning of clubbing of income and setoff and carry forward of losses
- + Detail provisions of Income-tax Act in this regard
- + Computation of clubbing of incomes and set off and carry forward of losses

3.1 Introduction :

On many occasions tax payers do not disclose certain assets and investments in their records or disclose them at lower value in order to evade tax. Sometimes they try to reduce their tax liability by transferring their assets in favour of their relatives. In order to counter act such practices special provision relating to clubbing of income have been incorporated in the Act u/s 60 to 64. We shall study these provisions in this chapter.

3.2 Presentation of Subject Matter

3.2.1 Clubbing of Income:

Following are the incomes belonging to other persons to be clubbed with the income of an assessee as the assessee has arranged for tax evasion under these circumstances.

(1) Transfer of income without transfer of asset (Sec. 60) :

In cases where an assessee makes revocable or irrevocable transfer of an income from an asset without transfer of an asset, the income arising to transferee therefrom is deemed to be the income of an assessee and included in his total income.

(2) Revocable transfer of assets (Sec. 61) :

In case where the assessee makes revocable transfer of assets the income arising to transferee therefrom shall be included in the total income of the assessee.

(3) Irrevocable transfer for a specified period (sec. 62) :

In cases where the assessee makes irrevocable transfer of assets for a specified period the income arising therefrom shall be taxable as the income of the assessee after the date when the power to revoke the transfer arises. Until such date the income is deemed to be accruing to the transferee subject to following conditions.

- (a) Transfer, if affected through the medium of trust, is not revocable during the life time of the beneficiary.
- (b) In the case of any other transfer, the same is not revocable within the life time of beneficiary.
- (c) In both the above transfers the transferer derives no direct benefit from such income.

(4) Income of spouse [sec. 64(1)] :

The spouse means husband and wife who are lawfully wedded. The following incomes of an individual and the spouse are clubbed :

(a) Income from a concern wherein the spouse has substantial interest [sec. 64(1)(ii)] :

The income arising to the spouse of an individual by way of salary, commission

fees or any other remuneration, whether in cash or in kind, from a concern in which the individual has substantial interest. However, the remuneration solely attributable to the application of technical or professional knowledge and experience of the spouse need not be clubbed.

An individual is deemed to have a substantial interest, if the shares carrying 20% or more voting power are owned by him (individually or along with his relatives) at anytime during the previous year in case of a company or is entitled to not less than 20% of the profits in case of a concern other than a company. The income shall be included in the income of the spouse whose income (exclusive of income under this clause) is higher.

(b) Income from assets transferred [sec. 64 (i)(iv)] :

Where an asset (other than house property) is transferred directly or indirectly by an individual to the spouse otherwise than for adequate consideration or in connection with an agreement to live apart, any income from such asset is deemed to be the income of the transferor.

(5) Income of daughter in law [sec. 64(i)(vi)] :

Where an asset is transferred by an individual directly or indirectly to daughter-in-law (son's wife) on or after 1st June 1973, otherwise than for adequate consideration the income arising therefrom will be added in the income of individual.

(6) Income from assets transferred to a person or association of person etc. for the benefit of spouse [sec. 64(i)(vii)]:

Where an asset is transferred by an individual, directly without adequate consideration for an immediate or deferred benefit of spouse the income arising from such transfer will be added in the income of the individual (transferer)

(7) Income from assets transferred to a person or association of persons etc. for the benefit of son's wife [sec 64(1)] :

Where an asset is transferred by an individual, directly or indirectly to a person or association or persons without adequate consideration for an immediate or deferred benefit of son's wife the income arising from such transfer will be added in the income of individual (transferor).

(8) Income of a minor child [sec. 64(1A)] :

The income arising to a minor child shall be included in the income of the parent:

- (i) Where total income is greater, in case where marriage of parents subsists.
- (ii) Who maintains the minor child during the previous year, where the marriage of the parents does not subsist.

However the following incomes of minor child shall not be clubbed with the income of the parents.

- (i) income arising from manual work done by the minor.
- (ii) income arising from the activity involving application of his skills, talent or specified knowledge & experience.

+ Exception :

The income of a physically or mentally handicapped minor child, however, need not be included in the income of his parents.

(9) Income form converted property sec. 64(2) :

Where an individual, being a member of H.U.F transfers directly or indirectly his self acquired property into property of H.U.F otherwise than for adequate consideration such property is called converted property. The income from such converted property and capital gains from transfer of such property shall be included in the total income of the individual and not in the income of H.U.F.

After the partition of the converted property, the income arising to the spouse from such converted property shall be treated as the income of the individual but not of the spouse.

+ Treatment of loss [sec. 64] :

Where there is a loss to a specified person in circumstances specified u/s 64 (regarding clubbing of incomes) the individual will also be entitled to set off such loss. Thus for all provisions of section 64 income will also include a 'loss' or 'negative income'.

+ Deemed incomes :

Section 68 and 69 specify certain amounts, which are deemed as income of assessee and included in his taxable income. They are :

(1) Cash credit (sec. 68) :

Any sum credited in the books of assessee during the previous year for which no satisfactory explanation about the nature and source thereof is offered to the assessing officer shall be deemed income of the assessee and added to his taxable income of the previous year.

(2) Unrecorded and unexplained investments [sec. 69] :

Any investment made by the assessee but not recorded in the books of account maintained by him and no satisfactory explanation about the nature and source of investment is offered to the Assessing Officer shall be deemed to be the income of the assessee and added to his taxable income of the previous year in which investment was made.

(3) Unrecorded and unexplained money etc [sec. 69 A] :

Any money, bullion, jewellery or other valuable articles owned by the assessee but not recorded in his books of account and no satisfactory explanation about the nature and source of acquisition is offered to the Assessing Officer shall be deemed to be the income of the assessee and the value thereof shall be added to his taxable income of the previous year in which the owned these items.

(4) Under recorded investments, money, bullion etc [sec. 69B] :

Any investment, money, bullion, jewellery and other valuable articles owned by the assessee the actual value of which exceeds the value recorded in the books and no satisfactory explanation about such excess value is offered to the Assessing officer, shall be deemed to be the income of the assessee and such under recorded value thereof shall be added to his taxable income of the previous year in which the investment is made or he is found to be the owner thereof.

3.2.2 Set off and carry forward of losses :

Income earned by the assessee under the five heads of income, during the previous year is added together to ascertain gross total income. If there is income under these heads the ascertainment of gross total income becomes easy but if there is a loss from

any of the heads the problem arises as to whether it can be set off (or adjusted) against the income from other heads. To solve this problem sections 70 to 80 of the Act elaborate the procedure of set off and carry forward of losses. The set off and carry forward of losses is to be undertaken in following three steps:

(I) Set-off of loss from one source of income against another source under the same head of income (sec. 70)

Loss from one source of income can be set off against income from other source under the same head of income during the previous year. For example a loss from one business can be set off against the income from another business. A capital loss can be set off against capital gain or a loss from one house property can be set off against the income from another house property during the same previous year. This rule is however subject to following exceptions

(a) *Loss from speculation business :*

If there is a loss from speculation business it can be set off only against the profit from speculation business. It cannot be set off against the profit of non speculation (or normal) business. However, if there is a loss from non speculative business or profession it can be set off against income from speculation business.

(b) *Loss from the activity of owning and maintaining race horse :*

Loss from the business of owning and maintaining race horses cannot be set off against income, if any, from any other source except income from owning and maintaining race horses or from prize money received on a horse race.

(c) *Set off against winning from lotteries, crossword puzzles, gambling and betting:*

A loss cannot be set off against winning from lotteries, crossword puzzles, horse races, gambling and betting.

(II) Set off of loss from one head against income from another head (sec.71):

Loss under any head of income may be set off against income from another head in the same previous year. For instance,

- (a) Loss under the head 'Income from house property' can be set off against income from salary business, capital gains or other sources.

- (b) Business loss can be set off against income from salary, house property, capital gains or other sources.
- (c) A loss under the head 'Income from other sources' (except from the activity of owning and maintaining race horses) can be set off against income from salary, house property, business or capital gains.

This rule is however subject to following exceptions:

- (i) Loss from speculation business
- (ii) Loss from the activity of owning and maintaining race horses,
- (iii) Loss under the head capital gains and
- (iv) Loss under the head income from house property on account of unrealised rent.

These losses cannot be set off against income from any other head. Similarly loss against any other head cannot be set off against winning of lotteries, crossword puzzles, races, gambling and betting.

III) Carry forward and set off of losses [sec 72] :

If the losses cannot be set off during the same financial year in which they are incurred, due to inadequacy of income they may be carried forward for being set off against the income of same assessee in the succeeding years provided these losses have been determined by the Assessing Officer within the prescribed time. Under the Act following losses can be carried forward.

- (i) Loss under the head Income from house property
- (ii) Loss under the head Income from business or profession (i.e. loss from speculative or non-speculative business)
- (iii) Loss under the head 'Capital gains' (i.e. short term as well as long term losses)
- (iv) Loss from activity of owning and maintaining race horses.

Any losses other than those mentioned above cannot be carried forward and set off.

A) Loss from house property (Sec. 71 B) :

The unabsorbed loss from house property of P.Y. 1997 – 98 or any earlier years

cannot be carried forward and set off. But if such loss is on account of unrealised rent it can be carried forward or set off against income from house property of subsequent years. And if the unabsorbed loss from house property pertaining to the previous year 1998 – 98 or any subsequent years may be carried forward upto maximum period of eight years and set off against income from house property.

B) Loss from non speculation business or profession (Sec 72) :

The loss arising from non speculative business or profession should be set off against the income under other heads such as salary, house property, capital gains and other sources and the unabsorbed loss if any can carried forward to subsequent years & set off subject to following restrictions :

- (a) Such unabsorbed losses can be carried forward only by the person who incurred the losses and set off against his profit.
- (b) Such losses can be set off against profits of business or profession in subsequent years (& not necessarily the same business).
- (c) Such losses can be carried forward for 8 years.
- (d) The business or profession in which the loss was originally incurred may or may not continue during the years of set off.
- (e) The effect of such set off is to be given only after giving effect first to current years depreciation but before giving effect to unabsorbed depreciation and carried forward capital expenditure.
- (f) Return should be submitted in prescribed time.

C) Loss from speculative business (sec. 73) :

Speculative transaction is a transaction wherein a contract for purchase or sale of a commodity (including stock and shares) is settled otherwise than by actual delivery of commodity. A business wherein such speculative transactions are carried is called speculative business.

The loss arising from a speculative business is to be set off only against the income from another speculative business in the same year. The unabsorbed loss, if any, should be carried forward and set off only against the profit of speculative business of subsequent years subject to the restrictions stated under (a) (c) (d) (e) and (f) above.

✦ **Example 1 :**

Compute the total taxable income of Mr. X for A.Y. 2020-21 from the following information

Particulars	Rs.
Chemical business profit before depreciation	1,00,000
Current year's depreciation	20,000
Unabsorbed depreciation	30,000
Unabsorbed business loss (of chemical business)	40,000
Speculation profit from share business	20,000
Speculation loss from gold business	35,000

✦ **Solution :**

Computation of taxable income of Mr. X for a. Y. 2020 – 21

Particulars	Rs.	Rs
Chemical business profits		1,00,000
<i>Less</i> : Depreciation of current year + B/f Depreciation		50,000
		50,000
<i>Less</i> : Unabsorbed business loss set off		40,000
Profit from chemical business		10,000
Speculation profit from share business	20,000	
Speculation loss from gold business	(-) 35,000	
Unabsorbed speculation loss carried forward	- 15,000	
Income		10,000

✦ **Notes :**

- (1) Unabsorbed speculation loss is carried forward to subsequent year and be set only of against speculation profit of subsequent years.
- (2) It should be noted that unabsorbed business loss of past year is set off from business profit after charging current years depreciation but before charging unabsorbed depreciation of past years.

D) Capital loss – short term or long term (sec. 74) :

The capital loss (short term or long term) which cannot be set off against the income under the head ‘capital gains’ in the same assessment year shall be carried forward to the subsequent assessment year to be set off against the income under the head ‘capital gains’ such loss can be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment years of which the loss was first computed.

E) Loss on maintenance of race horses (sec. 74A) :

The loss on activity of owning and maintenance of race horses shall be carried forward for four assessment years following the assessment year in which it was first computed and set off against the income from the activity of owning and maintenance of race horses of such years.

F) Unabsorbed capital expenditure on scientific research and family planning:

Capital expenditure on scientific research and family planning which cannot be absorbed from the profits of current assessment year can be carried forward and absorbed from subsequent assessment years like unabsorbed depreciation.

✦ Order of set off :

Various claims and set off are to be carried on in the following order during the course of assessment:

- (1) *Current depreciation*
- (2) *Capital expenditure on scientific research and family planning.*
- (3) *Carried forward business losses*
- (4) *Unabsorbed depreciation*
- (5) *Unabsorbed capital expenditure on scientific research & family planning.*

ILLUSTRATIONS

Illustration 1 :

The following are the particulars furnished by Mr. Krishna for A.Y. 2020 – 21 :

Income from salary computed	30,000
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Income from house property computed	8,640
Profit from cotton business	52,000
Loss from ground nut business	10,000
Profit from speculation business	25,000
Short term capital gains	12,000
He also furnished the particulars of losses brought forward from the past assessment year	
Loss from cotton business	8,000
Loss from food grain business discontinued in the same year	12,000
Loss from speculation business	30,000
Long term capital loss	5,000

Compute the taxable income for the assessment year 2020 – 21

✦ **Solution :**

Computation of taxable income of Mr. Krishna for A. Y. 2020 – 21 :

Particulars	Rs.	Rs.	Rs.
I) Income from salary			30,000
II) Income from house property			8,640
III) Income from business			
Profit from cotton business		52,000	
<i>Less</i> : Loss from ground nut business		10,000	
		42,000	
<i>Less</i> : Carried forward losses from :			
Cotton business – set off	8,000		
Food grain business – set off (Discontinued)	12,000	20,000	22,000
Profit from speculation business		25,000	
<i>Less</i> : Carried forward loss from speculation			

business set off	30,000	
Unabsorbed speculation loss carried forward	- 5,000	
IV) Capital gains :		
Short term capital gains	12,000	
Less : Carried forward long term, capital loss set off	-5,000	7,000
Gross total income / total income		67,640

✦ **Notes :**

- (1) Carried forward loss of discontinued food grains business can be set off against current business profit.
- (2) Unabsorbed speculation loss of Rs. 5000 should be carried forward and set off against speculation profit of subsequent years.

Illustration 2 :

From the following particulars of income furnished by Mr. Mallanma for the assessment year 2020 – 21 and losses carried forward compute his total income :

(a) Long term capital gain	15,000
(b) Short term capital gains	10,000
(c) Income from silk business	40,000
(d) Speculation income	5,000
(e) Income from agency business	6,000
(f) Interest on debenture of a company	15,000
(g) Income from house property (Gross Computed)	8,000

The carried forward items from the previous assessment year are :

(i) Loss in agency business	5,000
(ii) Loss from cotton business (discontinued in year before past year)	12,000

(iii) Loss from silk business	5,000
(iv) Speculation loss	8,000
(v) Short term capital loss	12,000
(vi) Long term capital loss (from the previous two years)	7,000

Current year's depreciation for silk business amounted to Rs. 800

✦ **Solution :**

Computation of total income of Mr. Mallama for A. Y. 2020 – 21

Particulars	Rs.	Rs.	Rs.
I) Income from Business :			
Income from silk business	40,000		
Less : Depreciation	800	39,200	
Income from agency business		6,000	
		45,200	
Less : Carried forward loss in agency business	5,000		
Carried forward loss from cotton business	12,000		
Carried from loss from silk business	5,000	22,000	23,200
Speculation income		5,000	
Less : Carried forward speculation loss set off		8,000	
Unabsorbed speculation loss carried forward		3,000	--
II) Income from house property :			8,000
III) Capital gains :			
Long term, capital gains		15,000	
Short term capital gain		10,000	
		25,000	

Less : Carried forward capital losses set off			
Short term	12,000		
Long term	7,000	19,000	6,000
IV) Income from other sources :			
Interest on debenture of Co.			15,000
Gross Total Income			52,200

Note : (1) Speculation loss of Rs. 3,000 which could not be absorbed should be carried forward and set off against speculation profit of subsequent year.

Illustration 3 :

Mr. Raghuram furnishes the following particulars for the three consecutive assessment years :

Particulars	Year before Previous (c)	Previous (b)	Current (a)
Income from salary (Computed)	50,000	55,000	60,000
Income from cloth business	—	60,000	30,000
Loss from cloth business	40,000	—	—
Income from let out property	40,000	10,000	30,000
Loss from self occupied house	—	12,000	10,000
Loss from gold speculations	30,000	—	—
Profit from gold speculations	—	1,00,000	1,50,000
Dividend from cooperative society	5,000	5,000	5,000
Long term capital loss	60,000	—	—
Short term capital loss	10,000	—	20,000
Long term capital gains	—	30,000	60,000
Donation to National Relief Fund	5,000	5,000	5,000

Compute his total taxable income for these assessment years

Solution :

Computation of total income of Mr. Raghuram for A. Y. 202X – 202X (c)

Particulars	Rs.	Rs.	Rs.
I) Income from salary			50,000
II) Income from house property let out			40,000
III) Income from business :			
Loss from cloth business			- 40,000
Loss from gold speculations carried forward	30,000		—
IV) Capital gains :			
Long term capital loss carried forward	60,000		
Short term capital loss carried forward	10,000		--
V) Income from other sources :			
Dividend from cooperative society			5,000
Gross total income			55,000
Less : Deduction for dividend u/s 80 (G)			5,000
Total income :			50,000

Assessment year 202X – 2X (b)

Particulars	Rs.	Rs.	Rs.
I) Income from salary			55,000
II) Income from house property let out		10,000	
Less : Loss from self occupied house		12,000	-2000
III) Income from business (cloth)		60,000	
Profit from gold speculation business	1,00,000		
Less : Carried forward speculation loss set off	30,000	70,000	1,30,000
IV) Capital gains :			
Long term capital gains		30,000	

Less : Carried forward capital loss		
Set off to the possible extent	30,000	
V) Income from other sources :		
Dividend from cooperative society		5,000
Gross total income		1,88,000
Less : deduction for dividend u/s 8 (G)		5,000
Total taxable income :		1,83,000

Assessment year 202X – 2X (a)

I) Income from salary		60,000
II) Income from house property – let out	30,000	
Less : loss from self occupied house	10,000	
III) Income from business (cloth)	30,000	
Profit from gold speculation	1,50,000	1,80,000
IV) Capital gains		
Long term capital gains	60,000	
Less : Short term capital gains	20,000	
	40,000	
Less : Carried forward capital loss set off	40,000	--
V) Income from other sources :		
Dividend from cooperative society		5,000
Gross income		2,65,000
Less : Deduction for dividend u/s 80 (G)		5,000
Total taxable income		2,60,000

✦ **Note :**

- (1) For A. Y. 202X – 202X (c) business loss of Rs. 40,000 is set off against other incomes and speculation loss of Rs. 30,000 & capital loss of Rs. 70,000 are carried forward.
- (2) For A. Y. 202X – 202X (b) loss from house property of Rs. 2,000 is set off

against other incomes while unabsorbed capital loss of Rs. 40,000 is carried forward after setting off speculation loss of Rs. 30,000 and capital loss of Rs. 30,000.

Illustration 4 :

Mr. Abhishek submits the following information for A. Y. 2020-21

Salary income computed	60,000
Income from house property	
House X – Income	15,000
House Y – loss	22,000
Income from business :	
Business M – Profit	10,000
N – Loss	12,000
Business O – Profit (Speculative)	40,000
P – Loss (Speculative)	60,000
Capital gains :	
Long term capital gains	10,000
Short term capital loss	18,000
Income from other sources :	
Income from card game	15,000
Loss from card game	8,000
Loss from maintenance of race horse	18,000
Interest on government bonds	13,000

Compute his taxable income from A. Y. 2020-21 assuming that he has saved Rs. 13,000 in PPF A/c

Solution :**Computation of taxable income of M. Abhishek for A. Y. 2020 – 21**

Particulars	Rs.	Rs.	Rs.
I) Income from salary			60,000
II) Income from house property			
House X – Income		15,000	
Less : House Y – Loss		-22,000	-7,000
III) Income from business			
Business M		10,000	
Less : Loss from business N		12,000	-2,000
Speculation business O – Profit	40,000		
Less Speculation business P – Loss	60,000		
Speculative loss carried forward	20,000	--	
IV) Capital gains :			
Long term capital gains	10,000		
Less : Short term capital loss	18,000		
Capital loss carried forward	8,000	--	
V) Income from other sources :			
Income from card game		15,000	
Interest on government bonds		13,000	
Loss from maintenance of race horse carried forward	18,000	--	28,000
Gross Total Income			79,000
Less : Deduction for savings in PPF u/s 80I			13,000
Total taxable income			66,000

+ Note :

- (1) Loss from house property and non speculative business is set off against other incomes such as salary or income from other sources of current assessment

year.

- (2) Speculation loss, capital loss & loss from maintenance of race horse are carried forward to the subsequent years and to be set off against incomes from those respective heads in forthcoming years.
- (3) Loss from card game cannot be deducted from income from card games by virtue of section 58.

3.2.3 e-filing of Returns:

E-filing is the short form of electronic filing of income taxes. E-filing is when you electronically file your income tax returns online for a particular year. This means you no longer need to visit the nearest Income Tax Department's office to file your returns physically. The Process to file Income Tax Returns (ITR) by using the internet is called E-filing. The process to e-file ITR is quick, easy, and can be completed from the comfort of an individual's home or office. E-filing ITR can also help in saving money as you would not have to hire an individual to file ITR.

A step-by-step Guide on How to Login or Register on the e-filing portal:

1. Step 1: Visit the e-filing website <https://www.incometax.gov.in/iec/foportal>
2. Step 2: Register or Login to e-file your returns
 - In case you have registered yourself on the portal earlier, click on the 'Login' Here' button.
 - In case you have not registered yourself on the portal, click on the 'Register' Yourself' button.
3. Step 3: Click on 'Taxpayer' and then enter the details of your PAN and click on 'validate'. Next, click on 'Continue'.
4. Step 4: Provide details such as your name, address, gender, residential status, date of birth, etc.
5. Step 5: Provide your Email ID and registered mobile number.
6. Step 6: Once the form has been filled up, click on 'Continue'.
7. Step 7: You will have to verify the details following which a 6-digit One Time Password (OTP) will be sent to your registered mobile number and Email address.

8. Step 8: Enter the OTP follow the instructions given to complete the registration process successfully.
9. Step 9: Once the OTP has been verified, a new window will open where you will have to verify the details provided by you. In case any detail given is incorrect, you can change it, following which another OTP will be sent to validate the change.
10. Step 10: The final step will be set up a password and secure login message.
11. Step 11: Click on 'Register' following which you will receive an acknowledgment message stating that the registration process has been completed successfully.

In this way can be filling the return through income tax portal. It is understood that the process to file Income Tax Returns (ITR) by using the internet is called E-filing. Which helps to e-file ITR very easy and quick, and it can be completed from the comfort of an individual's home or office.

3.2.4 Online Payment of Tax:

The process of tax payment has become easier as it can be made online now. Hence, it is need to visit the official website in order to make your income tax payment online. Moreover, first choose Challan 280, then enter your personal information, review the details which you entered, and submit it online. The process earlier to submit your tax offline required a lot of time and paperwork making the whole process very complicated. As technology advances, a lot of task can be done online reducing paperwork, time, and effort. The same goes for the payment of tax which can now be done online in few easy steps.

➤ Steps to Pay Tax Online

In order to make income tax online, it is need to follow the steps mentioned below:

1. Step-1: Visit tin-nsdl.com and click on 'e-payment: Pay Taxes Online'
2. Step-2: Select the relevant challan i.e. ITNS 280, ITNS 281, ITNS 282, ITNS 283, ITNS 284 or Form 26 QB demand payment (only for TDS on sale of property) as applicable.

3. Step-3: Enter PAN / TAN (as applicable) and other mandatory challan details like accounting head under which payment is made, address of the tax payer and the bank through which payment is to be made etc.

In the next page, select '(0021) Income Tax (Other than Companies)' under the Tax applicable tab and provide the details asked for.

4. Step-4: On submission of data entered, a confirmation screen will be displayed. If PAN / TAN is valid as per the ITD PAN / TAN master, then the full name of the taxpayer as per the master will be displayed on the confirmation screen.
 5. Step-5: On confirmation of the data so entered, the taxpayer will be directed to the net-banking site of the bank. Thus, it is need to select the mode of payment.
 6. Step-6: The taxpayer has to login to the net-banking site with the user id / password provided by the bank for net-banking purpose and enter payment details at the bank site. Moreover, it is need to enter the captcha code displayed on the screen and click on 'Proceed'.
 7. Step-7: On successful payment a challan counterfoil will be displayed containing CIN, payment details and bank name through which e-payment has been made. This counterfoil is proof of payment being made.
- Specimen Copy: Tax Payer Counterfoil

Tax Payer Counterfoil			
PAN <input type="text"/>			
Received from :	Payment Status : <input type="text" value="Success"/>		
Rs : <input type="text" value="54110/-"/>	SBI Ref No. :		
(in words) : Fifty Four Thousand And One Hundred And Ten Rupees Only	BSR Code	Tender date	Challan No
Drawn On : <input type="text" value="Internet Banking through SBI"/>	CIN	0013283	291217
PAN ON ACCOUNT OF INCOME TAX ON: Major Head :OTHER THAN COMPANIES TAX[0021] Minor Head : SELF ASSESSMENT TAX [300]	Date of challan :	29-12-2017	
For the assessment year : 2017-18	State Bank of India Gandhinagar Bangalore (Internet Collection Center)		

(Sources:<https://www.bankbazaar.com/tax/online-tax-payment.html#steps>)

Check Your Progress

A) Fill in the Blanks with appropriate alternatives.

- i) Income of minor child is Clubbed U/s of Income Tax Act.
 - a) 59
 - b) 60
 - c) 64 (IA)
 - d) 64(2)
- ii) Loss from house property is adjusted against of the same year.
 - a) income from salary
 - b) profit
 - c) income from other source
 - d) all of these
- iii) Loss cannot be carried forward.
 - a) house property
 - b) business
 - c) Capital
 - d) non of these
- iv) Capital loss can be carried forward to the extent of years
 - a) 3
 - b) 4
 - c) 8
 - d) 6

B) State whether the following statements are true or false.

- i) Loss of speculation business can be set off against only speculation business.
- ii) Short term capital loss is set off against long term capital gain.
- iii) Deemed income is included in assessee's income.
- iv) Income of daughter in law is clubbed in the income of father in law.

3.3 Summary :

In certain circumstances, income received by a person may be added in the income of another person. For example a kid receives interest on deposit kept by grand father. As he is minor, such income is added in the income of his father / mother who has higher income. This is clubbing of income.

On the other hand loss of business can be carried forward to the next year and set off against next year profit.

3.4 Key Terms :

Clubbing : Income received by one person is taxed in the hand of another person.

Set off : The loss of one year is adjusted against the profit in the next year.

Carry Forward – The loss of one year is allowed to be taken to the next year.

3.5 Answers to Check Your Progress

- A) i) – c ii) – d iii) – a iv) – c
B) i) – True ii) – True iii) – True iv) – True

3.6 Exercise

- 1) Why the provisions regarding clubbing of income are included in the Act?
- 2) Explain in brief any five incomes of other persons included in the total income of an assessee.
- 3) Explain the treatment of following in the course of assessment.
 - (a) Cash credits in the books of assessment
 - (b) Unexplained investments.
 - (c) Unexplained money and valuable articles

- (d) Unexplained expenditure
 - (e) Income of a minor
 - (f) Income from converted property
- 4) State the circumstances in which the income of the wife of an assessee is included in his total income
 - 5) ‘An assessee is not only liable in respect of his own income for income tax purpose but his liability may extended to some other income also discuss.
 - 6) Discuss the provisions regarding set off and carry forward and set off of losses under Income Tax Act, 1961.
 - 7) Explain in brief the provisions of Income Tax Act regarding set off and carryforwars of the following losses :
 - (a) Business loss
 - (b) Speculation loss
 - (c) Capital loss
 - (d) Loss from house property
 - (e) Loss from activity of maintenance of race horses.

Practical 1 : The procedure of Online Returns Filling of an Individual under Form ITR -1

Form ITR-1 is filled online by the individuals being a Resident (other than NOR) having total income up to Rs. 50 Lakhs, having income from salary, one house property other sources (interest, family pension etc.) and agricultural income up to Rs. 5,000. Before commencing the process of online filing of return of an individual through ITR-1 the assessee should keep with him the following documents:

1. Form 16
2. PAN card
3. Bank Pass Book
4. Aadhar

Step 1: Go to Website: Log on to income tax department site at <http://incometaxindiaefiling.gov.in> when the following window will appear:

e-Filing *Anywhere Anytime*
Income Tax Department, Government of India

DUE DATE FOR FILING TAX AUDIT REPORT (TAR) IS 15th JAN 2021. DUE DATE FOR FILING ITRs REQUIRING AUDIT IS 15th FEB 2021.

List of Income Tax Return and Forms available for e-Filing

Tax Information and Services

e-Filing Brochures

NO WAITING TIME. GET YOUR PAN INSTANTLY

APPLY NOW

How To e-Filing? Register Yourself

Registered User? Login Here

Forgot Password? Reset

Quick Links

- File DTVSV Form
- Instant PAN through Aadhaar
- Tax Calculator FY 2020-21
- Link Aadhaar
- e-Pay Tax | Chitans
- e-Verify Return
- View Form 26AS(Tax Credit)
- Outstanding Demand
- ITR Status
- Know Your TAN | AQ
- Verify Your PAN Details
- Tax Calendar
- Check Refund Disposit Status
- Submit Tax Evasion Petition or Benami Property holding
- Verification of applicability u/s 194N

Authenticate

- Notice/Order Issued by ITD
- Reminders | Campaigns

News & Updates

12/01/2021 - New!
e-filing website has enabled the public to file information on Tax Evasion under the link 'Submit Tax Evasion Petition or Benami Property holding'. Click here for Press Release 99 (12) 01.

11/01/2021
The facility to file modification for Asst Year 2020-21 on the 143C1 intimation issued by CPC Bengaluru, is now enabled for 'Return data correction' & 'Dry Reprocess the return'. The notification facility for 'Tax credit mismatch correction' will be enabled soon.

08/01/2021
In view of new restrictions by (BDA) of a maximum of 5 OTP requests for a single Aadhaar within a span of 30 minutes, taxpayers are requested to give sufficient time before multiple submissions for Aadhaar OTP.

Download

- IT Return Preparation Software
- Other Forms Preparation Software
- DSC Management Software
- e-Filing FAQs on DTVSV Forms
- FAQs on Return Filing
- ITR Notified Forms AY 2020-21

How to?

- Scan the Supporting Documents
- e-Verify Return
- Reset Pasword
- Update PAN/Aadhaar Details
- Report Account Misuse

Statistics

Individual Registered Users	21654526
Registered and Aadhaar Linked	16243340
Not Registered but Aadhaar Linked	16228335
e-Verified ITRs (20-21)	10954917

This year ITR filing is user friendly. Everything crystal clear. Effort of the team is appreciated. 08-09-2020

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 This site is best viewed at 1024 x 768 resolution with latest version of Chrome, Firefox, Safari and Internet Explorer.

INCOME-TAX SITE HOME PAGE

Step 2 : Do Registration: If you are filing the online return for the first time you have to do the online registration. To do so click the top window on the right hand side named *'Register Yourself'* and do the registration in registration form and generate the user ID and Pass Word by providing your PAN No., Name, email, phone no. etc. Immediately after clicking registration select user type as individual.

6:37 VoLTE 4G LTE1 67%

[incometaxindiaefiling.gov.in](#)

e-Filing Anywhere Anytime
Income Tax Department, Government of India

Home Downloads News & Updates

Registration Form - Individual

Step 1: Enter Basic Details Step 2: Registration Form Step 3: Registration Verification Step 4: Registration Successful

Please provide below details as per your PAN.

PAN -	<input type="text"/>
Surname -	<input type="text"/>
Middle Name	<input type="text"/>
First Name	<input type="text"/>
Date of Birth (DD/MM/YYYY) -	<input type="text"/>
Residential Status -	<input type="radio"/> Resident <input type="radio"/> Non Resident

[Continue](#)

Instructions
- Fields marked with asterisk(*) are mandatory

INDIVIDUAL REGISTRATION PAGE

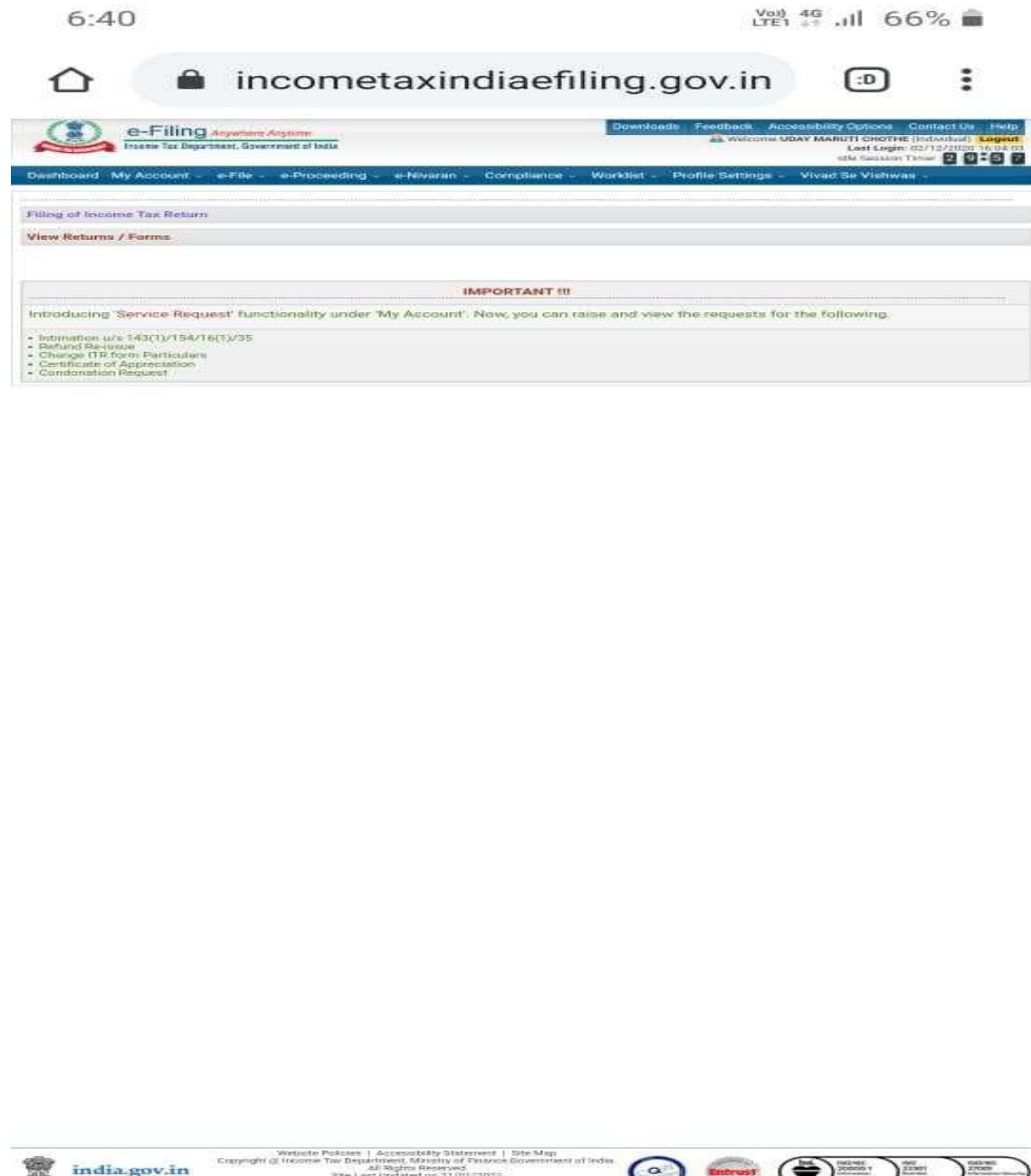
Step 3: Login: Click the window named 'Login here' appearing there below. Then following dashboard will appear:



The screenshot shows a mobile browser interface for the e-Filing portal. At the top, the time is 6:38, and the battery level is 67%. The browser address bar shows the URL incometaxindiaefiling.gov.in. The page header includes the e-Filing logo and navigation links: Home, Downloads, News & Updates, About Us, Feedback, Accessibility Options, Contact Us, e-Navaran, and Help. The main content area is titled 'Login' and contains a form with the following fields: User ID, Password, Captcha Code (displaying 'YYMTBG'), and Enter Captcha. Below the form are buttons for 'Login' and 'Forgot Password?'. A link for 'New Users? Register' is also present. To the right of the form, there is a 'Trouble Logging In?' section with a list of instructions: 'User ID is not case sensitive', 'Password is case sensitive', and 'Make sure that the details entered are correct.' At the bottom of the page, there is a footer with the India.gov.in logo, website policies, accessibility statement, site map, copyright information, and social media icons for eTrust, Twitter, Facebook, and Instagram.

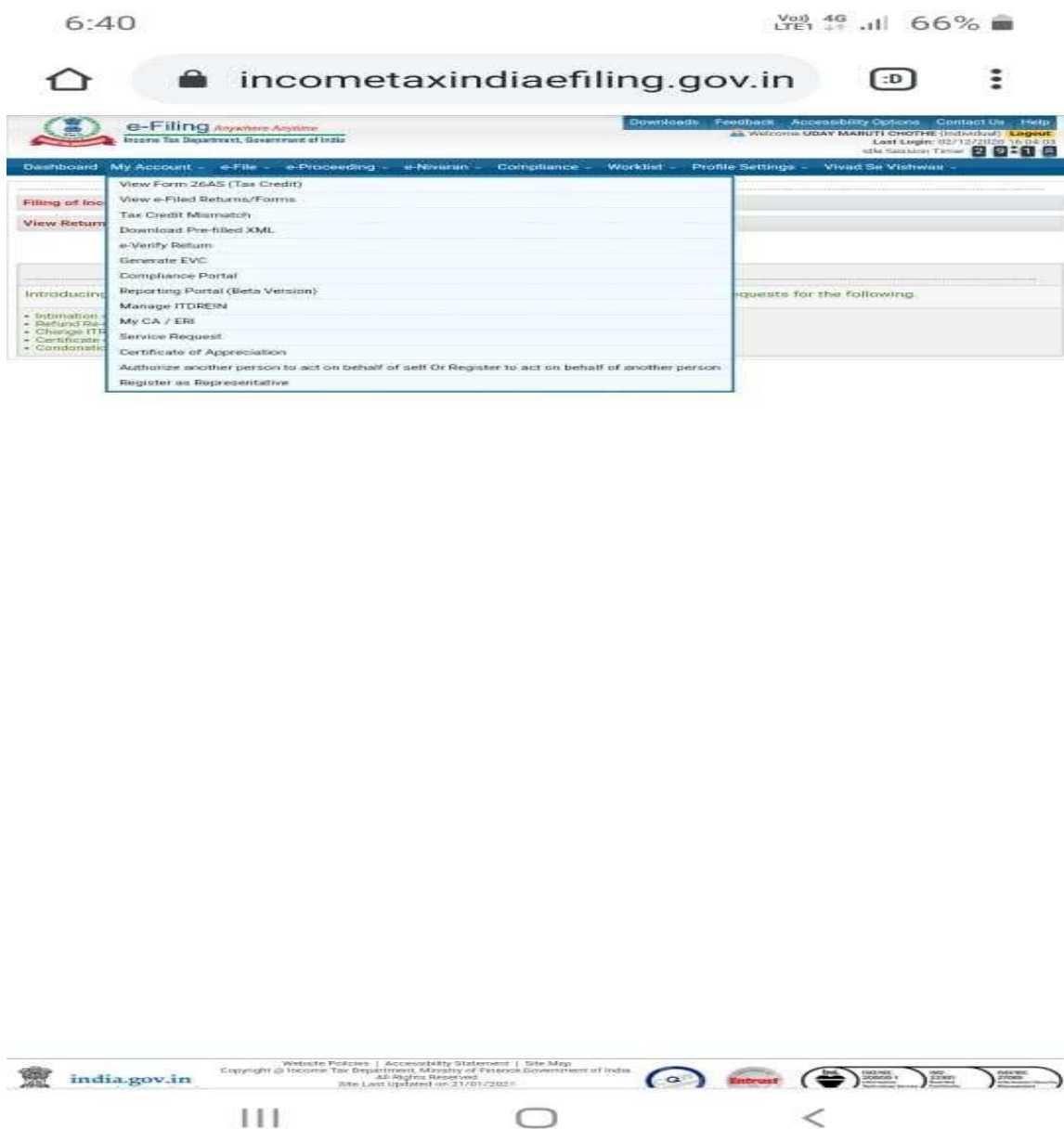
LOGIN PAGE

Fill up user ID and Pass Word created in step 2 captcha code and click on login. Then the following dash board will appear on the screen.



DASH BOARD

Step 4: View TDS details: Before filing your return you must view your 26 AS form from the menu given on the top left hand side by clicking on *My Account* and View Form 26AS. The following dash board will appear on your screen. From the screen you will view the TDS details to be considered while filing the return.



VIEW 26AS Page

Then go to Dashboard

Step 5 Click on Filing of Income Tax Return: Select Assessment Year, ITR form no : ITR-1, Filing type: Original, Submission Mode: Prepare and Submit Online, Press Continue.

The screenshot shows the 'Income Tax Return' filing page on the e-Filing portal. The page includes a navigation bar with options like 'Dashboard', 'My Account', 'e-File', 'e-Proceeding', 'e-Navbar', 'Compliance', 'Worklist', 'Profile Settings', and 'Vivad Se Vishwas'. The main content area is titled 'Income Tax Return' and contains a form with the following fields:

- PAN: A5EPC3044L
- Assessment Year: 2020-21
- ITR Form Number: ITR-1
- Filing Type: Original/Revised Return
- Submission Mode: Prepare and Submit On

Below the form, there is a list of details to be prefilled in the ITR form:

- PAN, Name, Date of Birth shall be prefilled from PAN database.
- Address, Aadhaar Number, mobile number and e-mail ID shall be prefilled from e-Filing Profile (Please update e-Filing Profile before proceeding).
- Tax Payment, TDS and TCS details shall be prefilled from Form 26AS.
- Details of Salary Income, allowances and deductions shall be prefilled from Annexure II of Form 24Q.
- Type of House Property shall be prefilled from last filed ITR.
- Details of Income from House property shall be prefilled from Form 26AS.
- Details of Interest income from Term Deposit shall be prefilled from Form 26AS.
- Details of Interest income details (u/s 244A) from Income Tax Refund.
- Tax relief u/s 89 shall be prefilled from Annexure II of Form 24Q.
- Bank account details shall be prefilled from last filed ITR and e-Filing Profile.
- Verification Details - Self/Representative PAN details as applicable based on Logged in PAN.

A table titled 'Bank account details' is shown below the list:

S.No	Bank Account Number	IFSC Code	Bank Name	Source	Select Account for Refund Credit
1	20281844896	SBIND000888	STATE BANK OF INDIA	Prevalidated	<input checked="" type="checkbox"/>
2	05052200067770	SYND0000505	SYNDICATE BANK	Latest ITR	<input type="checkbox"/>

Below the table, there is a checkbox labeled 'I want to use Hindi Form to prepare and submit' with 'Continue' and 'Cancel' buttons.

At the bottom, a blue banner states: 'Filing in response notices u/s 142(1), 148, 153A and 153C can be submitted through e-Proceeding option'.

Step 6 Part A General Information: Click on General Information

Auto filled information of your PAN No., Name etc. will be reflected. Fill the general information regarding Assessment Year, Nature of Employment, Filing Status from the given options. Read the instructions and fill up/ Edit the general information such as First Name, Middle Name, Aadhar No, Date of Birth, Mobile No.. Email ID, Address, Nature of Employment (Government / Private) Filled under section [139(1)on or before due date], Are you filing returns under seventh provision to section 139(1)- NO.

Note: (1) Returns under seventh provision are filed if the income is less than 2.5 lakh but some of the expenses such as foreign tour, electricity bill beyond certain limit are incurred by the assessee during the Previous Year.

(3) Click on Save Draft frequently while filling the return.



incometaxindiaefiling.gov.in

ITB-1 SAHAJ INDIAN INCOME TAX RETURN

Assessment Year - 2020-21

File & Submit | Save Draft | Exit

PAN * **First Name** **Middle Name** **Last Name*** **Date of Birth*** **Mobile Number*** **Email Address*** **Address** **Flat/Door/Block No*** **Name of Premises/Building/Village** **Road/Street/Post Office** **Area/ Locality*** **Town/City/District*** **State*** **Country*** **Pin Code*** **ZIP Code** **No Zip Code** **Nature of employment:** Other **File as -** **Are you filing return of income under Seventh proviso to section 139(1) but otherwise not required to furnish return of income? [Note: To be filled only if a person is not required to furnish a return of income under section 139(1) but filing return of income due to fulfilling one or more conditions mentioned in the seventh proviso to section 139(1)]**

GENERAL INFORMATION

Step 7 Computation of Income and Tax: Click on Computation of Income and Tax show at the top of window. Following screen will appear.

6:45 Vol 4G 65%

Preview & Submit Save Draft Exit

Part B Gross Total Income

B1. Gross Salary (ia+ib+ic)

(a) Salary as per section 17(1)

(b) Value of perquisites as per section 17(2)

(c) Profits in lieu of salary as per section 17(3)

Less: Allowances to the extent exempt u/s 10 (Ensure that it is included in salary income u/s 17(1)/17(2)/17(3))

Sl. No.	Nature of Exempt Allowance	Description (If Any Other selected)	Amount
1	Select		

(ii) Net Salary (i-ii)

(iv) Deductions u/s 16 (iva + ivb+ivc)

(a) Standard deduction u/s 16(a)

(b) Entertainment allowance u/s 16(b)

(c) Professional tax u/s 16(d)

(v) Income chargeable under the Head "Salaries" (iii - iv)

B2. Type of House Property

(i) Gross rent received/ receivable/ lettable value during the year

(ii) Tax paid to local authorities

(iii) Annual Value (i-ii)

(iv) 30% of Annual Value

(v) Interest payable on borrowed capital

(vi) Arrears/Unrealized Rent received during the year less 30%

(vii) Income chargeable under the head House Property (iii-iv+v)

Note: Maximum Loss from House property that can be set-off is INR 2,00,000. To avail the benefit of carry forward and set off of loss, please use ITR-2

B3. Income from Other Sources

Sl.No.	Nature of Income	Description (If Any Other selected)	Amount
1	Select		

Less: Deduction u/s 57(va) (in case of family pension only)

B4. Gross Total Income (B1+B2+B3)(If loss, put the figure in negative)

1

Less: Deduction u/s 57(ia) (In case of family pension only)

B4. Gross Total Income (B1+B2+B3)(If loss, put the figure in negative)

Note- To avail the benefit of carry forward and set off loss, please use ITR-2

Part C - Deductions and Taxable Total Income (Refer instructions for Deduction limit as per Income-tax Act)

Whether, you have made any investment/ deposit/ payments between 01.04.2020 to 31.07.2020 for the purpose of claiming any deduction under Part B of Chapter VIA? [Yes/No](If yes, please fill schedule DI)

Section	Amount	System Calculated
80C-Life insurance premia, deferred annuity, contributions to provident fund, subscription to certain equity shares or debentures, etc.	<input type="text"/>	<input type="text"/>
80CCC-Payment in respect Pension Fund, etc.	<input type="text"/>	<input type="text"/>
80CCD(1)-Contribution to pension scheme of Central Government	<input type="text"/>	<input type="text"/>
80CCD(1B)-Contribution to pension scheme of Central Government	<input type="text"/>	<input type="text"/>
80CCD(2)-Contribution to pension scheme of Central Government by employer	<input type="text"/>	<input type="text"/>
80D Deduction in respect of Health Insurance premium (Please fill 80D Schedule. This field is auto-populated from schedule 80D.)	<input type="text"/>	<input type="text"/>
Note: Total of 80D in system calculated value should not exceed Rs 100000		
80DD - Maintenance including medical	<input type="text"/>	<input type="text"/>



80TTA-Interest on saving bank Accounts in case of other than Resident senior citizens	<input type="text"/>	<input type="text"/>
80TTB- Interest on deposits in case of Resident senior citizens	<input type="text"/>	<input type="text"/>
80U-In case of a person with disability	Select <input type="text"/>	<input type="text"/>
C1. Total Deductions	<input type="text"/>	<input type="text"/>

Note: Total deductions under chapter VI A cannot exceed GTI.

C2. Total Income(B4 - C1)

Exempt income: (If agricultural income exceeds Rs 5000, other ITR, as applicable, has to be filed)

Sl.No.	Nature of Income	Description (If Any Other selected)	Amount
1	Select	<input type="text"/>	<input type="text"/>
Total Amount			<input type="text"/>

Part D - COMPUTATION OF TAX PAYABLE

D1.	Tax Payable on Total Income	<input type="text"/>
D2.	Rebate u/s 87A	<input type="text"/>
D3.	Tax payable after Rebate	<input type="text"/>
D4.	Health and Education Cess @4% on (D3)	<input type="text"/>
D5.	Total of Tax & Health and Education Cess	<input type="text"/>
D6.	Relief u/s 89 (Please ensure to submit Form 10E to claim this relief)	<input type="text"/>
Balance Tax After Relief (D5-D6)		<input type="text"/>
D7.	Interest u/s 234A	<input type="text"/>
D8.	Interest u/s 234B	<input type="text"/>
D9.	Interest u/s 234C	<input type="text"/>
D10.	Fee u/s 234F	<input type="text"/>
Total Interest and Fee Payable(D7 + D8 + D9 + D10)		<input type="text"/>
D11.	Total Tax, Fee and Interest(D5+D7 + D8 + D9 + D10 - D6)	<input type="text"/>

Preview & Submit Save Draft Exit

COMPUTATION OF TAX

Step 8 Computation of Income and Tax: This is the main part of returns wherein you have to fill the details of income given in form 16 provided by the employer. The following data obtained from form 16 is filled up in the respective fields:

(B1) Salary Details : Gross Salary, Salary under section 17(i), Value of Perquisites under section 17(ii), Profits in lieu of salary u/s 17 (iii), Allowances Exempt u/s 10 to be selected from the drop down list (such as HRA, Gratuity, Refund of PF, Insurance etc.), Standard Deduction u/s 16 (i) (Auto filled), Entertainment Allowance u/s 16 (ii), Professional Tax u/s 16 (iii)

Cross verify the data values in ITR-1 with those given in form 16 at each stage, Fill up the data, if any not shown in form 16 such as PPF, Insurance Premiums, Home loan interest etc.

(B2) Fill up the details of Income or loss (Housing Loan Interest) from House Property, if any.

(B3) Fill up Income from other sources such as interest, family pension and any other income details.

Part C: Deduction and Taxable Total Income: Fill up the deductions to be claimed u/s 80, if any such as 80

Exempt Income: Click on select drop down the exempt income to be claimed by the assessee if any.

Part D : Computation of Tax Payable:

This part is auto calculated

Click on Tax Paid and Verification menu at top of window: Following dash board will appear:

6:47 Vo3 4G LTE 65%

Preview & Submit Save Draft Exit

Total Taxes Paid

"PLEASE NOTE THAT CALCULATED FIELDS (IN GREY) ARE PICKED UP FROM OTHER SCHEDULES AND ARE NOT TO BE ENTERED. For ex : The taxes paid figures below will get filled up when the Schedules linked to them are filled."

D12(i).	Total Advance Tax Paid	0	D12(ii).	Total Self Assessment Tax Paid	0
D12(iii).	Total TDS Claimed	600	D12(iv).	Total TCS Claimed	0
D12(v). Total Taxes Paid (D12[(i)+(ii)+(iii)+(iv)])				600	
D13. Amount Payable (D11 - D12)(if D11 > D12)				0	
D14. Refund (D12 - D11)(if D12 > D11)				600	

Part E - Other Information

D15. Details of all Bank Accounts held in India at any time during the previous year (excluding dormant accounts) *

S.No.	IFS Code of the bank	Name of the bank	Account Number	Select Account for Refund Credit
1	SBIN000889	STATE BANK OF INDIA	2005184296	<input checked="" type="checkbox"/>
2	SYNB0005915	SYNDICATE BANK	0005200067770	<input type="checkbox"/>

Note

- Minimum one account should be selected for refund credit.
- In case of Refund, multiple accounts are selected for refund credit, then refund will be credited to one of the account decided by CPC after processing the return.

Verification

I, **DEVI MARUTI CHETHE**, son/daughter of **MARUTI VITHU CHETHE**, solemnly declare that to the best of my knowledge and belief, the information given in the return is correct and complete and is in accordance with the provisions of the Income-tax Act 1961.

I further declare that I am making this return in my capacity as **Select** and I am also competent to make this return and verify it. I am holding permanent account number **A00PC3044L**.

Place - Date - **30/01/2021**

Note

- Submission date** is the system date of e-Filing portal of Income Tax Department. The same is available in the Acknowledgement/ITR-V generated after submission of return.
- Verification Date** is the date of e-Verification at e-Filing portal of Income Tax Department or the date of receipt of ITR-V at CPC, Bengaluru. The same will be available in View Returns/Form option of e-Filing portal. In case of e-Verification, it is available in Acknowledgement.

Please select the verification option

I would like to e-Verify (Please ensure that you have valid Aadhar/Prevalidated Bank account/Prevalidated Demat account/Digital Signature certificate registered in e-Filing against your PAN to use this option).

I would like to e-Verify later within 120 days from date of filing.

I don't want to e-Verify and would like to send signed ITR-V through normal or speed post to Centralized Processing Center, Income Tax Department, Bengaluru - 560 500* within 120 days from date of filing.

Preview & Submit Save Draft Exit

VERIFICATION AND SUBMIT

Part E: Other information (Details of All Bank Accounts) Such as IFSC code and Account Numbers of individual assessee are filled in this part . It should be noted that for salaried person only the account in which monthly salary is credited should be given.

Verification:

1. Name of Assessee is auto filled,
2. Name of Son or Daughter should be filled as per PAN card.
3. Capacity – Select : Self

4. Place: It should be district place
5. Please select the verification option

Step 9 Click on Preview & Submit: Press on Submit

3.7 References for Further Study

1. Singhanian V. K. – Students Guide to Income Tax
2. Manoharan T. N. – Income Tax
3. Herekar P.M. – A Simple Approach to Income Tax
4. Kulkarni S. S. – Income Tax
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Introduction to GST

Index

- 4.0 Objectives
- 4.1 Introduction
- 4.2 Presentation of Subject Matter
 - 4.2.1 Concept of GST
 - 4.2.2 Nature and Basis of Charge
 - 4.2.3 Registration under GST
 - 4.2.4 Valuation of Taxable Services
 - 4.2.5 Provisions Pertaining to Returns Under GST
- 4.3 Summary
- 4.4 Terms to Remember
- 4.5 Answers to Check Your Progress
- 4.6 Exercise
- 4.7 References for Further Study

4.0 Objectives

After studying this unit, you will be able;

1. To understand the basics concept of GST.
2. To Gain Knowledge of GST and its compliances.
3. To give an understanding of the calculation of value of supply under GST
4. To make students aware about the process of registration under GST
5. To make students aware about the GST return filing process, rules and regulations.

4.1 Introduction:

Under Article 366 of the Constitution, Goods and services tax (GST) means any tax on supply of goods, or services or both except taxes on the supply of the alcoholic liquor for human consumption. You have already studied Income Tax which is a direct tax (i.e., tax is paid and borne by the same person who earns income). You will now be studying GST which is an indirect tax (i.e. tax is paid by the supplier but ultimately borne by the consumer). Following are some of the distinctions between direct and Indirect taxes:

Direct Taxes	Indirect Taxes
Tax on Income, wealth, profession etc. of persons.	Tax on Consumption of goods and services.
Tax payer. paystaxes directly to government	Indirect taxes are payable even before the goods/services reach the tax payer.
Direct taxes become payable after the income reaches the tax payer.	Indirect taxes are payable even before the goods/services reach the tax payer.
Direct tax rate is not flat. The rates are progressive-higher the income, higher the rate.	Indirect tax rates are flat or fixed. Hence, they are called regressive- the poor & the rich pay the same tax.

4.2 Presentation of the Subject Matter:

4.2.1 Concept of GST:

(1) Tax on Consumption

GST is a tax on consumption of goods & services i.e. tax is borne by the consumer in the State where goods & / or services are finally consumed.

(1) GST is a destination-based tax

GST being a destination-based tax is levied where goods/services are consumed. In destination-based tax, zero tax is applicable on exports and imports are taxed at the same rate as on domestic products. SGST will accrue to the state where goods/services are ultimately consumed.

The earlier taxes e.g., excise or services tax were Origin based taxes levied on the supplier in the state where goods/services were produced. Earlier Central Sales Tax (CST) accrued to the State where goods were first sold (not where goods were finally consumed).

(3) Value Added Tax

Goods and services Tax (GST) is in nature a value added tax (VAT) i.e., a tax that is collected step by step based on the value added at each stage of production or distribution. The businessman pays GST on the price of the product minus the GST previously paid on goods and services.

(3) Continuous Flow of Credit

GST aims to eliminate cascading effect of taxes (tax on tax) in the supply chain between producer/manufacturer and end consumer. A continuous chain of set off of earlier taxes from the original producer service provider's point up to the retailer's level established so that burden of only the net tax is passed on to end consumer. This is achieved through the mechanism of Input Tax credit.

(4) Tax On Supply

GST is a tax on supply not on manufacture or sale. Hence stock transfers/branch transfers/free gifts too can be taxed.

4.2.2 Nature and Basis of Charge:

(1) All Goods and Services

As per Article 366 (2A) of the Constitution GST is levied on all goods and services except alcoholic liquor for human consumption.

(2) Alcoholic Liquor for Human Consumption

Alcoholic Liquor for Human Consumption is outside the realm of GST. The manufacture production of alcoholic liquor continues to be subjected to State excise duty and inter State/ intra State sale of the same is subject to CST/VAT respectively.

(3) Petroleum Products

Petroleum crude, diesel, petrol, ATF and natural gas are not presently leviable to GST. GST will be levied on these products from a date to be notified on the recommendation of the GST Council.

Till such date, central excise duty continues to be levied on manufacture/production of petroleum crude, diesel, petrol, ATF and natural gas and inter State / intra state sale of the same is subject to CST/VAT respectively.

(4) Real Estate Sector

Real Estate Sector has been kept out of ambit of GST, i.e. GST will not be levied on sale/purchase of immovable property. Transfer of immovable properties is still subject to stamp duty levied by the state Government.

(5) Tobacco

Tobacco is within the purview of GST, i.e. GST is leviable on tobacco. However, Union Government has also retained the power to levy excise duties on tobacco and tobacco products manufactured in India. Resultantly tobacco is subject to GST as well as central excise duty.

(6) Dual GST Model

This is discussed in para number three as below.

➤ GST Rates:

- (1) GST Rates for supply of goods:** For inter State supply, IGST rates are nil, 0.25%, 3%, 5%, 12%, 18%, 28%. For intra state supply CGST will be 50% of IGST plus SGST (or UTGST) will be 50% of IGST. Besides, compensation cess is applicable in the case of supply of tobacco products, pan masala, motor cars, coal, aerated waters, etc.
- (2) GST Rates for supply of services:** For inter State supply, IGST is applicable. General rate of IGST on services is 18%. However, in a few cases, services are taxed at 5%, 12% & 28%. For intra state supply, CGST plus SGST (or UTGST) are applicable. CGST & SGST (or UTGST) rates are 50% of IGST rates. Moreover, a few services are exempt from GST.
- (3) Import Of Goods:** Import of goods is subject to basic customs duty, education cess and secondary & higher education cess. In addition, IGST & GST compensation cess too will be applicable. By virtue of section 25(1) of Customs Act, exemption is available on certain imports from payment of basic customs duty (by way exemption notification). IGST has been exempted in the case of some such imports.

(4) Exports: Exports are Zero rated i.e. have Nil rate of tax.

➤ **Classification of Goods and Services:**

HSN (Harmonized System of Nomenclature) code is used for classifying the goods under the GST. A new Scheme of Classification of Services has been devised wherein the services of various description have been classified under various sections, headings and groups. Each group consists of various Service Code (Tariff). Chapters referred are the Chapters of the First Schedule to the Customs Tariff Act, 1975.

➤ **Compensation CESS:**

The Goods & Services Tax (Compensation to States) Act, 2017 provides for compensation to the States, as recommended by the GST Council, for the loss of revenue arising on account of implementation of the goods and services tax.

Compensation will be provided to a state for a period of five years from the date on which the state bring its SGST Act into force (i.e. upto 1-7-2022). For the purpose of calculating the compensation amount in any financial year, year 2015-16 will be assumed to be the base year, for calculating the revenue to be protected. The growth rate of revenue for a state during the five year periods is assumed to be 14% per annum. The base year tax revenue consists of the states tax revenue from: (i) State Value Added Tax (VAT) (ii) Central Sales Tax (iii) Entry Tax, Octroi, Local body tax, (iv) Taxes on Luxuries, (v) Taxes on advertisement etc. However, any revenue among these taxes arising related to supply of alcohol for human consumption, and five specified petroleum products, will not be accounted as part of the base year revenue.

This cess will not be payable by exports & those who have opted for compensation levy. The input tax credit of this cess can be used to pay only compensation levy. The input tax credit of this cess can be used to pay only compensation cess & not the other taxes like CGST, SGST or IGST.

➤ **E-Way Bill System:**

(1) Meaning: E-way bill is an electronic document generated on the GST portal evidencing movement of goods.

(2) Form: It has two Components- Part A comprising of details of GSTIN of recipient place of delivery (PIN Code), invoice or challan number and date,

value of goods, HSN code, transport document number (Goods Receipt Number or Railway Receipt Number or Airway Bill Number or Bill of Lading Number) and reasons for transportation; and Part B comprising of transporter details (Vehicle number).

- (3) **Issuer:** Every registered person who causes movement of goods (which may not necessarily be on account of supply) of consignment value more than Rs. 50,000/- is required to furnish above mentioned information in part A of e-way bill, prior to the commencement of movement of goods. The part B containing transport details helps in generation of e-way bill.
- (4) **Aim:** E-way bill is a mechanism to ensure that goods being transported comply with the GST Law and is an effective tool to track movement of goods and check tax evasion.
- (5) The e-way bill provisions aim to remove the ills of the erstwhile way bill system prevailing under VAT in different states, which was a major contributor to the bottlenecks at the check posts. Moreover, different states prescribed different e-way bill rules which made compliance difficult. The e-way bill provisions under GST will bring in a uniform e-way bill rule which will be applicable throughout the country. The physical interface will pave way for digital interface which will facilitate faster movement of goods. It is bound to improve the turnaround time of vehicles & help the logistics industry by increasing the average distance travelled, reducing the travel time as well as costs.
- (6) **Implementation:** The e-way bill system has been introduced nationwide for all interstate movement of goods with effect from 1-4-2018. As regards intra-State supplies, option was given to States to choose any date on or before 3-6-2018. All states have notified e-way bill rules for intra State supplies last being NCT or Delhi where it was introduced w.e.f. 16-6-2018.

➤ **Anti-Profiteering Mechanism:**

Implementation of GST in many countries was coupled with increase in inflation and the prices of the commodities. This happened in spite of the availability of the tax credit. This was happening because the supplier was not passing on the benefit to the consumer and thereby indulging in illegal profiteering. Any reduction in rate of tax or the benefit of increased input tax credit should have been passed on

to the recipient by way of commensurate reduction in prices. National Anti-Profiteering Authority is constituted by the Central Govt. to ensure that prices remain under check and to ensure that businesses do not pocket all the gains from GST because profit is fine, but undue profiteering at the expenses of the common man is not.

➤ **GST Council:**

(1) Constitution: Article 279A of the Constitution empowers the president to constitute a joint forum of the Centre and States namely, Goods & services Tax Council (GST Council)

(2) Members: The GST Council shall consist of the following members namely:

1. The Union Finance minister is the Chairperson
2. The Union Minister of State in charge of revenue or Finance is the Member.
3. The minister in charge of Finance or Taxation or any other Minister nominated by each State Government are the Members.

(3) Recommendation: The GST Council shall make recommendation to the Union and the State on;

- i) The taxes, cesses and surcharges levied by the Union, the states and the local bodies which may be subsumed in the goods and services tax;
- ii) The Goods and services that may be subjected to, or exempted from the goods and services tax;
- iii) Model Goods and services Tax Laws, principles of levy, apportionment of Goods and services Tax Levied on Supplies in the course of inter State trade or commerce under article 269A and the principles that govern the place of supply;
- iv) The Threshold limit of turnover below which goods and services may be exempted from goods and services tax;
- v) The rates including floor rates with bands of goods and services tax;
- vi) Any special rate or rates for a specified period, to raise additional resources during any natural calamity or disaster;

vii) Special provision with respect to the States of Arunachal Pradesh, Assam, Jammu and Kashmir, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura, Himachal Pradesh and Uttarakhand (Such States are referred as special category states)

viii) Any other matter relating to the goods and services tax, as the Council may decide.

(4) Levy on Petroleum Products: The GST Council shall recommend the date on which the goods and services tax be levied on petroleum crude, high speed diesel, motor spirit (Commonly known as petrol) Natural gas and aviation turbine fuel.

(5) Guiding Principles: It has been provided in the Constitution (101st amendment) act, 2016 that the GST Council, in its discharge of various functions, shall be guided by the need for a harmonized structure of GST and for the development of a harmonized national market for goods and services.

➤ **Goods And Services Tax Network (GSTN):**

(1) Set-up:

i) Goods and services Tax Network (GSTN) has been set up by the Government as a private company under erstwhile Sections 25 of the Companies Act, 1956.

ii) Initially, the Central Government held 24.5 percent stake in GSTN while the state Government held 24.5 percent. The remaining 51 percent was held by non- Government Financial institutions.

iii) The GST Council in its 27th meeting held on 4th May, 2018 has approved the change in shareholding pattern of GSTN. Considering the nature of ‘state function’ performed by GSTN, the GST Council felt that GSTN be converted into a fully owned Government company. Accordingly, the Council approved acquisition of entire 51 percent of equity held by non-Governmental institutions in GSTN amounting to Rs. 5.1 crore, equally by the centre and the State Governments.

(2) Services Providers

i) Infosys has been appointed as managed service provider (MSP).

- ii) GSTN has selected 73 IT, IteS and financial technology companies and I Commissioner of Commercial Taxes (CCT, Karnataka). To be called GST Suvidha Providers (GSPs). GSPs would develop applications to be used by taxpayers for interacting with the GSTN.

(3) Data Access

- i) The design of GST systems is based on role based access.
- ii) The taxpayer can access his own data through identified applications like registration, return, view ledger etc.
- iii) The tax official having jurisdiction, as per GST law, can access the data.
- iv) Data can be accessed by audit authorities as per law.
- v) No other entity can have any access to data available with GSTN.

(4) Functions:

GSTN would functioning as below;

- i) Provide three front end services to the taxpayers namely registration paymentand returns.
- ii) Develop back end IT modules for the States who have opted for the same.
- iii) Facilitate Registration
- iv) Forward the returns to Central and State authorities
- v) Perform Computation and settlement of IGST
- vi) Match tax payment details with banking network.
- vii) Provide various MIS reports to the Central and The State Government based onthe taxpayer return information;
- viii) Provide analysis of taxpayer's profile and;
- ix) Run the matching enging for matching, reversal and reclaim of input tax credit.

➤ **Levy of GST:**

Taxable event under GST is supply of goods and/or services in India. Intra state supply is the taxable event for CGST /SGST/UGST. Inter state supply is the taxable event for IGST.

(1) CGST: An intra state supply will be subject to the levy of CGST u/s 9 of the

CGST Act.

- (2) **SGST:** An intra state supply within a State will also be subject to levy of SGST u/s 9 of the respective SGST Act, in addition to the CGST.
- (3) **UTGST:** An intra state supply within an Union Territory will also be subject to levy of UTGST u/s 9 of the respective UTGST Act, in addition to the CGST.
- (4) **IGST:** An inter state supply or import will be subject to the levy of IGST u/s 5 of the IGST Act.

Since the levy of SGST / UTGST is identical with that of CGST, we will be studying only the levy of CGST & IGST in detail as follows.

➤ **Basis of Charge:**

CGST [S.9(1)]

S.9 (1) of lays down the following elements of charges **CGST-**

- (1) **Levy:** The levy shall be called the Central Goods & Services Tax (CGST).
- (2) **Intra-State Supplies:** CGST shall be levied on all intra state supplies of goods or services or both. First there must be supply of goods and/or services; and then it must be intra state. Supply of goods where the location of the supplier and the place of supply of goods are in the same State or same Union territory shall be treated as intra State supply [S.8 of the IGST Act, discussed in detail in Chapter 8]
- (3) **Except:** CGST shall not be levied on the supply of alcoholic liquor for human consumption.
- (4) **Value:** CGST shall not be levied on the value determined under section 15.
- (5) **Rates:** CGST shall not be levied at such rates, not exceeding twenty per cent., as may be notified by the Government on the recommendations of the Council.
- (6) **Collected:** CGST shall be collected in such manner as may be prescribed in the Rules.
- (7) **Paid:** CGST shall be paid by the taxable person.

IGST [S.5(1)]

The elements of charge for IGST u/s 5(1) are identical except-

- (1) **Levy:** The levy shall be called the Integrated Goods & Services Tax (IGST).

- (2) **Intra-State Supplies:** IGST shall be levied on all intra state supplies of goods or services or both. First there must be supply of goods and/or services; and then it must be intra state. Supply of goods where the location of the supplier and the place of supply of goods are in the same State or same Union territory shall be treated as intra State supply [S.8 of the IGST Act, discussed in detail in Chapter 8]
- (3) **Imports [Prov-S.5(1) of IGST Act]:** IGST on goods imported into India shall be levied and collected in accordance with the provisions of the Customs Tariff Act, 1975/ the Customs Act, 1962. [see Para 4.1 in this Chapter].
- (4) **Rates:** CGST shall not be levied at such rates, not exceeding forty per cent.

➤ **Elements / Ingredient of Charge:**

Let us discuss these element/ ingredients of charge of GST in detail.

A. Taxable Supply

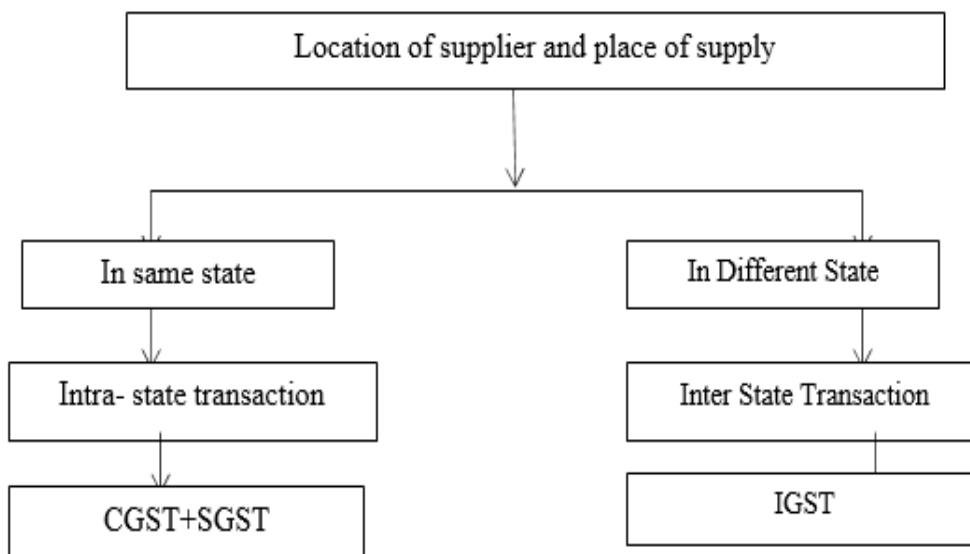
- (1) CGST + SGST/UTGST shall be levied on all intra state supplies of Goods or services or both.
- (2) CGST Act covers all supplies within the whole of India including Jammu and Kashmir. India includes territory of India. Its territorial waters, sea-bed, continental shelf, exclusive economic zone, and the air space above it [**S.2(56)**].
- (3) SGST Act covers all States including Union Territories having State Legislatures (Delhi and Pondicherry) [**S.2(103)**].
- (4) UTGST Act covers all **Union Territories** of- (i) the Andaman and Nicobar Islands; (ii) Lakshadweep; (iii) Dadra and Nagar Haveli; (iv) Daman and Diu (v) Chandigarh; and (vi) other territory [S.2(114)].
- (5) IGST shall be levied on all interstate supplies and Imports.
- (6) If the location of the supplier and the place of supply are within the same State, the transaction will be an intra-state supply, and all other supplies will be regarded as inter State supplies.
- (7) CGST/IGST shall not be levied on the supply of alcoholic liquor for human consumption.
- (8) CGST/IGST on the supply of specified petroleum products shall be levied with effect from such date as may be notified by the Government on the

recommendations of the Council.

➤ **Tax Payable**

- (1) The nature of tax would depend upon the nature of supply.
- (2) Inter State supplies and Imports will liable to IGST.
- (3) Intra State supplies will be liable to CGST and SGST/UTGST.
- (4) SGST is levied in case of intra state supplies within a particular State.
- (5) UTGST is levied in case of intra state supplies within a particular Union Territory.

Exhibit 1: How to Decide IGST or CGST + SGST While Raising Invoices?



Note: CGST + UTGST is levied for Intra Union Territory supplies.

➤ **Taxable Person**

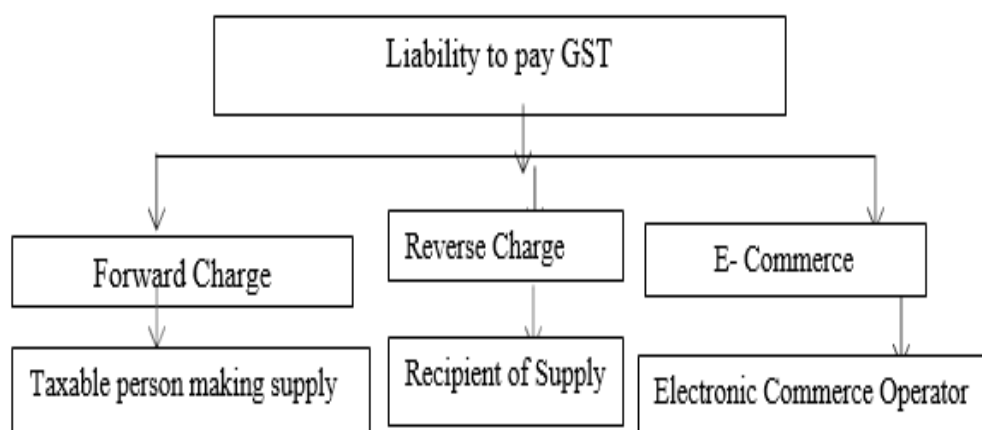
We have already studied the definition of Taxable person [S.2(107)] in Chapter 2 and Para 1.3 of Chapter 3. The taxable person may be- (a) the supplier or (b) the recipient.

(a) Supplier: We have already studied the definition of Supplier [S.2(105)] in Chapter 2. Normally the taxable person is the supplier. Tax payable by the supplier is known as the normal or forward charge.

(b) Recipient: We have already studied the definition of Supplier [S.2(93)] in Chapter 2. A supply would be subjected to tax in the hands of the recipient only in the following cases:

- Notified supplies under Section 9(3)
- Supplies received from unregistered persons under section 9(4)
- The e-commerce operator under section 9(5)

This is known as the Reverse Charge Mechanism (RCM). “Reverse Charge” means the liability to pay tax by the recipient of supply of goods or services or both instead of the supplier of such goods or services or both under sub section (3) or sub section (4) of section 9, or under sub section (3) or sub section (4) or section 5 of the Integrated Goods and Services Tax Act [S.2(98).]



➤ **Rate of Tax:**

1. Notified Rates: The rate of tax will be applicable as specified in the Notification No. 1/2017- Central Tax (Rate) for goods and Notification No. 11/2017- Central Tax (Rate) for services. These rates are based on the recommendations of the GST Council.

(i) Four Tier Rate Structure: A four tier GST rate structure has been introduced by the GST Council. The tax rates have been fixed at 5%,12%,18%, and 28%. Other rates also applicable are 0.25% and 3%.

- (a) Revenue Neutral Rate (RNR) – 18%
- (b) Goods/Services which are basis necessities – 12%
- (c) Essential Goods/Services – 5%
- (d) Demerit & Luxury Goods/Services – 28% + Cess.

(ii) GST Rates on Goods: Six different GST rates have been notified [NN 1/2017] for the purpose of charging tax on **supply of goods** under IGST Act, CHST Act, SGST Act and UTGST Act as follows:

Different rates	Inter –state supply	Intra-state supply		
	IGST	CGST	SGST/UTGST	GST (i.e, CGST+ SGST/ UTGST)
Schedule 1-5%	5%	2.5%	2.5%	5%
Schedule2-12%	12%	6%	6%	12%
Schedule3-18%	18%	9%	9%	18%
Schedule4-28%	28%	14%	14%	28%
Schedule5-3%	3%	1.5%	1.5%	3%
Schedule6-0.25%	0.25%	0.125%	0.125%	0.25%

(iii) GST Rates on Services: Four different GST rates have been notified [NN 1/2017] for the purpose of charging tax on supply of services under IGST Act, CHST Act, SGST Act and UTGST Act as follows:

Different rates	Inter –state supply	Intra-state supply		
	IGST	CGST	SGST/UTGST	GST (i.e, CGST+ SGST/ UTGST)
Schedule 1-5%	5%	2.5%	2.5%	5%
Schedule2-12%	12%	6%	6%	12%

Schedule3-18%	18%	9%	9%	18%
Schedule4-28%	28%	14%	14%	28%

Note: In this book, wherever GST rate is mentioned:

- It is IGST rate (In the case of inter State supply)
 - It is total CGST rate and SGST/UTGST rate (in the case of intra state supply)
2. **Exemption:** Rate Notification may be issued to exempt any goods or services from payment of tax.
 3. **Rates Charged:** Intra state supplies are charged at the notified rate of CGST for that product (say 9%) the same rate is charged under SGST/UTGST (9%). Thus, intra state supply of that product is charged at 9% CGST+9%STGST/UTGST=Total 18%. Interstate supplies for the same product are charged IGST @ 18%.
 4. **Maximum Rates:** The rates of tax contained in these notifications cannot exceed 20% under CGST Law, 20% under SGST; and 40% under IGST.
 5. **Classification of Goods:** The GST Rates on Goods have been notified on the basis of Customs Tariff Act, which in turn, is based on **HSN** (Harmonized System of Nomenclature), developed by the World Customs Organization.
 6. **Classification of Services:** The GST Rates on Services have been notified on the basis of Scheme of Classification of Services listed in the Annexure to Notification No. 11/2017- Central Tax (Rate) for tax rates on services.

➤ **Taxable Value**

The rate of tax so notified will apply on the value of supply as determined under Section 15 (Discussed in Chapter 9). The transaction value would be accepted subject to inclusions/exclusions specified in the said Section, where the price is the sole consideration for the supply and the supplier and recipient are not related persons. In all other cases, the value of supply will be that value which is determined in terms of the valuation rules.

➤ **Petroleum Products [S.9(2)]**

CGST on supply of the following 5 items has not been levied immediately. It shall be levied with effect from such date as may be notified by the Government on the recommendations of the Council:

1. Petroleum Crude
2. High Speed Diesel
3. Motor Spirit (Commonly known as petrol)
4. Natural Gas and
5. Aviation turbine fuel.

4.2.3 Registration Under GST:

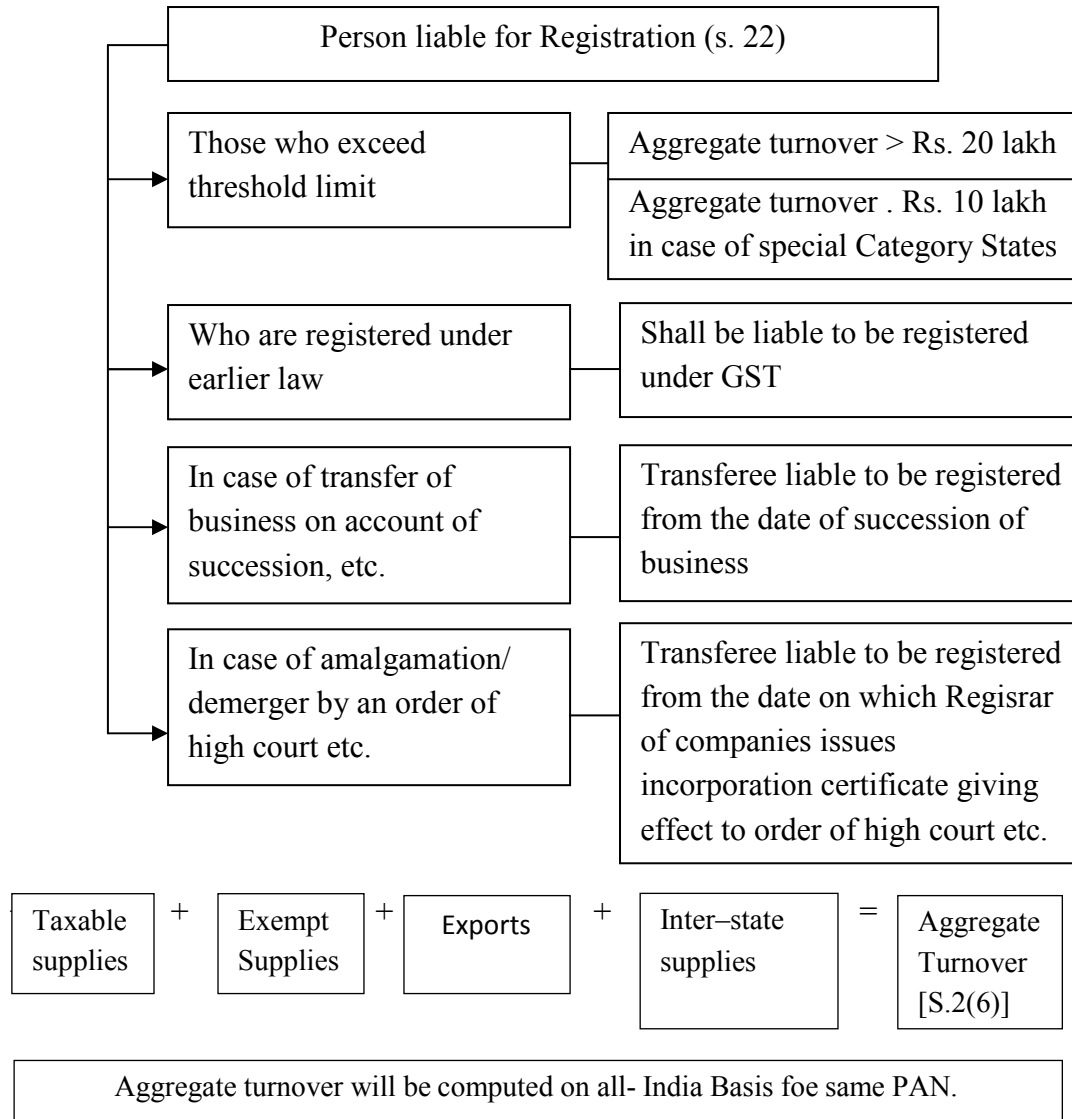
Registration is the most fundamental requirement for identification of taxpayers ensuring tax compliance in the economy. Without registration a person can neither collect tax from his customers nor claim any input tax credit of tax paid by him. Registration of any business entity under the GST Law implies obtaining a unique number (GST Identification No. or GSTIN) from the concerned tax authorities for the purpose of collecting tax on outward supplies, on behalf of the government, and to avail input tax credit for the taxes on his inward supplies.

4.2.3.1 Advantages:

The following are advantages to a taxpayer who obtains registration under GST:

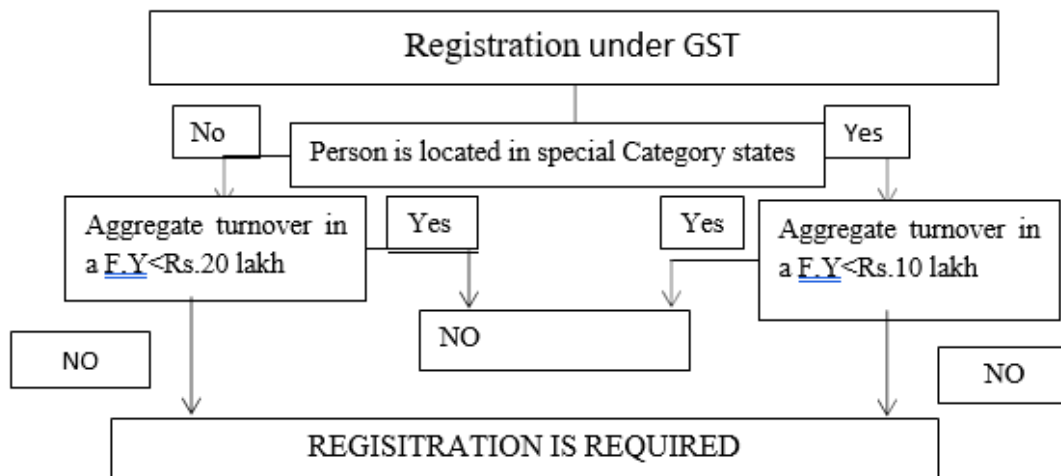
1. He is legally recognized as supplier of goods or services or both.
2. He is legally authorized to collect taxes from his customers and pass on the credit of the taxes paid on the goods or services supplied to the purchase's recipients.
3. He can claim Input Tax Credit of taxes paid and can utilize the same for payment of taxes due on supply of goods or services.
4. Registration enables seamless flow of Input tax Credit from suppliers to recipients at the national level.
5. Registered person an eligible to apply for Government bids or contract or assignment.
6. Registered person under GST can easily gain trust from customers.

4.2.3.2 Overview



4.2.3.3 Supplier on Exceeding Turnover Limit [S.22(1)]

The step-by-step process to check if a supplier is liable for registration is shown in the following flowchart: Supplier to register in each State from where the makes taxable supply



(1) **Supplier:** GST being a tax on the event of supply every supplier making a taxable supply is liable to be registered when his turnover exceeds the specified limit. According to S.2(105). Supplier in relation to any goods or services or both shall mean the person supplying the said goods or services or both and shall include an agent acting as such on behalf of such supplier in relation to the goods or services or both supplied. We have studied this definition in Chapter 2.

(2) **Separate Registration For each State:** S.22(1) begins with saying that Every supplier shall be liable to be registered under this Act in the State or Union territory from where he makes a taxable supply of goods or services or both.

Thus, a Supplier has to register in each sub State or Union territory from where he effects supply. The registration in GST is, thus State specific There is no single centralized registration under GST.

(3) **Single Registration For all Taxes:** GST is not tax specific which means that there is single registration for all the taxes i.e. CGST, SGST/UTGST, IGST and cesses.

4.2.3.4 Supplier to Register when turnover exceeds specific limit (Rs.20/10Lakh)

- (a) Every supplier of goods or services or both is required to obtain registration.
- (b) In the state or the Union territory from where he makes the taxable supply. (c) If his aggregate turnover exceeds Rs.20 lakh.

4.2.3.5 Aggregate Turnover

(1) **Definition [S.2(6)]:** Section 2(6) of the CGST Act states that aggregate turnover means the aggregate value of all taxable supplies, exempt supplies, exports of goods or services or both and inter state supply of person 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) **Scope:** Aggregate Turnover (ATO) covers all the supplies effected by a person having the same PAN as listed in the following table:

SCOPE OF ATO

No.	INCLUDES	ALL India/single PAN Basis
1	Taxable Supplies [S.2(108)]	Includes OUTWARD supplies under RCM
2	Exempt Supplies [S.2(47)]	Supplies with 'NIL' rate of tax
		Supplies wholly exempt from Tax [S.11]
		Supplies not taxable under the Act [S.2(78)] <ul style="list-style-type: none"> • Alcoholic liquor for human consumption • Supplies listed in section 9(2) • Supplies listed in Schedule III
3	Exports of goods / services	Including Zero-rated Supplies (to SEZ)
4	Inter-state supplies	Between units of a person under same PAN
5	Supplies made by the taxable person	On his Own account or on behalf of all his principles
Excludes:		
1.	Inward SUPPLIES TAXED UNDER RCM	-
2.	CGST/SGST/UTGST/IGST	-
3.	Compensation Cess	-

It should be noted that:

- (i) **Job Work:** Vide S.22-Explanation (ii)
- Supply of goods after completion of job work by a registered job worker shall be treated as the supply of goods by the principles.
 - Supply of goods after completion of job work by a registered job worker shall not be included in the aggregate turnover of the registered job worker.
- (ii) **Inward Supplies under RCM:** It may be noted that the inward supplies on which the recipient is required to pay tax under Reverse Charge Mechanism (RCM) do not form part of the aggregate turnover of the recipient. The value of such supplies on which tax is paid would not form part of the aggregate turnover of recipient of such supplies. However, the value of such supplies would continue to be part of the aggregate turnover of the supplier of such supplies.
- (iii) **Aggregate Turnover:** The aggregate turnover (ATO) is different from turnover in a state. The aggregate turnover is used for determining the threshold limit for registration as well as eligibility for composition scheme.

ATO Limits

States	Registration Limit[S.22]	Composition Limit [S.10/NN 8017]
North-East:		
Sikkim	10 Lakhs	75 Lakhs
Assam	10 Lakhs	75 Lakhs
Manipur	10 Lakhs	75 Lakhs
Meghalaya	10 Lakhs	75 Lakhs
Arunachal Pradesh	10 Lakhs	75 Lakhs
Negaland	10 Lakhs	75 Lakhs
Tripura	10 Lakhs	75 Lakhs
Hilly Areas	10 Lakhs	75 Lakhs
Himachal Pradesh	10 Lakhs	75 Lakhs
Uttarakhand	10 Lakhs	1 Crore
Other States//UT	10 Lakhs	1 Crore

Illustration 2: (Limit for J & K)

Mr. J has been involved in supplying taxable material in J&K since, 1-7-2017. His turnover in the month of Nov.2017 exceeds the limit of Rs.20 lacs. Is Mr. J required to register under GST law?

Solution:

Taxable turnover exceeds Rs.20 lacs (Limit applicable for J&K) therefore Mr.J is required to register under GST Law.

Illustration 2: (Own + Agency TO)

Mr. C of Calicut is trading in his own goods and also acting as an agent of Mr.B of Bengaluru, Mr.C turnover in the financial year 2017-18 is Rs.12 lacs on his own account and Rs.9 lacs.

Solution:

As per explanation (i) to S.22 in computing the total turnover both the value of supply on his own account that is Rs.12 lacs & lacs and on behalf of principle Rs.9 lacs will be aggregated. Hence the aggregate turnover will be Rs.21 lacs. Mr. C is liable to register compulsorily under the GST law.

Illustration 3:

Pure Oils, Delhi has started the supply of machine oils and high-speed diesel in the month of April 2018. The following details have been furnished by it for the said month.

Particulars	Rs.
1. Supply of machine oils in Delhi.	2,00,000
2. Supply of high speed diesel in Delhi.	4,00,000
3. Supply made by Pure oils from its branch located in Punjab.	1,80,000

Solution:

Particulars	Rs.
1. Supply of machine oils in Delhi.	2,00,000
2. Add: Supply of high speed diesel in Delhi.	4,00,000

3.Add: Supply made by Pure oils from its branch located in Punjab.	1,80,000
	7,80,000

➤ **Existing Taxpayer on 22-6-2017 [S.22(2)]**

All the taxpayer who were registered under various earlier tax laws are liable to be registered under GST with effect from the appointed day.

➤ **Transferee on Transfer of Business/Succession [S.22(3)]**

Where a business is transferred, whether on account of succession or any other reason, to another person as a going concern, the transferee/successor, is to be registered with effect from the date of such transfer. Thus, the transferee has to obtain fresh registration.

➤ **Transferee on Amalgamation/ Demerger [s.22(4)]**

Where the business is transferred pursuant to sanction of a scheme arrangement for amalgamation/ de-merger of two or more companies, by an order of a High Court/Tribunal, the transferee is to be registered with effect from the date on which the Register of Companies issues a certificate of incorporation giving effect to such order.

In short, a supplier exceeding the prescribed limit of turnover an existing registered taxpayer, and a transferee on transfer of business on succession/ amalgamation are liable for registration u/s 22.

➤ **Persons Not Liable for Registration [S.23]**

Section 23	Person not liable for registration
Sub-section	Particulars
(1)	The following persons shall not be liable to registration, namely:-
	(a) Any person engaged exclusively in the business of supplying goods or services or both that are not liable to tax or wholly exempt from tax under the integrated Goods and Services Tax Act.

	(b) An agriculturist, to the extent of supply of produce out of cultivation of land.
(2)	The Government may, on the recommendations of the Council, by notification, specify the category of persons who may be exempted from obtaining registration under this Act.

(1) Overview

Person engaged exclusively in supply goods/services/both not liable to tax	Person engaged exclusively in supply goods/services/both Wholly exempt from tax
Persons not liable for registration	
Agriculturist to the Extent of supply of produce out of cultivation of land	Specified category of persons notified by the government

(2) Exclusively Supplying non-taxable goods

Any person engaged exclusively in the business of supplying goods or services or both, that are not liable to tax, under this Act or under the Integrated Goods and Services tax Act, shall not be liable to registration.

(3) Exclusively Supplying Exempt goods:

Any person engaged exclusively in the business of supplying goods or services or both, that are wholly exempt to tax, under this Act or under the Integrated Goods and Services tax Act, shall not be liable to registration.

(4) Agriculturist:

An agriculturist shall not be liable to a registration to the extent of supply of produce out of cultivation of land. According to S.2(7), Agriculturist means an individual or a Hindu Undivided Family who undertakes cultivation of land-

(a) by own labour or

(b) by the labour of family or

- (c) by servants on wages payable in cash or kind or by hired labour under personal supervisions or the personal supervision of any member of the family.

➤ **Compulsory Registration in Certain Cases [S.24]**

Section 24	Compulsory Registration in Certain Cases
	Particulars
Notwithstanding anything contained in sub-section (1) of section 22, the following categories of persons shall be required to be registered under this Act,	
(i)	Persons making any inter-state taxable supply;
(ii)	Casual taxable persons making taxable supply;
(iii)	Persons who are required to pay tax under reverse – charge;
(iv)	Person who are required to pay tax under sub-section (5) of section 9;
(v)	Non-resident taxable persons making taxable supply;
(vi)	Persons who are required to deduct tax under section 51, whether or not separately registered under this Act;
(vii)	Persons who make taxable supply of goods or services or both on behalf of other taxable persons whether as an agent or otherwise;
(viii)	Input Service Distributor, whether or not separately registered under this Act:
(ix)	Persons who supply goods or services or both, other than supplies specified under sub-section (5) of section 9, through such electronic commerce operator who is required to collect tax at source under section 52;
(x)	Every electronic commerce operator ;
(xi)	Every person supplying online information and data base access or retrieval services from a place outside India to a person in India, other than a registered person; and
(xii)	Such other person or class of persons as may notified by the Government on the recommendations of the Council.

- **Casual Taxable Person (CTP):** Casual taxable person means a person who occasionally undertakes transactions involving supply of goods or services or both in the course or furtherance of business, whether as principle, agent or in any other capacity, in a state or a Union territory where he has no fixed place of business.
- **Compulsory Registration:**
 - 1) A casual taxable person making taxable supply in India has to compulsorily take registration there is no threshold limit for registration.
 - 2) However casual taxable person making supplies of specified handicraft goods need not take compulsory registration and are entitled to the threshold exemption of Rs.20 Lakh. Handicraft goods are specified in Notification no. 33/2017 Central Tax dated 15.09.2017 as amended by Notification no. 38/2017 Central Tax dated 13.10.2017.
 - 3) A casual taxable person cannot exercise the option to pay tax under compulsory levy.
- **Procedure for Registration (Rule 13):**
 - 1) **When:** Casual taxable person is required to obtain GST registration under a special category at least 5 days prior to the undertaking business.
 - 2) **Form:** There is no special form to register as a casual taxable person. The normal FORM GST REG-01 which is used by other taxable person can be used for obtaining registration by casual taxable person also.
 - 3) **Details:** A casual taxable person before applying for registration should declare his Permanent Account Number email address State or Union territory in part A or FORM GST REG 01 ON THE COMMON PORTAL EITHER Directly or through a Facilitation Centre notified by the Commissioner.
 - 4) **Verification:** The Permanent Account Number shall be validated online by the common portal from the database maintained by the Central Board of Direct Taxes. The mobile number declared shall be verified through a one time password sent to the said mobile number; and the email address shall be verified through a separate one time password sent to the said email address.
 - 5) **TRN:** On successful verification of the Permanent Account Number, mobile

number and email address, a temporary reference number (TRN) shall be generated and communicated to the applicant on the said mobile number and email address.

- 6) **Application:** Using this reference number generated the applicant shall electronically submit an application in part B of FORM GST REG 01, duly signed or verified through electronic verification code, along with the documents specified in the said Form at the common portal, either directly or through a Facilitation Centre notified by the Commissioner.
- 7) **Advance Deposit Of Tax:** The applicant will be given a temporary reference number by the Common Portal for making the mandatory advance deposit of tax for an amount equivalent to the estimated tax liability of such person for the period for which the registration is sought. The amount deposited shall be credited to the electronic cash ledger of casual taxable person. On depositing the amount, an acknowledgement shall be issued electronically to the applicant in FORM GST REG-02.
- 8) **RC:** The registration certificate shall be issued electronically only after the said deposit appears in his electronic cash ledger.

- **Validity of RC [s.27(1)]**

The certificate of registration shall be valid for the period specified in the application for registration or ninety days from the effective date of registration whichever is earlier.

- **Supply after RC [S.27(1)]**

The casual taxable person can make taxable supplies only after the issuance of the certificate of registration.

- **Extending RC [Rule 15]**

(1) **Application:** In case the casual taxable person intends to extend the period of registration indicated in his application of registration an application in FORM GST REG 11 shall be submitted electronically through the Common Portal either directly or through a Facilitation Centre notified by the Commissioner before the end of the validity of registration granted to him.

(2) **Max. 90 Days:** The validity period of ninety days can be extended by a further

period not exceeding ninety days.

- (3) **Adv. Tax:** The extension will be allowed only on payment of the amount an additional amount of tax equivalent to the estimated tax liability for the period for which the extension is sought.

➤ **Returns**

The casual taxable person is required to presently furnish only FORM GSTR-1 and FORM GSTR-3B electronically through the common portal, either directly or through a Facilitation Centre notified by the Commissioner. However a casual tax person shall not be required to file any annual return as required by a normal registered taxpayer.

➤ **ITC**

- 1) Input tax credit shall be availed in respect of goods or services or both received by a casual taxable person.
- 2) The taxes paid by a casual taxable person shall be available as credit to the respective recipients.

➤ **Refunds**

- 1) **Eligible:** The casual taxable person is eligible for the refund of any balance of the advance tax deposited by him after adjusting his tax liability.
- 2) **After Returns:** The balance advance tax deposit can be refunded only after all the returns have been furnished in respect of the entire period for which the certificate of registration was granted to him had remained in force.
- 3) **form:** The refund relating to balance in the electronic cash ledger has to be made in serial no 14 of the last FORM GSTR-3 return required to be furnished by him.

➤ **Non-Resident Taxable Person (NRTP):** Nonresident taxable person means any person who occasionally undertakes transaction involving supply of goods or services or both, whether as principle or agent or in any other capacity but who has no fixed place of business or residence in India.

➤ **No Composition:** A non-resident taxable person cannot exercise the option to pay tax undercomposition levy.

- **Compulsory Registration:** A non-resident taxable person making taxable supply in India has to compulsorily take registration. There is no threshold limit for registration.
- **Registration Procedure [Rule 13]**
 - 1) **When:** Nonresident taxable person (NRTP) has to apply for registration at least five days prior to commencing his business in India.
 - 2) **Form:** A NRTP is not required to apply in normal application for registration being filed by other tax payers. A simplified form GST REG-09 is required to be filled.
 - 3) **Passport/TIN/UID/PAN:** NRTP should apply using a valid passport. A business entity incorporated or established outside India, has to submit the application for registration along with its tax identification number or unique number on the basis of which the entity is identification by the Government of that country or its permanent Account number, if available.
 - 4) **Submit application:** A NRTP has to electronically submit an application along with a self-attested copy of his valid passport, for registration, duly signed or verified through Electronically Verified Code (EVC), in FORM GST REG-09, at least five days prior to the commencement of business at the common portal either directly or through a Facilitation Centre notified by the Commissioner.
 - 5) **Signature:** The application for registration made by a NRTP has to be signed by his authorized signatory who shall be a person resident in India having a valid PAN.
 - 6) **Verification:** On successful verification of PAN, mobile number and email address of the authorized signatory, the NRTP will be given a temporary number by the common portal.
 - 7) **Advance Tax Deposit:** The temporary reference number will be used by the NRTP for making the mandatory advance deposit of tax for an amount equivalent to the estimated tax liability of such person for the period for which the registration is sought. The amount deposited shall be credited to the electronic cash ledger of the Non-resident person.
 - 8) **RC:** The registration certificate shall be issued electronically only after the said deposit appears in his electronic cash ledger.

9) **Supply after RC:** The non-resident taxable person can make taxable supplies only after the issuance of the certificate of registration.

➤ **Validity of RC:** The Certificate of registration shall be valid for the period specified in the application for registration or ninety days from the effective date of registration whichever is earlier.

➤ **Extending RC [Rules 15]:**

1) **Application:** In case the non-resident taxable person to extend the period of registration indicated in his application of registration, an application in FORM GST REG-11 shall be submitted electronically through the common Portal, either directly or through a Facilitation Centre notified by the Commissioner, before the end validity of registration granted to him.

2) **Max.90 Days:** The validity period of ninety days can be extended by a further period not exceeding ninety days.

3) **Adv. Tax:** The extension will be allowed only on payment of the amount of an additional amount of tax equivalent to the estimated tax liability for the period for which the extension is sought.

➤ **Input Tax Credit**

1) Input tax credit shall not be available in respect of goods or services or both received by a non - resident taxable person except on goods imported by him.

2) The taxes paid by a non-resident taxable person shall be available as credit to the respective recipients.

➤ **Return:**

The non-resident taxable person shall furnish a return in FORM GSTR-5 electronically through the Common Portal, either directly or through a Facilitation Centre notified by the Commissioner including therein the details of outward supplies and inward supplies and shall pay the tax, interest, penalty, fees or any other amount payable under the act or these rules within 20 days after the end of a calendar month or within 7 days after the last day of the validity period of registration whichever is earlier.

➤ **Refund**

The amount of advance tax deposited by a non resident taxable person at the time of initial registration extension of registration, will be refunded only after the person has furnished all the returns required in respect of the entire period for which the certificate of registration granted to him had remained in force. Refund can be applied in the serial no.13 of the FORM GSTR-5.

➤ **Casual taxable Person [CTP] vs. Non – resident taxable Person [NRTP]**

Casual Taxable Person (CTP)	Non-Resident Taxable Person (NRTP)
Occasional supply of goods or services in a state or UT where he has no fixed place of business.	Occasional supply of goods or services but has no fixed place of business or residence in India.
Has a PAN Number.	Does not have a PAN Number.
CTP cannot take registration as NRTP.	An NRTP having PAN Number may take registration as a CTP.
Same application form for registration as for normal taxable person viz. GST REG-01.	Separate application form for registration viz. GST REG-9
Has to undertake transactions in the course or furtherance of business.	Business test is absent in the definition
Has to file normal GSTR-1, GSTR-2 and GSTR-3 returns.	Has to file separate simplified return in the format GSTR-5
Can Claim ITC of all inward supplies.	Can get ITC only in respect of import of goods and/or services.

4.2.4 Valuation of Taxable Services:

(1) Value of Taxable Supply:

GST is payable on ad-valorem basis. The GST rate is a percentage of value e.g. 18%. The value on which this % is charged is the value of taxable supply.

Section 15 of the CGST Act contains common provisions for determining the

value of goods and services. It provides the mechanism for determining the value of a supply which is made between unrelated persons and when price and only the price is the sole consideration of the supply.

When value cannot be determined under section 15, the same is determined using Chapter IV. Determination of Value of Supply of CGST Rules.

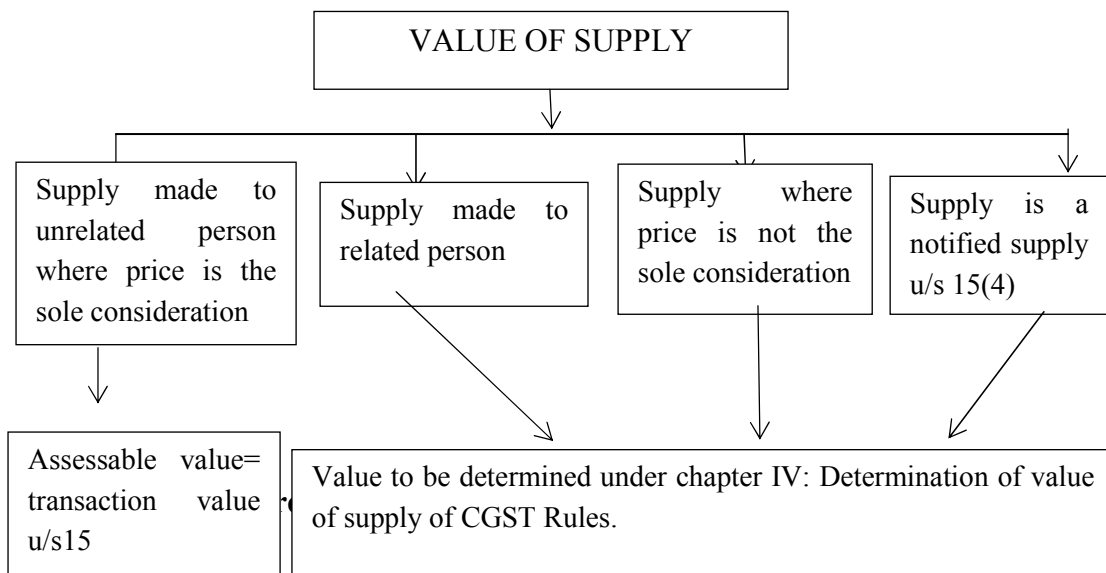
Provisions of value of supply under the CGST Act are also made applicable to IGST Act vide S. 20 of the IGST Act.

(2) Scope of S.15

Section 15 deals with the following aspects/situations:

- (a) Supply for price in Money to Unrelated Persons:** Supplies made for a price in money (Monetary Consideration) to unrelated persons are covered in S.15(1)-(3). The explanation to section 15 defines related person to cover various situations of control, including sole agent, sole distribution and sole consideration.
- (b) Other Supplies:** Supplies made for (i) non monetary consideration or (ii) For part monetary consideration and part other or (iii) involving additional consideration or (iv) to related persons Determination of Value of Supply of CGST Rules.

(3) Value of Supply vide S. 15 at a Glance:



Transaction Value [S.15(1)]

S.15(1) states that-

- The value of a supply of goods and/or services
- Shall be the transaction value
- Which is the price actually paid or payable
- As the sole consideration for such supply.
- Where the supplier & the recipient of the supply are not related.
- In most of the cases of regular normal trade, invoice value will be the transaction value.
- Even if the price is not actually paid the price payable as per agreement will be the transaction value.

Illustration 4:

MS. Radha makes supply of Rs.2,00,000 to Mr. Renu. The contract provides that Mr. Renu will pay Rs.50,000 to Ms. Radha and Rs.1,50,000 to Mr. Venu to settle the debt of Ms.Radha. Find the transaction value and GST liability in the hands of Ms. Radha. Applicable rate of CGST and SGST 9% each.

Solution:

Particulars	Value in (Rs)
Payment From Renu to Radha	50,000
Payment from Renu to Venu for setting the debt of Radha	1,50,000
Transaction value	2,00,000
CGST 9%	18,000
SGST 9%	18,000

➤ **Inclusions in Transaction Value [S.15(2)]**

Following Compulsory Inclusions are added to the price to compute the transaction value-

- (a) Taxes other than GST, if charged separately by the supplier.
- (b) Payment made to third parties by the recipient on behalf of the supplier.
- (c) Incidental Expenses
- (d) Interest late fee and penalty for delayed payment.
- (e) Subsidies

These are discussed as follow;

(a) Taxes other than GST, if charged separately by the supplier.

- i) Any taxes, duties, cesses, fees and charges levied
- ii) Under any law for the time being in force
- iii) Other than this Act the State Goods and Services Tax Act, Union Territory Goods and Services Tax Act and the Goods and Services Tax (Compensation to States) Act,
- iv) If charged separately by the supplier. It should be noted that –
- v) Transaction value under CGST will not include CGST, SGST, UTGST (Compensation to States) Cess.
- vi) Any non-GST taxes, duties, cess, fees & charges will be included in the transaction value, if charged separately by the supplier.
- vii) Example of such charges to be included are Central Excise Duty on manufactured tobacco; Municipal Taxes paid for rented premises.
- viii) In such cases GST will be charged on the value inclusive of such other taxes.

Illustration 5:

Admission to True Theatre is Rs.90 per ticket for a Marathi Movie as well as for a Hindi Movie Plus entertainment tax Rs.10% on Marathi Movie and 20% on other languages. In the month of November, True Theatre sold 2000 tickets of Marathi

Movie and 1500 tickets of Hindi Movie. Find the value of taxable supply of service. Applicable rate of GST 18% & 28%. Find the GST liability if any?

Solution:

Statement showing value of taxable supply of services and GST liability:

Value of taxable services:

Marathi Movie Rs. 1,98,000 (Rs. 99×2000 tickets)

Hindi Movie Rs. 1,62,000 (Rs. 108×1500 tickets)

Particulars	9% CGST	9% SGST	9% CGST	14% SGST
GST Liability(Rs)	17,820	17,820	22,680	22,680

(b) Payment made to third parties by the recipient on behalf of the supplier.

This Clause states that the value of supply shall include-

- Any amount that the supplier is liable to pay in relation to such supply.
- But which has been incurred by the recipient of the supply.
- Not included in the price actually paid or payable for the supply.

GST will be charged on the value inclusive of such amounts incurred by the recipient on behalf of the supplier.

Illustration 6:

Mr. Ramu sold goods to Mr. Lakshman for Rs. 50,000. As per the contract of sale, Mr. Ramu is required to deliver the goods in the premises of Mr. Lakshman. Mr. Ramu hires transporter for transportation for delivery of goods. However the freight is paid by Mr. Lakshman to transporter Rs.2,500. Find the transaction value of supply of goods.

Solution:

Particulars	Value in (Rs)
Value of supply of goods	2,50,000
Add; Freight paid by recipient of supply.	2,500
Taxable Value of Supply of Goods	2,52,000

(c) Incidental Expenses and Additional Charges

This clause states that the value of supply shall include-

- Incidental Expenses
- Including commission and packing
- Charged by the supplier to the recipient of a supply.
- Any amount charged for anything done by the supplier in respect of the supply of goods or services or both.
- At the time of, or before delivery of goods or supply of services.

GST will be charged on the value inclusive of such incidental expenses and additional charges.

Illustration 7:

AKJS Foods Pvt. Ltd. gets an order for supply of processed food from a customer. The customer wants the consignment tested for gluten of specified chemical residues. AKJS Foods Pvt. Ltd. does the testing and charges a testing fee for the same from the customer. AKJS Foods Pvt. Ltd. argues that such testing fees should not form part of the consideration for the sale as it is a separate activity. Is his argument correct in the light of section 15?

Solution:

Section 15(2) mandates the addition of certain elements to transaction value to arrive at taxable value. Clause (C) of section 15 (2) specifies that amount charged for anything done by the supplier in respect of the supply at the time of or before delivery of goods or supply of services shall be included in taxable value. Since AKJS Foods Pvt. Ltd. does the testing before the delivery of goods, the charges therefor will be included in the taxable value. Therefore, AKJS Foods Pvt. Ltd.'s argument is not correct. The testing fee should be added to the price to arrive at taxable value of the consignment.

Illustration 8:

Mr. A is a seller of AC. He supplied an AC for Rs.75,000 to Mr. B with the condition that A will dismantle and remove old AC from the premises of Mr. B by

charging Rs.5,000. Find the value of taxable supply of goods in the hands of Mr. A.

Solution:

The value of taxable supply of goods is Rs. 80,000.

Illustration 9:

Mr. Mohan located in Manipal purchases 10,000 Hero ink pens worth Rs. 4,00,000 from Lekhana Wholesalers located in Bhopal. Mr. Mohan's wife is an employee in Lekhana Wholesalers. The price of each Hero pen in the open market is Rs.52. The supplier additionally charges Rs.5,000 for delivering the goods to the recipient's place of business.

Solution:

Mr. Mohan and Lekhana Wholesalers would not be treated persons merely because the spouse of the recipient is an employee of the supplier. Therefore the transaction value will be accepted as the value of the supply. The incidental expenses incurred by the supplier in respect of the supply up to the time of delivery of goods to the recipient should be included in the transaction value. This means the transaction value will be: Rs. 4,05,000 (i.e. 4,00,000+5,000).

Illustration 10:

M/S VM & Co. an Audit firm based in Mumbai undertaken an audit assignment of his client based in Chennai. The Contract mentioned about the audit fees of Rs.5,00,000 and arrangement for taxi by the Client which may be the worth Rs.15,000. Find the transaction value on which M/S VM and Co. is liable to pay GST.

Solution:

Transaction value in the hands of M/s VM & Co., is liable to pay GST.

(b) Interest late fee and penalty for delayed payment.

This clause states that the value of supply shall include-

- Interest or
- Late Fee or
- Penalty

- For delayed payment of any consideration
- For any supply

GST will be charged on the value inclusive of such Interest.

Illustration 11:

A Supply priced at Rs. 2000 is made, with a credit period of 1 month for payment. Thereafter interest of 12% is charged. The payment is received after the lapse of two months from the date of supply. The amount of 12% p.a. on Rs. 2000 for one month after the fee credit period is Rs. 20. Such interest will be added to the value and thus, the value of taxable supply will work out to be Rs. 2,020. GST will be charged on the value inclusive of such interest.

(c) Subsidies

This clause states that the value of supply shall include-

- Subsidies directly linked to the price.
- Excluding subsidies provided by the Central Government and State Governments.

It should be noted that-

- The amount of subsidy shall be included in the value of supply of the supplier who receives the subsidy.
- GST will be charged on the value inclusive of such subsidies.

Illustration 12:

Bharat Gas seels cooking gas cylinders. Subsidy is directly transferred to the account of the customer. Selling price per cylinder is Rs.800. Customer received subsidy Rs.200 directly from Government to his bank account. Net outflow of the buyer is Rs.600. Find the value of supply of goods (per cylinder) in the hands of Bharat Gas.

Solution:

The amount of subsidy is directly credited to the account holder % not received by the Bharat Gas making the supply. Therefore, such subsidy will not be considered as part of transaction value as a is not received by the Bharat Gas making the supply. Hence transaction value is Rs. 800 per cylinder.

Illustration 13:

Sista Advertisers conceptualized and designed the advertising campaign for a new product launched by jio Pvt Ltd. for a consideration of Rs.9,00,000. Sista Advertisers owed Rs.10,000 to one of its vendors in relation to the advertising service provided by it to Jio Pvt Ltd. Such liability of Sista Advertisers was discharged by jio Pvt Ltd. Jio Pvt Ltd. Delayed the payment of consideration and thus, paid Rs.25,000 as interest. Determine the value of taxable supply made by Sista Advertisers.

Solution:

Particulars	(Rs.)
Services Charges (Price)	9,00,000
Payment made by jiopvt. Ltd to vendor of Sists advertisers [Liability of the supplier discharged by the recipient, included in value of Supply vide S.15 (2) (b)]	10,000
Interest for delay in payment of consideration. [Included in the value in terms of S.15(2)(d)]	25,000
Value of Taxable Supply	9,35,000

Illustration 14:

Compute the value of taxable supplies if the contracted value of supply is 18,00,000 which included following:

No.	Particulars.	Rs.
1.	Cost of primary packing	45,000
2.	Cost of protective packing on customers request	25,000
3.	Design and drawing changes	1,00,000
4.	Pre-installation consultancy charges	50,000

Additional Information:

- (1) Freight charges of Rs.65,000 is paid by recipient on behalf of the supplier.
- (2) Rs.20,000 Commission paid to agent by recipient on instruction of supplier.

Solution:

Particulars	Rs.
Contracted value of supply of Machine (Price)	18,00,000
Add: (i) Freight charges paid by recipient [S.15(2)(b)] 2,000	
(ii) Commission paid to agent [S.15(2)(b)] 65,000	85,000
Total Taxable Value	18,85,000

Exclusion of Discount From Transaction Value [S.15 (3)]

- (a) Discount Given at or before Supply :** The value of the supply shall not include any discount which is given before or at the time of the supply if such discount has been duly recorded in the invoice issued in respect of such supply.
- (b) Discount Given after Supply:** The value of the supply shall not include any discount which is given after the supply has been effected if-
- (i) Such discount is established in terms of an agreement entered into at or before the time of such supply and specifically linked to relevant invoices; and
 - (ii) Input tax credit as is attributable to the discount on the basis of document issued by the supplier has been reserved by the recipient of the supply.

Illustration 15:

Ultas Bakery Products Ltd sells biscuits and cakes through its dealers, to whom it charges the list price minus standard discount and pays GST accordingly. When goods remain unsold with the dealers, it offers additional discounts on the stock as an incentive to push the sales. Can this additional discount be reduced from the price at which the goods were sold and concomitant tax adjustments made?

Solution:

The discounts were not known or agreed at the time of supply of goods to the

dealers. Therefore, such discounts cannot be reduced from the price on which tax had been paid in terms of section.

Illustration 16:

M/s Dinesh Enterprise sells mineral water bottles, with MRP Rs.20 per bottle. However, customers get discount of Rs.4 per bottle. In the month of OCT. 2017. M/s Dinesh Enterprise sold 2,000 bottles. Applicable rate of GST 18%. Find the tax liability.

Solution:

Particulars	Rs.
Transaction Value	32,000
Add: CGST 9% on Rs.32,000	2,880
Add: SGST 9% on Rs. 32,000	2,880
Invoice Price	37,760

Illustration 17:

Superb Cars Ltd. Sells a car worth Rs.5,00,000 to Sundar Automobiles. Superb Cars Ltd. Incurred loading charges of Rs. 6,000 on the car. Superb Cars Ltd. Provided a discount of 1% on the car price. As part of Diwali scheme. Superb cars Ltd. Agreed to provide a further discount of 0.5% if Sundar Automobiles makes payment by 31st of the month via net banking. Sundar Automobiles makes the payment by 31st of the month of using net banking. Find the Net GST liability in the hands of Superb Cars Ltd. Applicable rate of GST 18%.

Solution:

Particulars	Rs.
Value of the product	5,00,000
Add: Loading Charges	6,000
Sub-Total	5,06,0000
Less: Discount 1% on Rs.5 Lakh	(5,000)

Transaction Value	5,01,000
Add: CGST 9%	45,090
Add: SGST 9%	45,090
Invoice Price	5,91,180

Illustration 18:

In the above illustration, due to a severe cash crunch, Superb Cars Ltd requests Sundar Automobiles to make the payment within 2 days, promising a discount of 2% on doing so. Sundar Automobiles makes the payment within 2 days.

Solution:

Since, the discount was not known at the time of supply, it couldn't be claimed as a deduction from the transaction value for GST calculation.

Illustration 19:

XYZ Pvt. Ltd. Has provided the following particulars relating to goods sold by it to ABC Pvt. Ltd.

Particulars	Rs.
List price of the goods (exclusive of taxes and discounts)	1,25,000
Tax levied by Municipal Authority on the sale of such goods.	15,000
CGST and SGST chargeable on the goods	19,200
Packing charges (not included in price above)	15,500

XYZ Pvt. Ltd. Received Rs. 9,500 as a subsidy from a Non-Profit making organization in respect of timely supply of such goods. The price of Rs. 1,25,000 of the goods is after considering such subsidy. XYZ Ltd. Offers 4% discount on the list price of the goods which is recorded in the invoice for the goods.

Determine the value of taxable supply made by XYZ Pvt. Ltd.

Solution:

Particulars	(Rs.)
List price of the goods	1,25,000
Add: Tax levied by Municipal Authority on the sale of such goods CGST & SGST chargeable on the goods.	15,000
Packing Charges	15,500
Subsidy received from a non government body is received from a non government body, the same is included in the value in terms of section 15(2) €	
Total	9,500
Less: Discount @ 4% on Rs. 1,25,000	1,65,000
Value of Taxable Supply	5,000
	1,60,000

Illustration 20:

Pratiksha Pvt. Ltd., a registered supplier, furnish the following details relating to supplies effected during December, 2017:

Particulars	Amount (Rs.)
Sales price charged to customers within state (excluding GST)	10,00,000
Service charges levied in the invoices.	11,000
Packing and forwarding expenses incidental to sale.	14,200
Weighment charges, shown separately in invoices.	7,800
Commission charged to buyers.	15,000

Prompt payment discount, indicated in invoice 1%, if payment made within 1 month. The rates of taxes for the goods supplied are as under:

Particulars	Rate
CGST	6%
SGST	6%
IGST	12%

Additional Information:

60% of the customers did not make the payment within one month from the date of supply. Hence the supplier recovered the prompt payment discount offered to them.

Solution:

Particulars	(Rs.)
Sales price charged to customers within state	10,00,000
Add: Service charges levied in the invoices	11,000
Packing & forwarding expenses incidental to sale	14,200
Weighment charges, shown separately in invoices	7,800
Commission charged to buyers	15,000
	10,48,000
Less: Prompt payment discount, indicate in invoice	10,000
Value of Taxable Supply	10,38,000
SGST Payable at 6%	62,280
CGST at 6%	62,280

4.2.5 Provisions Pertaining to Returns Under GST:

The basic features of the returns mechanism in GST include electronic filing of returns uploading of invoice level information and auto-population of information relating to Input Tax credit (ITC) from returns of supplier to that of recipient, invoice-level information matching and auto reversal of Input Tax credit in case of mismatch. The returns mechanism is designed to assist the taxpayer to file

returns and avail ITC.

Under GST, a regular taxpayer needs to furnish monthly and one annual return. There are separate for a taxpayer registered under the composition scheme, non-resident taxpayer, taxpayer registered as an Input service Distributor, a person liable to deduct or collect the tax (TDS/TCS) and a person granted Unique Identification Number.

It is important to note that a taxpayer is NOT required to file all types of returns. In fact, taxpayers are required to file returns depending on the activities they undertake.

All the returns are to be filed online. Returns can be filed using any of the following methods:

1. GSTN portal (www.gst.gov.in)
2. Offline utilities provided by GSTN
3. GST Suvidha providers (GSPs) – If you are already using the services of ERP providers such as Tally, SAP, Oracle etc, there is a high likelihood that these ERP providers such as Tally, SAP, Oracle etc, there is a high likelihood that these ERP providers would provide inbuilt solutions in the existing ERP systems.

➤ **Furnishing Details of Outward Supplies (Section 37):**

1. Furnishing details of outward supplies BY 10 of next month and intimation to recipient u/s 37 (1)

Every registered person, other than :

- a) an Input service Distributor,
- b) a non-resident taxable person and
- c) a person paying tax under the provisions of section 10 or section 51 or section 52, shall furnish, electronically, in such form and manner as may be prescribed,
 - a) the detail of outward supplies of goods or services or both effected during a tax period on or before the tenth day of the month succeeding the said tax period and
 - b) such details shall be communicated to the recipient of the said supplies within

such time and in such manner as may be prescribed:

2. Details cannot be furnished from 11 to 15 of the succeeding months:

Provided that the registered person shall not be allowed to furnish the details of outward supplies during the period from the eleventh day to the fifteenth day of the month succeeding the tax period.

3. Power to extend the time limit is with commissioner

The commissioner may, for reasons to be recorded in writing, by notification, extend the time limit for furnishing such details for such class of taxable persons as may be specified therein:

4. Deemed Notification at state/ union territory:

Any extension of time limit notified by the commissioner of state tax or commissioner of Union territory shall be deemed to be notified by the commissioner.

The expression details of outward supplies shall include details of invoices, debit notes, credit notes and revised invoices issued in relation to outward supplies made during any tax period.

5. Supplier should accept or reject the details between 15th to 17th of the succeeding month. u/s 37(2)

Every registered person who has been communicated the details

- a) under sub section (3) of section 38 or
- b) the details pertaining to inward supplies of Input Service Distributor under sub-section (4) of section 38 Shall either or reject the details so communicated on or before the seventeenth day, but not before the fifteenth day, of the succeeding month of the tax period and the details furnished by him under sub-section (1) shall stand amended accordingly.

6. Rectification of unmatched entries and payment of tax with interest in case of short fall of tax u/s 37(3):

Any registered person, who has furnished the details under sub-section (1) for any tax period and which have remained unmatched under section 42 or section 43, shall, upon discovery of any error or omission therein, rectify such error or omission in such manner as may be prescribed, and shall pay the tax and interest, if any in case

there is a short payment of tax on account of such error or omission, in the return to be furnished for such tax period.

7. Time limit for Rectification

No rectification of error or omission in respect of the details furnished under sub-section (1) shall be allowed after

- (a) Furnishing of the return under section 39 for the month of September following the end of the financial year to which such details pertain.
- (b) Furnishing of the relevant annual return. Whichever is earlier.

➤ Furnishing Details of Inward Supplies (Section 38)

1. Verification of details by the Recipient Furnished by the supplier u/s 38(1):

Every registered person, other than

- a) an Input Service Distributor or
- b) a non – resident taxable person or
- c) a person paying tax under the provisions of section 10 or section 51 or section 52, shall verify, validate, modify or delete, if required the details relating to outward supplies and credit or debit notes communicated under section 37(1):
 - i) To prepare the details of his inward supplies and credit or
 - ii) Debit notes & may include therein the details of inward suppliers and credit or debit notes received by him in respect of such supplies that have not been declared by the supplier under sub section (1) of section 37.

2. Details of Inward supplies including details of Reverse Charge to be Filled from 11th to 15th of Succeeding month u/s 38(2)

Every registered person, other than

- a) an Input Service Distributor or
- b) a non resident taxable person or
- c) a person paying tax under the provisions of section 10 or section 52 shall furnish electronically,
 - i) the details of inward supplies of taxable goods or services or both.

- ii) Inward supplies of goods or services or both on which the tax is payable on reverse charge basis under this Act and
- iii) Inward supplies of goods or services or both taxable under the Integrated Goods & Services Tax Act or on which Integrated goods and services tax is payable under section 3 of the Customs Tariff Act, 1975 and
- iv) Credit or Debit notes received in respect of such supplies during a tax period.

After the tenth day but on or before the fifteenth day of the month succeeding the tax period in such form and manner as may be prescribed.

3. Power to extend the time limit is with Commissioner:

The three Commissioner may for reasons to be recorded in writing by notification extend the time limit for furnishing such details for such class of taxable persons as may be specified therein.

4. Deemed Notification at state/Union territory.

Any extension of time limit notified by the Commissioner of State tax or Commissioner of Union territory tax shall be deemed to be notified by the Commissioner.

5. Communication to the Outward supplier of details of the modification made u/s 38(3)

The details of supplies modified deleted or included by the recipient and furnished under sub section (2) shall be communicated to the supplier concerned in such manner and within such time as may be prescribed.

6. Intimation to the supplier u/s 38 (4)

The details of supplies modified deleted or included by the recipient in the return furnished under sub section (2) or sub section (4) of section 39 shall be communicated to the supplier concerned in such manner and within such time as may be prescribed.

7. Rectification of unmatched entries and payment of tax with interest in case of short fall of tax u/s 37(5)

Any registered person, who has furnished the details under sub section (2) for any tax period and which have remained unmatched under section 42 or section 43, shall upon discovery of any error or omission therein rectify such error or omission in the tax period during which such error or omission is noticed in such manner as may be prescribed and shall pay the tax and interest if any in case there is a short payment of tax on account of such error or omission, in the return to be furnished for such tax period.

8. Time Limit for Rectification

No rectification of error or omission in respect of the details furnished under sub section (2) shall be allowed after

- a) Furnishing of the return under section 39 for the month of September following the end of the financial year to which such details pertain or
- b) Furnishing of the relevant annual return whichever is earlier.

➤ Furnishing of Returns (Section 39):

1. Monthly Return to be furnished by the supplier by 20th of next month u/s 39(1):

Every registered person, other than:

- a) an Input Service Distributor or
- b) a nonresident taxable person or
- c) a person paying tax under the provisions of section 10 or section 51 or section 52 Shall, for every calendar month or part thereof, furnish, in such form and manner as may be prescribed, a return, electronically, of
 - i) Inward & Outward supplies of goods or services or both.
 - ii) Input tax credit availed.
 - iii) Tax payable
 - iv) tax paid
 - v) Such other particulars as may be prescribed.

On or before 20th day of the month succeeding such calendar month or part thereof.

2. Quarterly Return to be submitted by Composite supplier by 18th of the next month after the end of the quarter u/s 39(2).

A registered person paying tax under the provisions of section 10 shall, for each quarter or part thereof, in such form and manner as may be prescribed, a return, electronically, of turnover in the State or Union territory, inward supplies of goods or services or both tax payable and tax paid within eighteen days after the end of such quarter.

3. Deductor deducting TDS to furnish monthly return by 10th next month u/s 39(3):

Every registered person required to deduct tax at source under the provision of section 51 shall furnish in such form and manner as may be prescribed a return electronically for the month in which such deduction have been made within ten days after the end of such month.

4. Input Service Distributor (ISD) to furnish monthly return by 13th of next month u/s 39(4)

Every taxable person registered as an Input service Distributor shall, for every calendar month or part thereof, furnish, in such form and manner as may be prescribed a return electronically, within thirteen days after the end of such month.

5. Non-Resident taxable person to furnish return by 20th of next month or within 7 days after the last day of the period of Registration whichever is earlier u/s 39(5)

Every registered nonresident taxable person shall for every calendar month or part thereof, furnish, in such form and manner as may be prescribed a return electronically, within twenty days after the end of such month or within seven days after the last day of the period of registration specified under sub section (1) of section 27, whichever is earlier.

6. Power to extend the time limit is with Commissioner u/s 39(6)

The Commissioner may, for reasons to be recorded in writing, by notification, extend the time limit for furnishing the returns under this section for such class of registered persons as may be specified therein.

7. Deemed Notification at State/Union territory

Any extension of time limit notified by the Commissioner of State tax or Union territory tax shall be deemed to be notified by the Commissioner.

8. Tax to be paid upto the due date of furnishing the return u/s 39(7)

Every registered person, who is required to furnish a return under sub section (1) or sub section (2) or sub section (3) or sub section (5), shall pay to the Government the tax due as per such return not later than the last date on which he is required to furnish such return.

9. Even if no taxable supplies are made during the period, Returns is to be furnished by the registered person u/s 39(8)

Every registered person, who is required to furnish a return under sub section (1) or sub section (2) shall furnish a return for every tax period whether or not any supplies of goods or services or both have been made during such tax period.

10. Rectification of Mistake u/s 39(9):

If any registered person after furnishing a return under sub section (1) or sub section (2) or sub section (3) or sub section (4) or sub section (5) discovers any omission or incorrect particulars therein, other than as a result scrutiny, audit, inspection or enforcement activity by the tax authorities he shall rectify such omission or incorrect particulars in the return to be furnished for the month or quarter during which such omission or incorrect particulars are noticed, subject to payment of interest under this Act. The above provision is subject to Section 37 and 38.

11. Time Limit For Rectification Of Mistake.

No such rectification of any omission or incorrect particulars shall be allowed after:

- a) The Due date for furnishing of return for the month of September or
- b) Second Quarter Following the end of the financial year or
- c) The actual date of furnishing of relevant annual return, whichever is earlier.

12. No Returns for the subsequent periods can be filed if previous periods return have not been furnished u/s 39(10)

A registered person shall not be allowed to furnish a return for a tax period if the return for any of the previous tax periods has not been furnished by him.

➤ **FIRST RETURN. (SECTION 40)**

Filing of First Return by person making Outward Supplies: Every Registered person who has made outward supplies in the period between the date on which he became liable to registration till the date on which registration has been granted shall declare the same in the first return furnished by him after grant of registration.

➤ **Matching, Reversal and Reclaim of Reduction in Output Tax Liability (Section 43)**

1. Credit Note Details by supplier corresponds to reduction in claim of ITC u/s 43(1)

Details of every credit note relating to outward supply furnished by a registered person for a tax period shall, in such manner and within such time as may be prescribed be matched.

- a) With the corresponding reduction in the claim for input tax credit by the corresponding registered person in his valid return for the same tax period or any subsequent tax period.
- b) For duplication of claims for reduction in output tax liability.

2. Acceptance and Communication of matched amount to supplier u/s 43(2)

The claim for reduction in output tax liability by the supplier that matches with the corresponding reduction in the claim for input tax credit for the recipient shall be finally accepted and communicated in such manner as may be prescribed to the supplier.

3. Communication of Discrepancies to both parties U/s 43(3)

Where the reduction of output tax liability in respect of outward supplies exceeds the corresponding reduction in the claim for input tax credit or the corresponding credit note is not declared by the recipient in his valid returns. The discrepancy shall be communicated to both such persons in such manner as may be prescribed.

4. Communication to supplier for claiming doubt claim u/s 43(4)

The Duplication of claims for reduction in output tax liability shall be communicated to the supplier in such manner as may be prescribed.

5. Output tax Liability of the supplier increases if the discrepancy is not rectified by the recipient u/s 43(5)

The amount in respect of which any discrepancy is communicated under sub – section (3) and which is not rectified by the recipient in his valid return for the month in which discrepancy is communicated shall be added to the output tax liability of the supplier, in such manner as may be prescribed in his return for the month succeeding the month in which the discrepancy communicated.

6. Suppliers Output tax liability increases due to double claim u/s 43(6)

The amount in respect of any reduction in output tax liability that is found to be on account of duplication of claims shall be added to the output tax liability of the supplier in his return for the month in which such duplication is communicated.

7. Reduction of liability of supplier if recipient declares details in his return u/s 43 (7)

The supplier shall be eligible to reduce, from his output tax liability the amount added under sub section (5) if the recipient declares the details of the credit note in his valid return within the time specified in section 39(9).

8. Interest payable by the supplier on his increased output tax liability u/s 43(8)

A supplier in whose output tax liability any amount has been added under sub section (5) or sub section (6), shall be liable to pay interest at the rate specified under section 50(1) in respect of the amount so added from the date of such claim for reduction in the output tax liability till the corresponding additions are made under the said sub sections.

9. Refund of interest on reduction of Output tax Liability u/s 43(9)

Where any reduction in output tax liability is accepted under sub section (7), the interest paid under sub section (8) shall be refunded to the supplier by crediting the amount in the corresponding head of his electronic cash ledger in such manner as may be prescribed.

However, the amount of interest to be credited in any case shall not exceed the amount of interest paid by the recipient.

10. If reduction of output tax liability is in contravention of section 43(7), interest will be payable u/s 43(10)

The amount reduced from output tax liability in contravention of the provisions of section 43(7) shall be added to the output tax liability of the supplier in his return for the month in which such contravention takes place and such supplier shall be liable to pay interest on the amount so added at the rate specified in sub section (3) of section 50.

➤ **Annual Return (Section 44)**

1. Annual Return to be filed electronically upto 31st December of Succeeding Financial year u/s 44(1)

Every registered person, other than:

- a) an Input service Distributor,
- b) a person paying tax under section 51 or section 52,
- c) a casual taxable person and
- d) a non resident taxable person.

Shall Furnish an annual return for every financial year electronically in such form and manner as may be prescribed on or before the thirty first day of December following the end of such financial year.

2. Annual Return to be accompanied with a copy of audited annual accounts and a reconciliation statement if accounts are required to be audited. u/s 44(2)

Every registered person who is required to get his accounts audited in accordance with the provisions of section 35(5) shall furnish, electronically the annual return under section 44(1) along with a copy of the audited annual accounts and a reconciliation statement, reconciling the value of supplies declared in the return furnished for the financial year with the audited annual financial statement, and such other particulars as may be prescribed.

➤ **Final Return (Section 45)**

Final Return to be furnished only on Cancellation of Registration :Every registered person Who is required to furnish a return under sub-section (1) of section 39 and Whose registration has been cancelled shall furnish a final return within three months of the date of cancellation or date of order of cancellation, whichever is later, in such form and manner as may be

➤ **Notice to Return Defaulters (section 46)**

Return Defaulters Notice: Where a registered person fails to furnish a return under section 39 or section 44 or section 45, a notice shall be issued requiring him to furnish such return within fifteen days in such form and manner as may be prescribed.

➤ **Levy of late fee.(section 47)**

1. Delay in Furnishing the return Late fee of Rs.100 per day subject to a maximum of RS.5,000 is payable u/s 47(1)

Any registered person who fails to furnish the details of outward or inward supplies required under section 37 or section 38 or returns required under section 39 or section 45 by the due date shall pay a late fee of one hundred rupees for every day during which such failure continues subject to a maximum amount of five thousand rupees.

2. Delay in Furnishing the Annual return Levy of Late fee of RS.100 per day subject to a maximum of 0.25% of the turnover in the state or union territory is payable u/s 47(2):

Any registered person who fails to furnish the return required under section 44 by the due date shall be liable to pay a late fee of one hundred rupees for every day during which such failure continues subject to a maximum of an amount calculated at a quarter per cent (0.25%) of his turnover in the state or Union territory.

➤ **Return Filing Forms:**

Sr.No	Form No.	Particulars	Time Frame
1.	GSTR-1	Details of outward supplies of taxable goods and/or/services effected	10th of the next month

2.	GSTR-1A	Details of outward supplies as added, corrected or deleted by the recipient	-
3.	GSTR-2	Details of inward supplies of taxable good and/or services claiming input tax credit	15 th of the next month
4.	GSTR-2A	Details of inward supplies made available to the recipient on the basis of form GSTR-1 furnished by the supplier. Part A – from supplier, part B – form ISD part C- from Tax Deductor at source, part D – from Tax collector at source	-
5.	GSTR-3	Monthly return on the basis of finalization of details of outward supplies and inward supplies along with the payment of amount of tax	20 th of the next month
6.	GSTR-3A	Notice to a registered taxable person who fails to furnish return under section 39 and section 45	-
7.	GSTR-3B	Monthly return, in case time limit of furnishing of details under section 37/38 has been extended	-
8.	GSTR-4	Quarterly Return for compounding taxable persons	18 th of the month succeeding quarter
9.	GSTR-4A	Details of inward supplies made available to the recipient registered under composition scheme on the basis FORM GSTR-1 furnished by the supplier	-

10.	GSTR-5	Return for Non-Resident foreign taxable person	20 th of month
11.	GSTR-6	Return for Input service Distributor	13 th of month
12.	GSTR-6A	Details of inward supplies made available to the ISD recipient on the basis of FORM GSTR-1 furnished by the supplier	-
13.	GSTR-7	Return for authorities deducting tax at source	10 th of month
14.	GSTR-7A	TDS Certificate by deductor	Within 5 days of crediting the amount so deducted to the Government.
15.	GSTR-8	Details of supplies effected through e-commerce operator and amount of collected as required under section 52	10 th of month
16.	GSTR-9	Annual return	31 st December of next financial year.
17.	GSTR-9A	Simplified Annual return by compounding taxable persons registered under section 10	31 st December of next financial year.
18.	GSTR-9B	Copy of audited annual accounts and reconciliation statement	-
19.	GSTR-10	Final return	Within 3 months of the date of cancellation or date of cancellation order, whichever is later.
20.	GSTR-11	Details of inward supplies to be	-

		furnished by a person having UIN	
21.	GST PCT-1	Application for enrolment as GST Practitioner	-
22.	GST PCT-2	Enrolment certificate as GST Practitioner	-
23.	GST PCT-	Show cause to as GST Practitioner	-
24.	GST PCT-	Order of cancelling enrolment as GST Practitioner	-
25.	GST PCT-5	List of GST Practitioner	-
26.	GST PCT-6	Consent of taxable person to GST practitioner	-

➤ **Check Your Progress:**

A. Multiple Choice Questions:

- 1) GST Stands for
 - a. Goods and supply Tax
 - b. Government sales Tax
 - c. Goods and Services Tax
 - d. Good and Simple Tax
- 2) GST is levied in India on the basis of principle.
 - a. Origin
 - b. Destination
 - c. Either a or b
 - d. Both a or b
- 3) The main objectives of GST implementation is
 - a. To Consolidate multiple Indirect tax levies into single tax.
 - b. Overcoming limitation of Existing indirect tax structure.
 - c. Creating efficiencies in tax administration.
 - d. All of above.
- 4) Which of the following is not a bill passed by parliament for the implementation of GST in India:
 - a. The Central GST Act, 2017.
 - b. The State GST Act,2017.

- c. The Integrated GST Act,2017. d. None of above.
- 5) Petroleum products have been temporarily been kept out of GST.
a. One b. Two c. Three d. Five
- 6) In India, GST structure is In nature.
a. Single b. Dual c. Triple d. (a) & (b) both
- 7) GST is not levied on which of the following:
a. Alcoholic Liquor for Human Consumption
b. Five Petroleum Products
c. Immovable Property
d. All of above
- 8) What are the taxes levied on an intra State supply?
a. CGST b. SGST c. CGST & SGST d. IGST
- 9) What is the maximum rate prescribed under CGST Act?
a. 12% b. 28% c. 20% d. 18%
- 10) Who will notify the rate of tax to be levied under CGST Act?
a. Central Government suo moto
b. State Government suo moto
c. GST Council suo moto
d. Central Government as per the recommendations of the GST Council

4.3 Summary:

In present unit we have seen the various aspects of GST starting from Introduction of GST to GST return filing. This will help you out when you will practically start working on GST part. In this unit we are understand the basics concept of GST, which we can implement to practical aspect of the same. GST is a new development in the field of indirect taxes. We had a lot of different indirect taxes in India but after the introduction of GST, all those previous taxes got subsumed in GST. Hence, we have seen the various aspects of GST starting from

introduction of GST to GST return filing. The initial part of the chapter is all about the basics of GST and the various taxes applicable under GST. The Second part of the chapter gave the complete understanding of valuation of supply under GST. Third part of the chapter gave us the complete understanding about the registration process under GST and the last part of the chapter discussed about the various returns to be filed under GST.

4.4 Terms To Remembers:

- **GOODS:** It means 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 severed before supply or under a contract of supply.
- **SERVICE:** 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, currency or denomination for which a separate consideration is charged.
- **TAX:** A tax is a compulsory financial charge or some other type of levy imposed on a taxpayer. Taxes are mandatory contributions collected by governments.
- **GST:** It is a tax on goods and services with value addition at each stage having comprehensive and continuous chain of set of benefits from the producer's / service provider's point up to the retailer's level where only the final consumer should bear the tax.
- **GSTIN:** GSTIN or the Goods and Services Taxpayer Identification Number is a unique PAN-based 15-digit number given to a taxpayer registered under the GST law. (A taxpayer will have to register for the GST across all the states where they have a branch of their organization, and the GSTIN will vary from state to state even if the PAN is the same.)
- **GSTN:** GSTN stands for the Goods and Services Tax Network. It is a non-profit, non-government private limited company that will provide IT infrastructure and services to the Central and State Governments, tax payers and other stakeholders for implementation of the Goods and Services Tax (GST).

4.5 Answers to Check Your Progress:

1. c 2. b 3. c 4. b 5. a
6. b 7. d 8. c 9. c 10. d

4.6 Exercise:

- 1) (TO of all branches with same PAN) A dealer X has two offices one in Delhi and another in Haryana. In order to determine whether X is liable for registration turnover or both the offices would be taken into account and only if the total exceeds Rs. 20 lakh, X is liable for registration.
- 2) (Exempt Supplies) Rohan Oils, Punjab is engaged in supplying machine oil as well as petrol. Supply of petrol is not leviable to GST, but supply of machine oil is taxable in order to determine whether Rohan Oils is liable for registration turnover of both the supplies, not taxable as well as taxable, would be taken into account and if the total exceeds Rs.20 lakh, Rohan Oils is liable for registration.
- 3) (Exempt TO): Mr. Rajan is a farmer with an annual turnover in relation to agricultural products of Rs. 18,00,000. Since this income is from exempt goods (see Chapter 6), the turnover is exempt from GST. However, Mr. Rajan also supplies plastic bags worth Rs. 2,50,000 along with his crop and charges separately for this. Mr Rajan is required to register under GST because his aggregate turnover exceeds the threshold limit of Rs. 20 lakh.
- 4) Mr. A makes a supply of Rs.200000 to Mr. B. the contract provides that Mr. B will pay Rs.50000 to Mr. A and Rs.150000 to Mr. C to settle the debt of Mr. A . Find the transaction value and GST Liability if the GST rate is 18% (Ans :Transaction value Rs.200000 and GST Liability : CGST = Rs.18000 and SGST = Rs.18000)
- 5) Admission to theatre is Rs.90 per ticket for Marathi movie as well as for Hindi movie plus 10% entertainment tax on Marathi movie and 20% entertainment tax on Hindi movie. Find the value of supply (Answer: Marathi movie = Rs.99000 and Hindi movie = Rs.162000).
- 6) Mr. B a service provider is providing coaching service to 10th Class student in Vashi. He is providing coaching/tuitions since 2014-15 & having an annual

turnover of Rs.15 lakhs. On appointed day. Mr.B was registered under Service Tax. Mr. B liable to be registered under GST w.e.f. 22-6-2018.

- 7) Mr A is a GST registered person. He transfers his business as a going concern asset with all to Mr. B who is an unregistered person. Mr. is liable to be registered with effect from the date of such transfer whether or not his turnover is above the threshold turnover limit.
- 8) Mr. C is a GST registered person. He died due to sudden heart attack, His only son, Mr.D succeeds to his business. Mr.D is liable to be registered with effect from the date of such succession without considering the threshold turnover limit.
- 9) The Selling price of a notebook is Rs. 50. For notebooks sold to student in Government Schools, a company uses its CSR funds to pay the seller Rs. 30, so that the students pay only Rs. 20 per notebook. The taxable value of the notebook will be Rs. 50 as this is a non-government subsidy directly linked to the price. If the same subsidy is paid by the central Government or State Government the taxable value of the notebook would be Rs. 30.
- 10) Palre Biscuit Co. Gives a discount of 30% on the list price to its distribution. Thus, for a carton of Spicebisk, in the invoices the list price is mentioned as Rs. 200 on which a discount of 30% is given to arrive at the final price of Rs. 140. The taxable value is Rs. 140. As the discount is allowed at the time of supply and shown in the invoices. This is in the nature of trade Discount.
- 11) The agreement of Bala Electrical appliances with its dealers is that sale of rice cookers over 100 pieces in the Diwali month will entitle them to discount of 5% per cooker sold in the next month. The next month's stock has already been dispatched when the sales figures for the Diwali month are worked out. However, as the agreement was in existence at the time of supply and the discount can be worked out for each invoice the taxable value will be the billed price minus 5%. The dealer must reverse the proportionate input tax credit on the relevant stock to bring it in line with the reduced tax
- 12) A Company announces turnover discounts after reviewing dealer performance during the year. The discounts are based on performance slabs and are given as cash back. As these discounts were not known at the time of supply of the goods. They will not be deducted from taxable value of those goods.

- 13) Mr. A Sold goods to MR. B for Rs.50000. as per agreement, Mr. A is required to deliver the goods. Mr. A hires the transportation for delivery but the transport charges is paid by Mr. B. find the value of supply. (Answer: Rs.52000)
- 14) Compute the value of supply if the contracted value is Rs.1800000 which includes the following
- a) Cost of primary packing – Rs.45000, b) Cost of protective packing Rs.25000, c) Design and drawing charges Rs.100000, d) pre installation consultancy charges Rs.50000. Freight charges of Rs 65000is paid by buyer on behalf of seller. Rs.20000 commission paid to agent by buyer on the instruction of seller. (Answer: Rs.1885000).

Practical : Group Discussion Topic - GST (Goods and Services Tax) in India

There are 5 students who are discussing about GST in India

Group Discussion Starts,

Mr.A: We have a topic on GST today for discussion. GST or goods and services tax is the new indirect taxation system to come into effect in India. The intention is to make India a single market. I think it is a decent way to move forward.

Mr.B : Good morning everyone. I agree with A. It is a very good move. Rather than having so many taxes levied by different states and bodies, GST forms a single tax system. GST is essentially a tax which is calculated only on the value added at each stage in a typical supply chain I.e. Manufacturer to the end customer.

Mr.A: Yes, also it would be much easier to manage by everyone. Also many taxes like excise duty, additional excise duty, service tax, customs duty at Central level would be replaced. Also at state level octroi, entertainment tax, state VAT etc would be replaced. If we consider this, GST would be so easy to manage as it would replace all of existing taxes.

Mr.C: Hi guys, I agree this is a single tax which would replace other taxes but if we see clearly it is not a single GST but a dual GST- central and state. This actually is almost same as it was. If GST has to be a success, it should be a single GST system and not a dual system. Currently it would add no value but replace old ones with new ones without actual advantage.

Mr.D: I completely agree with C. CGST and SGST are nothing but new names of existing structure. For GST to be successful it should have single GST system.

Mr.E: You are missing the bigger picture here. India being such a big country and with population so large, we cannot directly replace existing system at one go. It's better to have dual administration in GST with centre and state playing their respective roles in the taxation. The point is GST replaces so many taxes which are there and structures them into more manageable system.

The existing structure had so many problems. For example, multiple taxes on same value at Central level and state level. These taxes were in form of excise duty, service tax, sales tax, and then VAT. Now think from perspective of a businessman, so many taxes and so many records. The people need to concentrate on work they do and not managing and understanding taxes. With GST, this issue gets resolved on its own. On every value created tax is paid and then it moves on.

With all the complexity of current system, corrupt can manipulate the system easily by increasing complexity and misinterpreting laws and taxes for unfair advantage. With more simpler GST system, it would be more difficult to manipulate.

Mr.A: That's a very fair point E. Also with GST comes the technology backbone which would support the GST. With government backed IT infrastructure everything would be more accountable and transparent.

Mr.C : Theoretically things look good but practically moving everything to GST is not easy. Also information and education to people would be a big issue.

Mr.D: As I mentioned before also, the GST would be successful only if it is single GST regime and not dual. Having dual GST model would mean the same thing as currently. Across the world, GST is a tried and tested model but in a single administration model.

Mr.B: India is an unique country and replacing years of taxation model would require phased approach and involvement of both centre and state.

Mr.A: Thanks everyone. It was a great discussion on GST. I think we all agree that it is a good system but time will tell how and when it would be implemented with full effect.

Conclusion

India has many taxes in place like excise, sales tax, service tax, entertainment tax, VAT etc. These taxes are divided at Central as well as state level. These taxes are difficult to manage and sometimes causes the issue of taxation on already levied taxes in addition to inconvenience to businesses and customers. GST aims to solve it with single indirect taxation system.

4.7 References for further Study:

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Unit-1

Introduction and Elements of Cost

Index :

- 1.0 Objectives
- 1.1 Introduction
- 1.2 Presentation of Subject Matter
 - 1.2.1 Meaning of Cost Accounting
 - 1.2.2 Scope of Cost Accounting
 - 1.2.3 Objectives of Cost Accounting
 - 1.2.4 Advantages of Cost Accounting
 - 1.2.5 Elements of Cost
 - 1.2.6 Classification of Cost
 - 1.2.7 Cost Unit and Cost Centre
 - 1.2.8 Subdivision of Cost
 - 1.2.9 Cost Sheet
 - 1.2.10 Quotation
- 1.3 Summary
- 1.4 Terms to Remember
- 1.5 Answers to Check Your Progress
- 1.6 Exercise
- 1.7 References for Further Study

1.0 Objectives:

After studying this unit students should be able to —'

- Understand the concept of Cost Accounting.
- Explain the scope of Cost Accounting.
- Know the objectives of Cost Accounting.
- Understand the Elements of Cost, Cost Unit, Cost Centre, Cost Sheet and Quotation.
- Prepare the Cost Sheet and Quotation.

1.1 Introduction:

Cost accounting is a branch of accounting which is developed to overcome the limitations of financial accounting. Financial accounting is the oldest branch of accounting which is concerned with record keeping and preparation of financial statements. In financial accounting, the Profit and Loss Account and Balance Sheet are prepared but these statements give limited information. Management requires so much information to execute its functions effectively and this information is provided by the cost accounting. The development of cost accounting is so quick and fields covered by it are also expanding.

1.2 Presentation of Subject Matter

1.2.1 Meaning of Cost Accounting:

The term cost indicates the amount of expenditure incurred on or attributable to a specified thing or activity or cost unit. Cost accounting is related to the accounting of cost. There are different terms used in the field of accounting of costs. These terms are like Costing, Cost Accounting and Cost Accountancy. The meaning of these terms is different.

Costing is a technique and process of ascertaining costs. This technique consists of principles and rules which govern the procedure of ascertaining the cost of product/service.

Cost accounting is the accounting system used in costing. That means it is the procedure of classifying, recording and appropriate allocation of expenditure for the

determination of the cost of product or service for the presentation of suitably arranged data for purposes of control and guidance of management.

Cost accountancy is the application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability.

To understand the meaning and nature of the term cost accounting, it is necessary to go through the various definitions of cost accounting given by different authors which are as follows —

- 1) "Cost accounting is the branch of accounting dealing with classification, recording, allocation, summarization and reporting of current and prospective costs" — Kohler.
- 2) "It is the process of ascertaining cost from the point at which expenditure is incurred or committed to the establishment of its ultimate relationship with cost centre and cost units. In its widest usage, it embraces the preparation of statistical data, the application of cost control methods and the ascertaining of the profitability of activities carried out or planned." — Institute of Cost and Management Accountants (ICMA), England and Wales.
- 3) "Cost accounting is a set of procedures for determining the cost of product and various activities involved in its manufacture and sales and for planning and measuring performance."- C.G Gillespie.
- 4) "Cost accounting is the application of accounting and costing principles, methods and techniques in the ascertainment of costs and the analysis of saving or excess cost incurred as compared with previous experience or with standards"- Wheldon.

The above definitions explain that cost accounting is related to the cost of a product or service. It is the mechanism by means of which cost of product or services are ascertained and controlled. It is the process of classifying, recording and appropriate allocation of expenditure for the determination of the total cost of product or service and for the presentation of suitably arranged data to the management with the purpose of control and guidance. It deals with the cost of production, administration, selling and distribution. From the above definition and explanation we can mention the features of cost accounting as under –

- i) It is a process of accounting for costs.
- ii) It is related with cost ascertainment, cost control and cost reduction.
- iii) It records total cost of product or service.
- iv) It classifies the total cost as per elements of cost.
- v) It establishes standards so that actual costs may be compared to find out deviations.
- vi) It provides suitably arranged data for purpose of control and guidance of management.

The nature of cost accounting is multi-dimensional. It is the science, art and practice of a cost accountant. It is a science because it is a body of systematic knowledge having certain principles which a cost accountant should process for proper discharge of his responsibilities. It is an art as it requires the ability and skill with which cost accounting principles are applied to solve various managerial problems. Practice includes continuous efforts in cost accounting to present information for the purpose of managerial decision making and keeping statistical information.

1.2.2 Scope of Cost Accounting:

The term scope denotes the areas covered by that particular activity. The scope of cost accounting also indicates the areas or field included in cost accounting. Cost accounting comes into existence for the help of management. The management of every business firm has to carry different function like planning, organizing, controlling, decision making etc. These functions of management cannot be satisfactorily carried out with the help of financial accounting only. At the beginning the scope of cost accounting was limited to ascertain the cost but as the time changes the scope of it becomes wider. The scope of cost accounting can be explained as under —

- 1) Collection and classification of costs:** In cost accounting costs are collected and classified by different ways in order to provide information to management for planning and control purpose and to ascertain the profitability of each activity. It enables a concern to measure the efficiency and then to maintain and improve it.

- 2) **Control of costs:** Cost accounting, by using different techniques able to control materials, labour and overheads costs. The stores ledger, levels of stocks help to control the materials, different wage plans, record of labour work help to control labour costs and classification of overheads help to control overhead costs.
- 3) **Business Policies:** Business policies require the consideration of alternatives and this is facilitated by cost accounting. Cost accounting provides the information regarding make or buy, introduce new product, capacity utilization, problem of limiting factor, replacement of an asset etc. with the help of marginal costing technique and differential cost analysis. So management can decide the proper business policies.
- 4) **Budgeting:** Cost accounting provides the use of budgets and performance reports for the purpose of attaining objectives of management. With the help of budgets management can plan well and with the help of performance reports effective control can be possible.
- 5) **Cost Audit:** The operation of a system of cost audit in the organization will assist in prevention of errors and frauds. It will help to improve cost accounting methods and techniques to facilitate prompt and reliable information to management.
- 6) **Special Factors:** Cost accounting informs management about the special factors like optimum profitability, seasonal variation in volume and costs, idle time of labour, idle capacity of the machine etc. It also helps to reduce the losses during the off season.
- 7) **Price Determination:** The fixation of price cannot be properly done without proper figures of costs are available. Cost accounting helps management to fix the remunerative selling prices of various items of goods in different circumstances.

1.2.3 Objectives of Cost Accounting:

Cost accounting has certain objectives which are as follows —

- i) **Cost Ascertainment:** The main objective of cost accounting is to ascertain the cost of product, services or jobs. Total cost as well as per unit cost is ascertained by using any suitable costing methods or costing technique.

ii) Cost Analysis: Now a day, cost analysis has got more importance because mere cost ascertainment is not sufficient. Therefore to provide a correct analysis of costs both by process or operations and by different elements is become the important objective of cost accounting.

iii) Determination of Selling Price: Determination the proper selling price of a product or service is one of the very important decisions of the management. Cost accounting provides the base for determine the selling price by disclosing detailed and relevant cost figures.

iv) Ascertainment of Profitability: Ascertainment of profitability of each product or service is one of the objectives of cost accounting. Cost accounting, by comparing the cost data with selling price, helps to ascertain the profit of each product or service. It also advises to management as to how these profits can be maximized.

v) Cost Control: Cost accounting helps in controlling the costs of product. The objective of cost accounting is to develop a system of cost control for materials, labour and overheads, as well as control of stock; therefore the cost minimized the capital locked up.

vi) Cost Reduction: In the today's competitive age cost reduction is become the main objectives of cost accounting. Due to proper analysis of cost, management can disclose ways of wastage of materials, labour and overheads and by taking proper decisions or actions these wastages can be avoided and cost can be reduced.

vii) Preparation of Reports: In business it is necessary to prepare financial statements, reports by frequent intervals. Cost accounting provides data regarding various costs, stock levels, stock values etc. which help to prepare financial statements and reports.

viii) Providing Base for Decisions: The one of the important objectives of cost accounting is to provide base for management decisions. Cost accounting supply useful data to management for taking various decisions such as introduce a new product, replacement of labour or machine, make or buy, shut down or continue a particular activity etc.

1.2.4 Advantages of Cost Accounting:

There are many advantages of cost accounting. Some of the important advantages are given below:

1. The cost accounting system is useful to ascertain the cost of any product or service.
2. It is helpful to reduce the cost and increase the profit.
3. With the help of cost accounting the business firm can determine the selling price of the product or service.
4. The cost accounting system provides data about profitable and unprofitable products and activities on the basis of it management can take suitable corrective measures which may lead to higher profit.
5. All items of costs can be analyzed to minimize the losses and wastage emerging from the manufacturing process and reduce the costs associated with different activities.
6. Cost accounting helps in improving production methods so that costs can be controlled and profit increased.
7. Cost data can be obtained and compared with standard cost within the firm or industry.
8. Cost accounting helps management in avoiding losses arising due to many factors, such as low demand, competitive conditions, change in technology, seasonal demand for the product etc.
9. Negotiations with government and labour unions can easily be made with the information provided by the cost accounting system.
10. Cost accounting helps management in knowing the costs of different alternatives and selecting the most advantageous course of action. Decisions like make or buy, continue or drop a product, buy or lease, sell or process further, operate or shut down and other short-term decisions are easily taken with the help of cost accounting data.
11. More accurate and reliable financial accounts can be prepared promptly for use of management.

12. An adequate cost accounting system ensures maximum utilization of physical and human resources, checks fraud and manipulations and helps employees as well as the employers in their basic goals getting higher earnings and maximizing the profit of the concern.

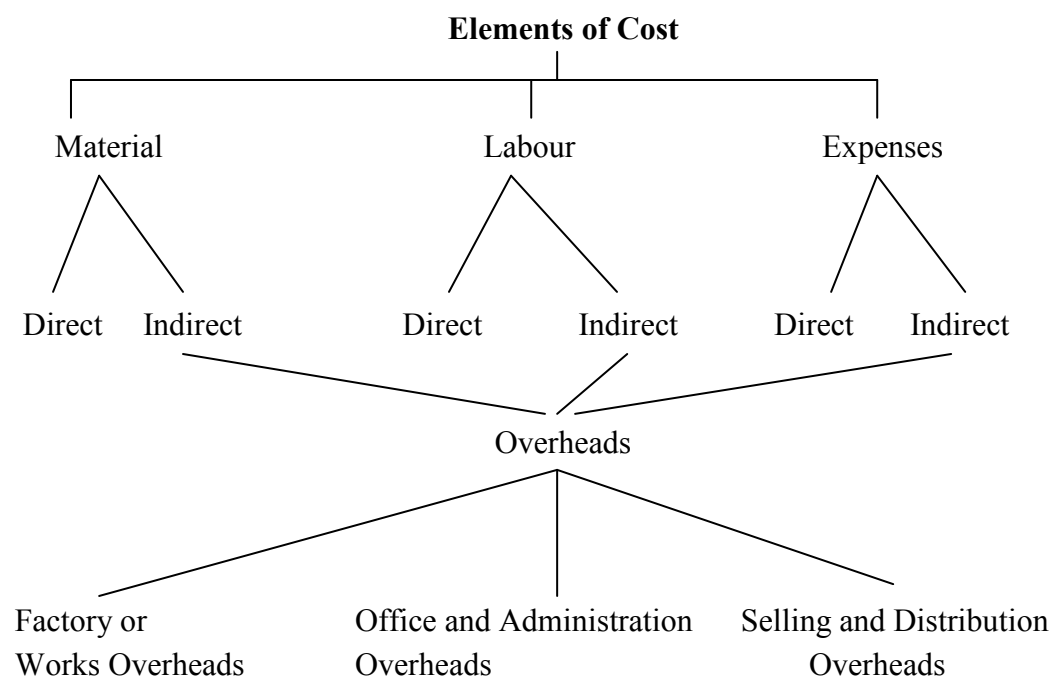
1.2.5 Elements of Cost:

The term cost indicates the amount of expenditure incurred on or attributable to a specified thing or activity or cost unit. The expenditure may be actual or notional. It is the general meaning of cost. But the term cost cannot be exactly defined. Its interpretation depends upon the nature of the business or industry and the context in which it is used. The cost is mainly expressed from the manufacturer's or producer's point of view and not in the viewpoint of consumer or end user. The monetary value of all sacrifices made to achieve an objective i.e. to produce goods and services is termed as cost. Cost refers to the expenditure incurred in producing a product or in rendering a service. Cost ascertainment is based on uniform principles and techniques. Hence cost is objectively determined.

As cost indicates the total amount of expenditure incurred on or attributable to a specified thing or activity from production to make that thing available to customer, it has different components. These components are called as elements of cost. All these expenses can be basically classified in to three categories or there are basically three elements of cost. These basic elements are as follows:

1. Materials
2. Labour
3. Expenses

These elements are further classified in to different sub-elements. The following chart shows the classification of elements of cost.



Material:

The element from which the product is made is known as material. This material may be in a raw form or finished/manufactured form. According to the Chartered Institute of Management Accountants (CIMA), London, “Material cost is the cost of commodities supplied to an undertaking.” It may be direct or indirect. Therefore there are two categories of material namely Direct Material and Indirect Material.

Direct Material:

Direct material is that material which can be identified in the product and can be conveniently measured and directly charged to the product. It is an integral part of the finished product, e.g. timber in furniture, cloth in dress making, leather used in shoe making, bricks and cement used in construction of building are called direct material. Direct material is also called as production material, process material, prime cost material, stores material, constructional material etc.

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.
- 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.

Indirect Material:

The material which cannot be conveniently assigned to a specific product is termed as indirect material. Though such material forms the part of a product it is of very small value it may be treated as indirect material e.g. thread or buttons used in dress making, nails, paint, polish paper etc. used in furniture making; threads, nails, polish etc. used in shoe making etc. 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. Indirect material may be used in the factory or in the office or in the selling and distribution division.

Labour/Wages:

Human efforts needed for the working in a factory, office and selling department are called as labour/wages. According to CIMA London, "Labour cost means the cost of remuneration (i.e. Wages, Salaries, Commission, Bonus etc.) of the employees of an undertaking." It includes all fringe benefits like provident fund contribution, gratuity, overtime, incentive, idle time, holiday wages etc. Labour/wages is also divided as direct as well as indirect.

Direct Labour/Wages:

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 labour or 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. e.g. 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. Direct labour is also

called as process labour, productive labour, operating labour etc. Direct Labour includes

- 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.

Indirect Labour/Wages:

Labour used in the work which is incidental or supportive to goods produced or services provided is indirect labour. The wages paid to labour who assists the direct labour in production process is treated as indirect labour, if it cannot be conveniently charged to a particular product e.g. 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.

Expenses:

All amount incurred to produce goods or services and make them available to customers except material and labour is called as expenses. According to CIMA, London, “Expenses means the cost of services provided to an undertaking and the notional cost of the use of owned assets.” Expenses also divided as direct and indirect.

Direct expenses:

It includes all expenditure other than direct material or direct labour that is specifically incurred for a particular product or process. Such expense is charged directly, conveniently and wholly to the particular cost unit or cost centre 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. Direct expenses are also termed as chargeable expenses, productive expenses etc.

Indirect Expenses:

These are the expenses which cannot be directly, conveniently and wholly allocated to particular cost unit or cost centre. Examples of such expenses are rent, lighting, insurance etc.

Overheads/On - cost:

The total indirect cost is termed as overheads. That means indirect material, indirect labour and indirect expenses constitutes overheads. According to CIMA, London, "Overheads is the total cost of indirect materials, indirect labour and indirect expenses." Overheads are the cost of materials, labour and expenses which cannot be economically identified with particular cost unit.

Classification of Overheads:

Overheads are broadly classified on the basis of functions. A manufacturing concern generally has three divisions' viz. factory or works, office, and selling and distribution division. Therefore overheads are classified into three categories as Factory or Works Overheads, Office and Administration Overheads, and Selling and Distribution Overheads.

Factory/Works Overheads:

The overheads which are concerned with production/manufacturing activity or concerned with work carried out in a factory are termed as factory overheads. These overheads are also termed as works overheads, production overheads, manufacturing overheads. It includes indirect materials used in the factory such as consumable stores, lubricants, cotton waste, oil, etc.; indirect labour such as gate keeper salary, time keeper salary, foreman salary, works manager salary etc.; and indirect expenses such as factory rent, factory insurance, factory lighting etc.

Office and Administration Overheads:

The overheads which are incurred to carry on office and administration work are termed as Office and Administration Overheads. These overheads are not directly connected with production or sales. It includes indirect materials used in office such as printing and stationary material, brooms, dusters etc.; indirect labour such as

salary of office manager, salary of accountant and clerks, etc. and indirect expenses such as rent, insurance, lighting, telephone bill of office etc.

Selling and Distribution Overheads:

The overheads which are concerned with selling and distribution activities are termed as selling and distribution overheads. It includes indirect materials used in sales and distribution department such as packing material, printing and stationary material etc.; indirect labour such as salaries of salesmen and sales manager, salary of delivery van driver, wages of workers in packing department etc. and indirect expenses such as delivery van expenses, insurance, advertising etc.

1.2.6 Classification of cost:

It is the process of grouping costs according to their characteristics. Costs are classified or grouped according to their common characteristics. A suitable classification of costs is of vital important in order to identify the cost with cost centres or cost units. Cost can be classified into the following groups.

- (i) According to elements.
- (ii) According to functions or operations.
- (iii) According to nature or behaviour.
- (iv) According to controllability.
- (v) According to normality.
- (vi) According to association with product.
- (vii) According to Management Decision Making.
- (viii) According to the basis of manufacturing process.
- (ix) According to time.

i) By nature or element :

According to this classification, the costs are divided into three categories i.e. Materials, Labour and Expenses. There can be further sub classification of each element. This classification is important as it helps to find out the total cost, how such total cost is constituted and valuation of work in progress.

ii) By functions or operations :

(a) Production cost : It begins with the supplying of materials, labour and services and ends with the primary packing of the product. Thus, it includes the cost of direct material, direct labour, direct expenses and factory overheads.

(b) Administration cost : 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, rates and insurance, legal charges, depreciation, audit fee, repairs of office building etc.

(c) Selling and Distribution cost : 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 sales 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 and unloading charges, salaries of dispatch clerk and workers, special packing charges, delivery van expenses, carriage outward etc.

(d) Research cost : The cost of searching- new or improved products, new application of materials, new or improved methods are called research costs.

(e) Development costs : These are costs 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 method and ends with the commencement of formal production of the product or employment of the method.

(f) Pre- Production costs : These are those costs which are incurred on making a trial production run prior to formal production.

iii) Classification according to nature or behaviour :

Some costs increase or decrease in direct proportion to the volume of production, some costs remain unaffected, while others change but not in direct proportion 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 per 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 vary 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.

iv) According to controllability : According to this feature costs may be classified into controllable and uncontrollable heads.

(a) Controllable costs : Costs which can be influenced by the action of a specified executive of an undertaking are known as controllable costs. A business organization is usually divided into a number of responsibility centres and each such centre is headed by an executive. Controllable costs incurred in a particular responsibility centre can be influenced by the action of the executive heading that responsibility center.

(b) Uncontrollable costs : Cost which cannot be influenced by the action of a specified member of an undertaking are known as uncontrollable costs. For example, expenditure incurred by, say, the tool room is controllable by the foreman in charge of that section but the share of the tool-room expenditure which is apportioned to a machine shop is not to be controlled by the machine shop foreman.

v) According to normality : On this basis, it is classified into two categories.

- (a) **Normal cost:** It is the cost which is normally incurred at a given level of output in the conditions in which that level of output is normally attained. It is a part of cost of production.
- (b) **Abnormal cost:** It is the cost which is not normally incurred at a given level of output in the conditions in which that level of output is normally attained. It is not a part of cost of production and charged to costing Profit and Loss Account.
- (vi) **According to association:** According to this feature costs may be classified into product cost and period cost.
 - (a) **Product cost:** Product cost of those costs which are associated with and directly identifiable with the product. In other words, costs which are assigned to the product are product costs. A product costs is thus the sum of the costs assigned to a product for a specific purpose.
 - (b) **Period costs:** Period costs are costs that are reported as expenses of the period in question. These are costs which are not assigned to the product but are charged against revenue costs of the period in which they are incurred. All non manufacturing costs such as general and administrative expenses, selling and distribution expenses are example of period costs.
- (vii) **According to Management Decision Making:**

Costs are classified for the purpose of management decision making under different circumstances as under:

a) Marginal cost: It is the aggregate of variable costs, i.e. prime cost plus variable overhead. Marginal cost per unit is the change in the amount at any given volume of output by which the aggregate cost changes if the volume of output is increased or decreased by one unit. Marginal cost is used in Marginal Costing system. For determining marginal cost, semi-variable costs, if any, are segregated into fixed and variable cost. Then, variable costs plus the variable part of semi-variable costs is the total marginal cost for the volume of production in consideration.

b) Differential Cost: It is the change in cost due to change in activity from one level to another. Differential Cost is found by using the principle which highlights the points of differences in costs by adoption of different alternatives. This technique is used in export pricing, new products and pricing goods sought to be promoted in

new markets, either within the country or outside. The algebraic difference between the relevant cost at two levels of activities is the differential cost. When the level of activity is increased, the differential cost is known as incremental cost and when the level of activity is decreased, the decrease in cost is known as decremental cost.

c) Opportunity Cost: It is the value of the alternatives foregone by adopting a particular strategy or employing resources in specific manner. It is the return expected from an investment other than the present one. The opportunity cost is considered for selection of a project or justification of investment, studying viability of an investment option.

d) Replacement Cost: It is the cost of an asset in the current market for the purpose of replacement. Replacement cost is generally used for determining the optimum time of replacement of an equipment or machine in consideration of maintenance cost of the existing one and its productive capacity.

e) Relevant Costs: These are costs relevant for a specific purpose or situation. In the context of decision making relating to a specific issue, only those costs which are relevant are considered. A particular cost item may be relevant in a decision making and may be irrelevant in some other decision making situation. For example, present depreciated cost of machine is relevant in case of decision of its sale but it is irrelevant in case of decision of its replacement.

f) Imputed Costs: These are hypothetical or notional costs, not involving cash outlay, computed only for the purpose of decision making. In economics, 'imputed' indicates an ascribed or estimated value when there is no criteria of absolute monetary value for such purpose. Imputed costs are similar to opportunity costs. Interest on internally generated fund, which is not actually paid is an example of imputed cost.

g) Sunk Costs: These are historical costs which are incurred i.e. 'sunk' in the past and are not relevant to the particular decision making problem being considered. Sunk costs are those that have been incurred for a project and which will not be recovered if the project is terminated. While considering the replacement of a plant, the depreciated book value of the old asset is irrelevant as the amount is a sunk cost which is to be written off at the time of replacement.

(viii) According to the basis of manufacturing process:

Costs are also classified on the basis of nature of production or manufacturing process as follows:

a) Batch Cost: Batch cost is the aggregate cost related to a cost unit which consists of a group of similar articles which maintain its identity throughout one or more stages of production.

b) Process cost: When the production process is such that goods are produced from a sequence of continuous or repetitive operations or processes, the cost incurred during a period is considered as process cost. The process cost per unit is derived by dividing the process cost by number of units produced in the process during the period.

c) Operation Cost: It is the cost a specific operation involved in a production process or business activity. When there are distinctly separate operations involved in a process, cost for each operation is found out for effective control mechanism.

d) Operating Cost: It is the cost incurred in conducting a business activity. Operating costs refer to the cost of undertakings which do not manufacture any product but which provide services.

e) Contract cost: It is the cost of a contract with some terms and condition of adjustment agreed upon between the contractee and the contractor. Contract cost usually implied to major long term contracts as distinct from short term job costs. Escalation clause are sometimes provided in the contract in order to take care of anticipated change in material price, labour cost etc.

f) Joint Costs: These are the common cost of facilities or services employed in the output of two or more simultaneously produced or otherwise closely related operations, commodities or services. When a production process is such that from a set of same input, two or more distinguishably different products are produced together, products of greater importance are termed as joint products and products of minor importance are termed as by-products and the costs incurred prior to the point of separation of the products are termed as Joint Costs.

g) By-Product Cost: It is the cost assigned to the by-product.

h) Avoidable Costs: Avoidable Costs are that costs which under given conditions of performance efficiency should not have been incurred. Avoidable

costs are logically associated with some activity or situation and are ascertained by the difference of actual cost with the happening of the situation and the normal cost. When spoilage occurs in manufacture in excess of normal limit, the resulting cost of spoilage is avoidable cost. Cost variances which are controllable may be termed as avoidable cost.

i) Unavoidable Costs: These are inescapable costs which are essentially to be incurred, within the limits or norms provided for. It is the cost that must be incurred under a programme of business restriction. It is fixed in nature and inescapable.

(ix) According to time:

A cost item is related to a specific period of time and cost can be classified according to the system of assessment and specific purpose as indicated in the following ways:

a) Historical Costs: Historical costs are the actual costs of acquiring assets or producing goods or services. They are 'postmortem' costs ascertained after they have been incurred and they represent the cost of actual operational performance. Historical costing system follows a system of accounting to which all values are based on costs actually incurred or as relevant from time to time.

b) Pre-determined Costs: These costs for a product are computed in advance of production, on the basis of a specification of all the factors affecting cost and cost data. Pre-determined costs may be either standard or estimated.

c) Standard Costs: These are predetermined costs. A predetermined norm applied as a scale of reference for assessing actual cost, whether these are more or less. The standard cost serves as a basis of cost control and as a measure of productive efficiency when ultimately posed with an actual cost. It provides management with a medium by which the effectiveness of current results is measured and responsibility of deviation placed. Standard costs are used to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them.

d) Estimated Costs: These costs of a product are prepared in advance prior to the performance of operations or even before the acceptance of sale orders. Estimated cost is found with specific reference to product in question, and activity

level of the plant. It has no link with actual and hence it is assumed to be less accurate than the standard cost.

Group Discussion:

Group Discussion is an effective tool in problem solving, decision making and personality assessment. It improves your thinking, listening and speaking skills. It also promotes your confidence level. Group Discussion skills may ensure academic success, popularity and good admission or job offer.

Group Discussion is conducted under the supervision of a supervisor or testing officer or a board of testing officers. Generally two topics are given to the groups allowing them five minutes to discuss among themselves and come to conclusion out of the two. Any one from the group can communicate the decision of the group to the testing officer. In professional group discussion every topic or subject given for discussion has two sides, one is positive or acceptable and another is negative or non-acceptable. A candidate has to express his view on any one side. A group generally may be of 10 students/candidates. All the candidates in the group are given token numbers. The testing officer will closely observe your role during the discussion.

Rules/Guidelines for Group Discussion:

While group discussion everyone should take note of guidelines. Very brief discussion guidelines could include items like:

- Allow everyone a chance to speak.
- Listen respectfully and actively.
- Criticize ideas, not individuals.
- Commit to learning, not debating.
- Avoid blame, speculation, inflammatory language.
- Avoid assumptions about others, especially based on their perceived social group.

Mistakes you must avoid in a Group Discussion:

While group discussion everyone should must try to avoid the common mistakes which are enlisted below:

- Don't take the lead, if you don't know the topic.

- Don't hesitate to take the lead, if you know it.
- Don't copy or follow someone else's ideas or comments.
- Don't contradict your own points.
- Don't avoid eye contact with fellow participants.
- Avoid interrupting others.

You must remember that your comments should be logical, justifiable, impressive, convincing and knowledgeable. If these aspects are covered, there will be clear chance of your success in the group discussion.

Example: In this unit example of group discussion is given for study purpose and it is based on the unit content. A teacher is a observer and 8 students are included in a group.

Topic for discussion: Is cost accounting beneficial to all stakeholders of a business firm?

In favour of Point	Against the Point
Friends or (Ladies and Gentlemen), to my mind cost accounting is beneficial to all stakeholders of a business firm.	Friends or (Ladies and Gentlemen), to my mind cost accounting is not beneficial to all stakeholders of a business firm.
1. The users/stakeholders of accounting information are internal and external. All these users/stakeholders are beneficial from cost accounting.	1. The users/stakeholders of accounting information are internal and external. All these users/stakeholders are not beneficial from cost accounting.
2. The internal users/stakeholders of accounting information include members of management at different levels and external users/stakeholders of accounting information include shareholders, creditors, financial analysts, government authorities, stock exchanges, labour unions etc. All these users/stakeholders are beneficial from cost accounting, to	2. The internal users/stakeholders of accounting information include members of management at different levels and external users/stakeholders of accounting information include shareholders, creditors, financial analysts, government authorities, stock exchanges, labour unions etc. Out of these only internal users/stakeholders are beneficial from

some or more extent.	cost accounting.
3. The important benefits of cost accounting are ascertainment of cost, cost control, reduction of cost which leads to maximize the profit ultimately beneficial to all users/stakeholders.	3. The important benefits of cost accounting are ascertainment of cost, cost control, reduction of cost which is useful to take various management decisions. Therefore only internal users/stakeholders are beneficial from cost accounting.
4. Cost accounting helps to prepare more accurate and reliable financial accounts which are helpful to all users/stakeholders.	4. Cost accounting helps to take different management decisions like make or buy, continue or drop a product, buy or lease, sell or process further, operate or shut down etc. which are helpful to only internal users/stakeholders.

Note- This is one of the examples of group discussion. Students should conduct such type of group discussions on various topics related to this unit.

1.2.7 Cost Unit and Cost Centre:

Costing technique includes collection and classification of expenditure according to elements of cost and allocation and apportionment of the expenditure to the cost unit or cost centre or both. The elements of cost have been already explained and the terms cost unit and cost centre are explained below.

Cost Unit:

In cost accounting it becomes necessary to select a proper unit with which expenditure may be identified. Cost unit is a unit of measurement in which cost may be ascertained. The CIMA, London, defines a cost of unit as “a unit of quantity of product or service or time in relation to which costs may be ascertained or expressed.” Proper selection of unit is very important in ascertaining the cost. Unit selected should be clear, simple and commonly used. Following are some examples of cost units:

Product/ Service	Cost Unit	Product/ Service	Cost Unit
Brickworks	Per 1000 brick	Soaps	Number/Carton
Building	Square foot	Wire / Cable	Meter / Kilometer
Cement	Tonne	Dairy (Milk)	Liter
Power	Kilowatt	Goods transport	Bag/Ton kilometer
Paper	Rim	Passenger transport	Passenger kilometer
Food grains	Kg./Quintal/Tonne	Wood / Gas	Cubic Feet (cft)
Sugar	Kg./Quintal/Tonne	Hospital	Per patient day

Cost centre:

According to the CIMA, London Cost centre means “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 centres may be classified as follows:

- i. Productive, unproductive and mixed cost centres.
- ii. Personal and impersonal cost centres.
- iii. Operation and process cost centres.

1.2.8 Sub-division/Components 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.

The total cost is divided into different parts or divisions for the purpose of cost control and cost reduction. These parts are called as sub-division/components of cost. By grouping the elements of cost the following divisions of cost are obtained.

1. Prime Cost/Direct Cost/First Cost:

Direct Material + Direct Labour + Direct Expenses

2. Works/Factory Production/Manufacturing Cost:

Prime Cost + Works or Factory Overheads

3. Cost of Production/Office Cost:

Works Cost + Office and Administration Overheads

4. Cost of Goods Sold:

Cost of Production + Opening Stock of Finished Goods – Closing Stock of Finished Goods

5. Cost of Sales/Total Cost:

Cost of Goods Sold + Selling and Distribution Overheads

The difference between the cost of sales and sales represents **profit or loss**.

1.2.9 Cost Sheet:

A cost sheet is a statement which is prepared to show the total cost as well as components of cost. It shows the break-up and build-up of costs. It is a document which provides for the assembly of the detailed cost of a cost centre or a cost unit. It analyses and classifies in a tabular form the cost of different items for a particular period. It also shows the cost per unit of a product or service at different stages of total cost as well as at different stages of product or service. Cost Sheet may be

prepared on the basis of actual cost or estimated cost. Cost Sheet includes only cost therefore non-cost items, purely financial items, provisions and incomes are not included in cost sheet.

Uses of Cost Sheet:

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 / quotations.
- g) Preparation of Budgets.
- h) Disclosure of operational efficiency for Cost control.

Specimen form of Cost Sheet:

Cost Sheet for the year ended/period ended....

Units Produced.....

Particulars	Units	Rs	Total Cost Rs.	Cost per unit Rs.
Direct Materials/Raw Materials Consumed*	xxx	xxx		
Direct Wages		xxx		
Direct Expenses		-----		
PRIME COST	xxx		xxx	xxx
Add : Factory Overheads or Works On-cost.		xxx		
Indirect materials		xxx		

Particulars	Units	Rs	Total Cost Rs.	Cost per unit Rs.
Indirect wages- inspection		xxx		
instructors, Gatemen,		xxx		
Drawings office salary		xxx		
Factory Rent, Rates, Taxes &		xxx		
Insurance		xxx		
Lighting heating		xxx		
Power & fuel		xxx		
Repairs & Maintenance		xxx		
Cleaning Expenses		xxx		
Cost of research & experiments		xxx		
Works manager salary		xxx		
Consumable stores		xxx		
Depreciation of plant & machinery		xxx		
Water supply		xxx		
Loose tools written off		xxx		
Haulage or crane expenses		<u>xxx</u>		
Cost of defective work		xxx		
		<u>xxx</u>	<u>xxx</u>	<u>xxx</u>
Less-Sale of scrap		xxx	xxx	xxx
WORKS COST	xxx		xxx	xxx
Add : Opening Stock of Work in progress	<u>xxx</u>		<u>xxx</u>	
			xxx	

Particulars	Units	Rs	Total Cost Rs.	Cost per unit Rs.
Less : Closing Stock of Work in progress	<u>xxx</u>		<u>xxx</u>	
	<u>xxx</u>	xxx	<u>xxx</u>	
WORKS COST OF FINISHED GOODS		xxx	xxx	xxx
Add : Administration Overheads		xxx		
Counting house salaries		xxx		
Rent, Rates, Insurance		xxx		
Telephone & Postage		xxx		
Printing & Stationery		xxx		
Legal expenses		xxx		
Audit fees		<u>xxx</u>		
Depreciation of Office Furniture, Equipment & Building		<u>xxx</u>		
Repairs of Office Furniture, Equipment & Building		xxx		
		<u>xxx</u>		
	xxx	xxx		
COST OF PRODUCTION	<u>xxx</u>	<u>xxx</u>	xxx	xxx
Add : Opening Stock of Finished Goods	<u>xxx</u>	xxx	xxx	xxx
	xxx	xxx		
Less : Closing Stock of Finished Goods		xxx	xxx	xxx
COST OF GOODS SOLD		xxx		
Add : Selling & Distribution Overheads		xxx		
Sales Commission		xxx		
Salesmen's salaries		xxx		

Particulars	Units	Rs	Total Cost Rs.	Cost per unit Rs.
Advertisement & samples				
Carriage outwards		xxx		
Bad Debts		xxx		
Depreciation & expenses of delivery van		xxx		
Debt collection charges		<u>xxx</u>		
Rent of warehouse		xxx		
Sample & other free gifts				
Showroom rent & rates				
Traveller's salaries, commission	xxx		<u>xxx</u>	<u>xxx</u>
			xxx	xxx
COST OF SALES	xxx		<u>xxx</u>	<u>xxx</u>
Profit / Loss			<u>xxx</u>	<u>xxx</u>
SALES				

***Raw Materials Consumed**

Particulars	Rs
Opening Stock of Raw Materials	xxx
Add: Purchase of Raw Materials	xxx
Carriage inwards, Purchase Expenses,	xxx
Octroi etc.	<u>xxx</u>

Less : Closing Stock of Raw Material	xxx	
Material lost	xxx	
Material transferred to job or department	<u>xxx</u>	<u>xxx</u>
Raw Material Consumed		<u>xxx</u>

Note: While 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.

1.2.10 Quotation:

Cost sheet is prepared with the help of actual costs. On the basis of cost sheet we can prepare the estimated cost sheet which can be termed as tender or quotation for the purpose of determine selling price or predetermine the costs. Cost estimation is the process of pre-determining the cost of goods or services. Estimated costs are the future and budgeted costs and are based on the average of past actual costs adjusted for and anticipated changes in future.

A statement of price that is presented for a work order to be executed or service to be rendered or goods to be supplied is called as ‘Quotation.’ It is also termed as ‘Tender.’ Tender and Quotation are synonymously used. Generally the term ‘Tender’

is used in the Governmental transactions and the term 'Quotation' is used in non-governmental transactions.

Check Your Progress:

A. Choose the correct alternative:

1. The main objectives of cost accounting are
 - a) Cost ascertainment
 - b) Cost control
 - c) Cost reduction
 - d) All of above
2. costs vary in direct proportion to volume of output.
 - a) Fixed
 - b) Variable
 - c) Total
 - d) None of above
3. All type of indirect expenses constitute the
 - a) Prime Cost
 - b) Overheads
 - c) Total Cost
 - d) None of above
4. Prime Cost includes
 - a) Direct Materials
 - b) Direct Labour
 - c) Direct Expenses
 - d) All of above
5. Which of the following expenses is not included in the Cost Sheet?
 - a) Works Manager Salary
 - b) Rent
 - c) Interest on Loan
 - d) Carriage Outward
6. Which of the following expenses is not included in the Cost Sheet?
 - a) Depreciation on Machinery
 - b) Insurance
 - c) Cost of Defective Work
 - d) Excess Depreciation

B. State True or False.

1. Financial accounting and cost accounting are complementary to each other.
2. Cost accounting is the oldest branch of accounting.
3. The scope of cost accounting includes cost ascertainment cost presentation and cost control.
4. Cost accounting is nothing but a post-mortem of past costs.
5. Cost accounting is an instrument of management control.

6. Cost Sheet is a statement which gives the breakup of total cost by elements and sub divisions.
7. Variable cost per unit will remain the same.
8. Fixed cost per unit remains unaffected either with the increase or decrease in the output.
9. Abnormal loss is not included in cost sheet.
10. Financial incomes are the part of cost sheet.

Illustrations:

1. From the following information given by Bharat Industries for the month March, 2014 prepare Cost Sheet showing the Prime cost, Factory Cost, Cost of Production and the Cost of Sales and Profit.

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 (3/4 factory, 1/4 office)	5,000
Rent: Factory	5,000	Directors Fees	1,250
Office	2,500	Office printing & stationery	500 125
Repairs & Renewals		Telephone Charges	250
Factory Plant	1,250	Postage & Telegram	1250
Machinery	2,500	Salesmen's commission & salary	500
Office Premises	500	Travelling expenses	1,250
Carriage Outward	375	Advertising	500
Sales	2,00,000	Warehouse Charges	

Solution: 1**Cost Sheet for the month March, 2014**

Particulars	Rs	Total Cost Rs
Direct Materials		100000
Direct Wages		25000
Direct Expenses		5000
Prime Cost		130000
Add: Factory Overheads		
Oil & waste	250	
Wages of Supervisor	2500	
Wages of storekeeper	1250	
Motive Power	500	
Rent: Factory	5000	
Repairs and Renewals – Factory Plant	1250	
Machinery	2500	
Lighting – Factory	1250	
Depreciation – Plant & Machinery	500	
Consumable Stores	2500	
Manager's Salary (Factory – $\frac{3}{4}$)	<u>3750</u>	<u>21250</u>
Factory Cost		151250
Add: Office and Administration Overheads		
Rent – Office	2500	
Repairs and Renewals – Office Premises	500	
Lighting – Office	500	
Depreciation – Office Premises	1250	
Manager's Salary (Office – $\frac{1}{4}$)	1250	
Directors Fees	1250	
Office Printing and Stationary	500	
Telephone Charges	125	
Postage and Telegrams	<u>250</u>	<u>8125</u>
Cost of Production		159375
Add: Selling and Distribution Overheads		

Particulars	Rs	Total Cost Rs
Carriage Outward	375	
Salesmen's Commission and Salary	1250	
Travelling Expenses	500	
Advertising	1250	
Warehouse Charges	<u>500</u>	<u>3875</u>
Cost of Sales/Total Cost		163250
Profit		36750
Sales		<u>200000</u>

2. From the following particulars prepare a cost sheet showing the total cost per tonne for the period ended 31st March, 2014.

Particulars	Rs	Particulars	Rs
Raw Materials	33000	Productive Wages	35000
Direct Expenses	3000	Rent (Office)	500
Water Supply	1200	Factory Insurance	1100
Unproductive Wages	10500	Office Insurance	500
Factory Rent	7500	Legal Expenses	400
Factory Lighting	2200	Factory Heating	1500
Rent of Warehouse	300	Dep. On Plant and Machinery	2000
Dep. On Office Building	1000	Dep. On Delivery Van	200
Motive Power	4400	Haulage	3000
Director's Fees (Office)	2000	Director's Fees (Works)	1000
Bad Debts	100	Factory Cleaning	500
Advertising	300	Sundry Office Expenses	200
Sales Department Salary	1500	Estimating Expenses	800
Upkeep of Delivery Van	700	Factory Stationery	750
Bank Charges	50	Office Stationery	900
Loose Tools Written off	600	Commission on Sales	1500

The total output for the period has been 10000 tonnes.

Solution: 2**Cost Sheet for the month March, 2014****Output 10000 Tons**

Particulars	Rs	Total Cost Rs	Cost per Ton Rs
Direct Materials (Raw Materials)		33000	
Direct Wages (Productive Wages)		35000	
Direct Expenses		3000	
Prime Cost		71000	7.10
Add: Factory/Works Overheads			
Water Supply	1200		
Unproductive Wages	10500		
Factory Rent	7500		
Factory Lighting	2200		
Factory Insurance	1100		
Factory Heating	1500		
Dep. On Plant and Machinery	2000		
Haulage	3000		
Director's Fees (Works)	1000		
Factory Cleaning	500		
Estimating Expenses	800		
Factory Stationery	750		
Motive Power	4400		
Loose Tools Written off	600	<u>37050</u>	<u>3.70</u>
Factory/Works Cost		108050	10.80
Add: Office and Administration Overheads			
Rent (Office)	500		
Dep. On Office Building	1000		
Office Insurance	500		
Legal Expenses	400		
Director's Fees (Office)	2000		
Bank Charges	50		

Particulars	Rs	Total Cost Rs	Cost per Ton Rs
Office Stationery	500		
Sundry Office Expenses	<u>900</u>	<u>5550</u>	<u>0.56</u>
Cost of Production		113600	11.36
Add: Selling and Distribution Overheads			
Rent of Warehouse	300		
Dep. On Delivery Van	200		
Bad Debts	100		
Advertising	300		
Sales Department Salary	1500		
Commission on Sales	1500		
Upkeep of Delivery Van	<u>700</u>	<u>4600</u>	<u>0.46</u>
Cost of Sales/Total Cost		118200	11.82

3. From the following particulars prepares a cost statement showing the components of total cost and profit for the year ended 31st March, 2014.

Particulars	On 1' April 2013	On 31' March 2014.
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		7 30,000
Factory employees salary		60,000
Factory rent, taxes & insurance		7,250
Power expenses		9,500
Other production expenses		43,000

Sales for the year	8, 60,000
Income tax	5,000
Interest on debentures	10,000
Transfer to sinking fund for replacement of machinery	20,000
Dividend received	2,500
Goodwill written off	10,500
Payment of sales tax	16,000
General expenses	20,500
Office rent	12,000

Solution: 3

Statement of Cost and Profit.

For the year ended 31-3-2014.

Particulars	Rs.	Rs.
Opening stock of Raw Materials	40000	
Add : Purchase of Raw Materials	475000	
Carriage Inward	12500	
	527500	
Less : Closing stock of Raw Materials	50000	
Material Consumed		477500
Direct Wages		175000
Direct expenses		-----
PRIME COST		652500
Add : Factory Overheads		
Factory employees salary	60000	
Works managers salary	30000	
Factory rent taxes & Ins.	7250	
Power expenses	9500	
Other production expenses	43000	
		149750

Add : Opening Work-in Progress		802250
		15000
Less : Closing Work-in Progress		817250
		10000
FACTORY COST		807250
Add : Office & Administration Overheads		
General expenses	20500	32500
Office Rent	12000	
COST OF PRODUCTION		839750
Add : Opening stock of finished goods		6000
		845750
Less : Closing stock of finished goods		15000
COST OF GOODS SOLD		830750
Add: Selling & Distribution Overheads		
Sales Tax		16000
COST OF SALES		846750
Profit (Balancing figure)		13250
SALES		<u>860000</u>

4. 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 to show the profit earned.

Particulars	Rs
Opening stock	
Raw Materials - 500units	300
Finished goods - 500 units	1,610
Purchases:	
Raw Materials - 10,000 units	9,635

Closing stock	
Raw Materials - 300 units	755
Finished goods - 700 units	1,834
Office Salaries, Rent & Rates	1,224
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 unit.

Solution -4:

Statement of Cost and Profit

(No. of Units Produced- 10200)

Particulars	Units		Total Cost Rs.	Cost Per unit
Opening stock of raw materials	500	300		
Add: Purchases of R. M.	<u>10000</u>	<u>9635</u>		
	10500	9935		
Less: Closing Stock of R. M.	300	755		
Raw Materials Consumed	10200		9180	.90
Manufacturing Wages			9690	.95
Direct expenses			--	
PRIME COST			18870	1.85
Add : Factory On- Cost:				
Repairs & depreciation of plant		1020		
Coal Consumed		2958		
Rent & Rates		<u>1734</u>	5712	
FACTORY COST			24582	2.41
Office & Administrative On- cost :				

Particulars	Units		Total Cost Rs.	Cost Per unit
Salary, Rent & Rates		1224		
Printing & Stationery		918	2142	0.21
COST OF PRODUCTION			26724	2.62
Add: Opening stock of finished goods	500		<u>1610</u>	
	10700		28334	
Less: Closing stock of finished goods	700		<u>1834</u>	
COST OF GOODS SOLD	10000		26500	2.65
Add: Selling & Distribution On-cost				
Commission on sales			500	0.05
COST OF SALES			<u>27000</u>	<u>2.70</u>
Profit (Balancing figure)			3000	0.30
SALE (@ Rs. 3 per. unit. for 10,000 units sold)			30000	3.00

5. Given below is Profit & Loss Account of a manufacturing Co. for the year ending 31st March.

Profit and Loss Account

Dr.

Cr.

Particulars.	Rs.	Particulars.	Rs.
To Opening stock of Raw Materials	10000	By Sales	445800
Purchase of Raw Materials	150000	By Closing stock of Raw Materials	12000
Wages	124000		
Power	36000		
Establishment Exp.	23000		
Factory 8000			
Office 15000			

Particulars.	Rs.	Particulars.	Rs.
Rent	5000		
Factory 2000			
Office 3000			
Advertisement	6000		
Traveller's Commission	4000		
Maintenance of Delivery Vans	5000		
Rent of Warehouse	2500		
Telephone	800		
Factory 300			
Office 500			
Electric Charges	600		
Factory 200			
Office 400			
Depreciation.	800		
Factory 100			
Office 700			
Depreciation of factory machinery	3000		
Interest on loan	1000		
Bad debts	600		
Miscellaneous Exp.	11000		
Factory 2000			
Office 9000			
Net Profit	74500		
	457800		457800

The following analysis of office expenditure is given to you:

Office Expenditure	Administration	Selling	Distribution
Office Establishment	50%	40%	10%
Office Telephone	30%	50%	20%
Office Rent	40%	60%	Nil
Office Electric charges	20%	70%	10%
Office Miscellaneous Expenses	65%	20%	15%
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: 5

Statement of Cost

Particulars.	Rs.	Rs.
Opening stock of Raw Materials	10000	272000
Add : Purchase of Raw Materials	150000	
	160000	
Less : Closing stock of Raw Mat.	12000	
Material Consumed	148000	
Wages	124000	
Prime Cost		
Add : Factory Overheads		
Power	36000	
Establishment	8000	
Rent	2000	323600
Telephone	300	
Electricity Charges	200	
Dep. of Furniture	100	
Dep. of Machinery	3000	
Miscellaneous Expenses	2000	
Factory Cost		
Add: Office Overheads.		
A) Administration Overheads		

Establishment	7500	
Rent	1200	
Telephone	150	
Electricity Charges	80	
Dep. Of Furniture	420	
Miscellaneous Expenses	5850	15200
Cost of Production		338800
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	20940
Miscellaneous Expenses	1800	359740
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	1350	10560
Total Cost/Cost of Sales		370300

Note: - Interest on loan being a pure financial matter, it is excluded from cost.

6. Following are the particulars for the production of 2000 Fans of a company for the year 2014-15.

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 2015-16. 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 materials and wages.
- 4) Selling expenses per fan will remain the same.
- 5) Other expenses will remain unaffected by rise in output.

You are required to prepare cost sheet for the year 2014-15 and 'Estimated price' of 3,000 Fans to be produced during the year 2015-16 at which the Fans would be sold so as to show profit of 10% on sales.

Solution: 6**Cost Sheet**

For the year 2014-2015

Output = 2000 Fans

Particulars	Rs.	Total Cost Rs.	Per Unit Cost Rs.
Materials		3,20,000	160
Wages		4,80,000	240
Prime Cost		8,00,000	400
Add : Factory Overheads			
Manufacturing Expenses		2,00,000	100
Factory Cost		10,00,000	500
Add : Office Overheads			
Salaries	2,40,000		
Rent, Rates & Insurance	40,000		
General Expenses	80,000	3,60,000	180
Cost of Production		13,60,000	680
Add : Selling Overheads			
Selling Expenses		1,20,000	60
Total Cost		14,80,000	740
Profit		1,20,000	60
Sales		16,00,000	800

**Quotation / Estimated Price for 3000 Fans to be produced
During the year 2015-2016**

Particulars	Rs.	Rs.	Per Unit Cost Rs.
Materials (3000 *192)		576000	192
Wages (3000*252)		756000	252
Prime Cost		1332000	444
Add : Factory Overheads			
Manufacturing Expenses (100*444/400) (3000*111)		333000	111
Factory Cost		1665000	555
Add : Office Overheads			
Salaries	240000		
Rent, Rates & Insurance	40000		
General Expenses	80000	360000	120
Cost of Production		2025000	675
Add : Selling Overheads			
Selling Expenses (3000*60)		180000	60
Total Cost		2205000	735
Profit (90:2205000:10:?) (2205000*10/90)		245000	82
Sales.		2450000	827

7. A company finds that in 2014-15 the cost of manufacturing 200 scooters was Rs. 2400000 and selling price was Rs. 17500 per scooter. The cost was made up as:

Particulars	Rs.
Materials	1000000
Labour	800000
Factory Overheads	200000
Establishment and general expenses	<u>400000</u>
	<u>2400000</u>

For the year 2015-16 the company estimates the cost as under:

1. That each scooter will require materials of Rs 5200 and labour Rs 4500.
2. That the factory overheads will bear the same relation to wages as in the previous period.
3. That the office overheads percentage on factory cost will be the same as in the past.

Prepare a statement showing the profit per unit if company reduces the price by Rs 300.

Solution: 7

Statement of Cost

For 200 scooters

	Rs.
Materials	10,00,000
Labour	8,00,000
Prime Cost	18,00,000
Factory Overheads	2,00,000
Works/Factory Cost	20,00,000
Office Overheads	4,00,000
Cost of production	24,00,000

Working Notes:

- 1) Percentage of Factory overheads to Labour
= $\text{Factory Overheads} / \text{Labour} \times 100$
= $200000 / 800000 \times 100 = 25\%$
- 2) Percentage of Office Overheads to Factory/Works Cost
= $\text{Office Overheads} / \text{Factory or Works Cost} \times 100$
= $400000 / 2000000 \times 100 = 20\%$

Estimated Cost Sheet

Particulars	Per Unit Cost Rs
Materials	5200
Labour	4500
Prime Cost	9700
Factory Overheads (25% of Rs 4500)	1125
Works/Factory Cost	10825
Office Overheads (20% of Rs 10825)	2165
Cost of production	12990
Profit (balancing figure)	4210
Selling Price	17200

8. Lotus Company is a metal and wood cutting manufacturer, selling products to the home construction market. Provide you the following data for the month of October, 2019.

Particulars	Rs.
Sandpaper	5000
Material-handling costs	175000
Lubricants and Coolants	12500
Miscellaneous indirect manufacturing labour	100000
Direct manufacturing labour	750000
Direct materials, October 1, 2019	100000
Direct materials, October 31, 2019	125000
Finished goods, October 1, 2019	250000
Finished goods, October 31, 2019	375000
Work-in-process, October 1. 2019	25000
Work-in-process, October 31. 2019	35000

Plant-leasing costs	135000
Depreciation plant equipment	90000
Property taxes on plant equipment	10000
Fire insurance on plant equipment	7500
Direct material purchased	1150000
Sales Revenues	3400000
Marketing Promotions	150000
Marketing Salaries	250000
Distribution Costs	175000
Customer – Service Costs	250000

Required:

- 1) Prepare an income statement with a separate supporting schedule of cost of goods manufactured
- 2) For all manufacturing items indicate by V or F whether each is basically a variable cost or a fixed cost (where the cost object is a product unit).

Solution:

**Lotus Company's
Schedule for Cost of Goods Manufactured
for the month ending Oct 2019**

Particulars	Rs.	Rs.
Direct materials:		
Beginning Inventory	1,00,000	
Purchase of Direct Materials	11,50,000	
Cost of direct materials available for use	12,50,000	
Ending inventory	1,25,000	
Direct materials used		11, 25,000(V)
Direct manufacturing labour		7, 50,000(V)

Indirect manufacturing costs:

Sand Paper	5.000(V)	
Material-handling cost	1.75.000(V)	
Lubricants and coolants	12,500(V)	
Misc. indirect manufacturing labour	1,00,000(V)	
Plant leasing cost	1,35.000(F)	
Depreciation-plant and equipment	90,000(F)	
Property tax-plant and equipment	10,000(F)	
Fire insurance-plant and equipment	7.500(F)	5, 35,000
Manufacturing cost incurred during the month of October, 2019		24, 10,000
Add: Opening work-in-progress		25.000
		<u>24, 35.000</u>
Less: Closing work-in-progress		35,000
Cost of goods manufactured (to income statement)		<u>24, 00.000</u>

Lotus Company's**Income Statement for the month ending Oct 31, 2019**

Particulars	Rs.	Rs.
Revenues		<u>34.00.000</u>
Cost of goods sold:		
Beginning finished goods	2,50,000	
Cost of goods manufactured	24,00,000	
Cost of goods available for sale	<u>26,50,000</u>	
Ending finished goods	3,75,000	22.75.000
Gross Margin		<u>11.25,000</u>

Marketing, Distribution and Customer Service Costs:

Marketing promotions	1,50,000	
Marketing salaries	2,50,000	
Distribution costs	1,75,000	
Customer service cost	2,50,000	8,25,000
Operating Income		<u>3,00,000</u>

1.3 Summary:

Cost accounting is a developed branch of accounting. It is developed to overcome the limitations of financial accounting. Cost accounting is the process of classifying, recording and appropriate allocation of expenditure for the determination of the total cost of a product or service. It is the science, art and practice of a cost accountant. The scope of cost accounting is very wide. It includes cost collection and analysis, cost control and cost reduction, policy framing, budgeting, cost audit, price determination. The main objectives of cost accounting are ascertainment of cost, cost control, cost reduction, determining the selling price, controlling the efficiency and providing useful basis for operating policy of the business. Cost accounting is developed to help the management. Management with the help of cost accounting, can find out total cost as well as per unit cost, control and reduce the cost, determine the selling price, ascertain the profit etc. The headings under which the total expenditure is analysed are known as the elements of cost. All these expenses can be basically classified into three categories i.e. Materials, Labour and Other expenses. The cost is ascertained on the basis of Cost Unit, Cost Centre etc.

A Cost Sheet 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 not considered because such item does not form a part of the cost.

1.4 Terms to Remember

1. **Cost:** The term cost indicates the amount of expenditure incurred on or attributable to a specified thing or activity or cost unit.

2. **Costing:** It is a technique and process of ascertaining costs. This technique consists of principles and rules which govern the procedure of ascertaining the cost of product or service.
3. **Cost Accounting:** It is accounting system used in costing. That means it is the procedure of classifying, recording and appropriate allocation of expenditure for the determination of the cost of product or service.
4. **Cost Accountancy:** Cost accountancy is the application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainments of profitability.
5. **Cost Sheet:** A cost sheet is a statement which shows the break- up and build-up of costs.
6. **Materials:** Cost of tangible, physical input used in relation to output/production e.g. cost of raw materials, consumable stores, maintenance items etc.
7. **Labour :**Cost incurred in relation to human resources of the enterprise.
8. **Expense :** 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.

1.5 Answers to Check Your Progress:

A : 1 – d, 2 – b, 3 – b, 4 – d, 5 – c, 6 – d

B : 1 – T, 2 – F, 3 – T, 4 – F, 5 – T, 6 – T, 7 – T, 8 – F, 9 – T, 10 – F

1.6 Exercise

1. What is cost accounting? Discuss the objectives of cost accounting.
2. Explain the scope of cost accounting.
3. State the importance of cost accounting.
4. Cost accounting has become to be an essential tool of the management — Comment
5. What is cost accounting? Explain the nature of cost accounting.
6. What is meant by elements of cost? Explain the elements of cost.

7. How are elements of cost useful for management? What are the different types of expenditure that are not included in cost accounts?
8. Define overheads and explain the functional classification of overheads.
9. Short Notes:-
 - a) Cost Accounting
 - b) Scope of Cost Accounting
 - c) Objectives of Cost Accounting
 - d) Prime Cost
 - e) Classification of cost.
 - f) Cost Centre.
 - g) Cost Unit.
 - h) Overheads

10. Prepare a cost sheet from following information.

Particulars	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/-

11. The following figures are extracted from the books of Hindustan 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.

Particulars	Rs
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/-

12. Ashirwad 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 inventory 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/-

13. The following extract of costing information relates to a commodity for the half year ending 31st March 2015.

Purchase of Raw Materials	1, 20,000
Works Overheads	48,000
Direct wages	1, 00,000
Carriage on purchases	1,440
Stock (1st Oct. 2014)	
Raw Materials	20,000
Finished products (1,000 tons)	16,000
Stock 31st March 2015.	
Raw Materials	22,240
Finished Products (2,000 tons)	32,000
Work in progress (1st Oct. 2007)	4,800
Work in progress (31st March 2008)	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.

Ascertain - i) Value of raw materials used, ii) Cost of output for the period, 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/-

14. Prepare a cost sheet from the details given below for the year ended 31st March 2015.

Particulars.	Rs.
Raw materials	1, 98,000
Productive wages	2, 10,000

Direct Expenses	18,000
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 on 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 delivery van	4,200
Bank charges	300
Commission on sales	9,000

The total output for the period has been 60,000 units.

Answer: Prime Cost Rs 426000, Factory Cost Rs 648300, Cost of Production Rs 681600, Cost of Sales Rs 709200

15. The accounts of Pooja Company Ltd. show for 2008:- 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 for one refrigerator. Absorb Factory overheads on the basis of labour and Administration overheads on the basis of works cost. A profit of 12.5% on selling price is required.

(Answer: Total Prime Cost Rs 620000, Works Cost Rs 701000, Cost of Production Rs 757080 and Per Unit Prime Cost Rs 8500, Works Cost Rs 9550, Cost of Production Rs 10314, Selling Price Rs 11787)

16. The accounts of Bharat Manufacturing Company for the year ended 31st December 2014 show the following.

Particular	Rs.
Stock of Raw Materials (1-1-2007)	1, 87,500
Stock of Raw Materials (31-12-2007)	1, 44,000
Purchase of Raw Materials	5, 55,000
Carriage & Cartage on Purchases	21,450
Carriage & Cartage outwards	12,900
Direct charges	75,000
Drawing Office salaries	19,500
Counting Housing salaries	37,800

Repairs of Plant & Machinery	19,500
Rent, Taxes & Insurance - Factory Rs. 25,500	
Office Rs. 6,000	31,500
Reserve for doubtful debts	6,000
Rent of warehouse	13,350
Income Tax paid	75,000
Salesmen's Travelling Expenses	6,300
Productive wages	3,00,000
Show-room rent and rates	13,100
Audit Fees	22,500
Salesmen's salaries and commission	10,000
Air conditioning charges	9,750
Other production expenses	7,500
Depreciation: Plant & Machinery Rs. 22,500	
Furniture Rs. 750	23,250
Gas and Water Factory Rs. 3,750	
Office Rs. 1,500	5,250
Manager's salary (3/4 Factory & 'A Office)	30,000
Goodwill written off	7,500
Transfer to sinking fund	30,000
Sales	14,25,000

Prepare a statement of cost.

(**Answer:** Cost of Material consumed Rs 619950, Prime cost Rs 994950; Factory cost Rs 1115700, Cost of Production Rs 1201500, Cost of sales Rs 1257150, and Profit Rs 167850)

Practical: Group Discussion:

Group Discussion is an effective tool in problem solving, decision making and personality assessment. It improves your thinking, listening and speaking skills. It also promotes your confidence level. Group Discussion skills may ensure academic success, popularity and good admission or job offer.

Group Discussion is conducted under the supervision of a supervisor or testing officer or a board of testing officers. Generally two topics are given to the groups allowing them five minutes to discuss among themselves and come to conclusion out of the two. Any one from the group can communicate the decision of the group to the testing officer. In professional group discussion every topic or subject given for discussion has two sides, one is positive or acceptable and another is negative or non-acceptable. A candidate has to express his view on any one side. A group generally may be of 10 students/candidates. All the candidates in the group are given token numbers. The testing officer will closely observe your role during the discussion.

Rules/Guidelines for Group Discussion:

While group discussion everyone should take note of guidelines. Very brief discussion guidelines could include items like:

- Allow everyone a chance to speak.
- Listen respectfully and actively.
- Criticize ideas, not individuals.
- Commit to learning, not debating.
- Avoid blame, speculation, inflammatory language.
- Avoid assumptions about others, especially based on their perceived social group.

➤ Mistakes you must avoid in a Group Discussion:

While group discussion everyone should must try to avoid the common mistakes which are enlisted below:

- Don't take the lead, if you don't know the topic.
- Don't hesitate to take the lead, if you know it.

- Don't copy or follow someone else's ideas or comments.
- Don't contradict your own points.
- Don't avoid eye contact with fellow participants.
- Avoid interrupting others.

You must remember that your comments should be logical, justifiable, impressive, convincing and knowledgeable. If these aspects are covered, there will be clear chance of your success in the group discussion.

Example: In this unit example of group discussion is given for study purpose and it is based on the unit content. A teacher is a observer and 8 students are included in a group.

Topic for discussion: Is cost accounting is beneficial to all stakeholders of a business firm?

YES	NO
Friends or (Ladies and Gentlemen), to my mind cost accounting is beneficial to all stakeholders of a business firm.	Friends or (Ladies and Gentlemen), to my mind cost accounting is not beneficial to all stakeholders of a business firm.
1. The users/stakeholders of accounting information are internal and external. All these users/stakeholders are beneficial from cost accounting.	1. The users/stakeholders of accounting information are internal and external. All these users/stakeholders are not beneficial from cost accounting.
2. The internal users/stakeholders of accounting information include members of management at different levels and external users/stakeholders of accounting information include shareholders, creditors, financial analysts, government authorities, stock exchanges, labour unions etc. All these users/stakeholders are beneficial from cost accounting, to some or more extent.	2. The internal users/stakeholders of accounting information include members of management at different levels and external users/stakeholders of accounting information include shareholders, creditors, financial analysts, government authorities, stock exchanges, labour unions etc. Out of these only internal users/stakeholders are beneficial from cost accounting.

3. The important benefits of cost accounting are ascertainment of cost, cost control, reduction of cost which leads to maximize the profit ultimately beneficial to all users/stakeholders.	3. The important benefits of cost accounting are ascertainment of cost, cost control, reduction of cost which is useful to take various management decisions. Therefore only internal users/stakeholders are beneficial from cost accounting.
4. Cost accounting helps to prepare more accurate and reliable financial accounts which are helpful to all users/stakeholders.	4. Cost accounting helps to take different management decisions like make or buy, continue or drop a product, buy or lease, sell or process further, operate or shut down etc. which are helpful to only internal users/stakeholders.

Note- This is one of the examples of group discussion. Students should conduct such type of group discussions on various topics related to this unit.

1.7 References for Further Study:

1. Bhar B.K., Cost Accounting: Methods and Problems, Academic Publishers, Kolkata.
2. Jain S. P., Narang K. L., Cost Accounting, Kalyani Publishers, Ludhiana.
4. Jawahar Lal, Cost Accounting, Tata MaGraw Hill Publishing Co. Ltd., New Delhi.
5. CA Vinodkumar Agarwal & CA Subodh Shah, Cost Accounting.
6. CA Rakesh Agrawal, Cost Management



Unit-2

Job and Contract Costing

Index :

2.0 Objectives

2.1 Introduction

2.2 Presentation of Subject Matter

2.2.1 Job Costing

2.2.1.1 Job Costing and Unit Costing

2.2.1.2 Features

2.2.1.3 Practical Applications of Job Costing and Unit Costing

2.2.1.4 Preparation of Job Cost Sheet

2.2.2 Contract Costing

2.2.2.1 Meaning of Contract Costing

2.2.2.2 Features

2.2.2.3 Accounting Procedure

2.2.2.4 Retention Money

2.2.2.5 Escalation Clause

2.2.2.6 Work in Progress

2.2.2.7 Cost Plus Contract

2.2.2.8 Preparation of Contract Account

2.3 Summary

2.4 Terms to Remember

2.5 Answers to Check Your Progress

2.6 Exercise

2.7 References for Further Study

2.0 Objectives:

After studying this unit, students will be able :

1. To acquaint the knowledge and skill to prepare job cost sheet and contract account.
2. To realise the need of use of job costing as a means of determination of cost in certain conditions.
3. To study preparation of cost sheet under job costing environment for the purpose of cost determination, control, tendering and calculating profit or loss.
4. To know contract cost is calculated and profit on incomplete contract is treated in cost accounts.
5. To know basic terms and concepts of Contract costing.

2.1 Introduction:

Job Costing is an attempt to arrive at the cost of non standard, but one of a kind job undertaken by both large and small entrepreneurs to satisfy their customers. Since such activities are rare and non repetitive an attempt is made by the person in charge of the establishment to have a proper understanding of the effort involved and the consumption of material and other resources so as to know the cost thereof; based on which a proper quote can be given or conveyed. Such establishments do not have an elaborate set up for proper estimation of the job undertaken; but because of the personal involvement and grip over the day to day activities they are in a position to use their judgment and thumb rules to arrive at the estimation of the job cost for the sake of quotation. Besides; the repetitive nature of certain jobs makes their job easy for estimation; since they can always fall back upon the past records for judging the costs.

Contract Costing is nothing but an extension of the principles of Job Costing. Just as each Job is unique; each Contract is also unique. Main features in Contract Costing run parallel to those of Job Costing; with certain elements like Contracts spilling over more than one accounting period, incomplete contracts, valuation of WIP, difficulty in predicting future costs etc. making it necessary to have special adjustments while compiling the Contract Costs. All these enable one to arrive at a fair cost of the Contract for accounting as well decision-making purpose. In order to have a objective calculation of the Contract Costs the ICAI has also prescribed

Accounting Standards for assisting the Business Accountant in enabling him in doing his/her job efficiently.

2.2 Presentation of Subject Matter:

2.2.1 Job Costing:

Industries which manufacture products or render services against specific orders as distinct from continuous production for stock or sales; use the job costing or job order method of cost accounting. The method is also known under various other names, such as specific order costing, production order costing, job lot costing or lot costing. Every order in job costing is separate and it is not essential that the same manufacturing operations be carried out or the same materials be utilized in respect of each. However, a number of identical orders or identical products may be combined together to form lots or batches, each such lot or batch constituting a job order. In the job costing system, an order or a unit, lot, or batch of a product may be taken as a cost unit, i.e. a job.

In job costing, there is no averaging of costs except to the extent that in the ascertainment of unit cost, the cost of a lot of products in one order is obtained. A job or an order may extend to several accounting periods and job costs are, therefore, not related to particular periods.

2.2.1.1 Job Costing and Unit Costing:

The ICMA Terminology provides an excellent description of job costing which defines it as “that form of specific order costing which applies where work is undertaken to customers’ special requirements and each order is of comparatively short duration. The work is usually carried out within a factory or work shop and moves through processes and operations as a continuously identifiable unit”.

Whereas Job Costing is customer specific or centric; and if the work order involves doing a job which involves manufacturing identical units; then cost per unit in respect of the work order is given by;

$$\text{Cost per unit} = \frac{\text{Total Cost of the Work Order}}{\text{No. of units in the Work Order}}$$

Unit Costing on the other hand is the method of costing used when the cost units are identical. The principal followed in simple, identical cost units should have

identical costs; and this concept of equality of costs is the basic feature of unit costing. Thus in Unit Costing;

$$\text{Cost Per Unit} = \frac{\text{Total Cost}}{\text{Number of Units}}$$

It is important to note at this juncture that process costing, output costing and operating costing are all sub-divisions of Unit Costing method.

2.2.1.2 Features:

Job Costing functions on the premise that each job is unique; and hence it will have its own unique/different cost. Thus, when jobs are undertaken for execution they are given their own identification number to facilitate cost collection and compilation. This identification number finds its place on each requisition slip for material, job card for expending labour and all other documents specifying special/direct needs of a job. As far as Overheads are concerned these are charged as per the practice of the organization as a percentage of prime cost, or on labour hour basis etc. An important element of Job costing is the comparison of the estimated cost with the actual cost; so as to know the variance and ensure proper control over costs. The special features relating to production and cost ascertainment in industries where job costing can be applied are:

1. Each job is unique, specific and dissimilar.
2. Each job is undertaken to customer's special requirements and not for stock.
3. Each job is comparatively of a short duration.
4. Each job is capable of identification at all stages of production.
5. Each job order is separately identified by a job order number.
6. There is no uniformity in the flow of production from department to department.
7. Direct costs of labour, materials and expenses are booked directly against the job order.
8. Overheads are charged on the basis of predetermined rates.

2.2.1.3 Practical Applications of Job Costing and Unit Costing:

Job cost accounting is followed in three types of manufacturing organisations:

- (i) Jobbing concerns.
- (ii) Small firms.

(iii) Large enterprises manufacturing a variety of products.

(i) Jobbing concerns:

Some concerns manufacture a variety of products according to customer's specifications and do not generally confine their activities to producing uniformly any specific product for sale in the market. The jobs, products or services are dissimilar or unique and non-repetitive having different specifications and methods of manufacture, and each one requires different types, sizes and quantities of materials and equipment's and utilizes different labour hours. Such concerns must of necessity use job cost accounting.

(ii) Small firms:

Though manufacturing a number of specific products, small manufacturing concerns may find process costing difficult to apply because due to small sales, no product can have a run long enough to establish a product line. On account of the frequent changes from one product to another, job costing would be suitable for determining the cost of each lot of products.

(iii) Large enterprises manufacturing a variety of products:

A single department would be manufacturing several products, perhaps all at a time, so that none of the departments is specialized for continuous runs of product lines. As definite process departments cannot be established, job costing is more suitable in such cases.

Job costing is applicable to engineering concerns, construction companies, ship-building, furniture making, hardware and machine manufacturing industries, repair shops, automobile garages and several such other industries where jobs or orders can be kept separate.

2.2.1.4 Preparation of Job Cost Sheet:

On receipt of an order from the customer or an indication from the sales department for manufacturing a particular product, the production planning department prepares a suitable design for the product or job. It also works out the requirements of materials for the product and prepares a list of operations indicating the various operations to be carried out and their sequence, and the shops, departments, plants or machines to be entrusted with each of the operations.

A Production Order is issued giving instructions to the shops to proceed with the manufacture of the product. The production order constitutes the authority for work. Usually a production order contains all relevant information regarding production, such as detailed particulars of the job or product, the quantity or units to be manufactured, date of start of production, probable date of completion, details of materials required as per the bill of materials, the operations and the various shops involved in performing them and the route that the job should take.

The production order usually lays down only the quantities of materials required and the time allowed for the operations, but the values of materials and labour are also sometimes indicated. In the latter case, the production order serves the combined purpose of an order for manufacture as well as the cost sheet on which the cost of the order is compiled.

The production order also provides for the material and labour on account of normal wastage or spoilage of the product in the final stage or during the various stages of manufacture.

➤ Production orders may, in general, be of three types:

- (i) Assembly type of order.
- (ii) Sub-assembly type of order.
- (iii) Components or parts production type.

(i) Assembly type of order:

Where components are purchased and assembled into a product in the factory. A production order for assembly only is required.

(ii) Sub-assembly type of order:

Components are purchased and sub-assemblies and assemblies are made in the factory. Production orders for each sub-assembly and final assembly will be necessary.

(iii) Components or parts production type:

Components are manufactured and sub-assembled and the sub-assemblies are assembled into the final product. Separate production orders for each component, sub-assembly and final assembly are issued.

➤ **Copies of Production Orders May be Distributed as Follows:**

- (a) One copy to the stores for provisioning and issue of materials on demand.
- (b) One copy each to the departments or shops concerned to undertake production by demanding materials and employing men and machines on the operations.
- (c) One copy to the cost department for working out the cost of the job.

Separate job cost sheets are maintained for each job. If a job consists of several major or important operations, separate cost sub-sheets for recording the costs of the various operations may be maintained and the aggregate cost, in summary, shown in the main cost sheet.

- **Material Cost:**

On receipt of a production order, the shop draws the requisite materials from the stores. Surplus, excess or incorrect materials are returned from the shops to the stores on materials return notes. Scrap and waste arising in the course of manufacture are returned in a similar manner. The materials requisitions, materials return notes and materials transfer notes are 'evaluated' in accordance with the methods of pricing adopted by the concern.

- **Labour Cost:**

Labour summaries or wages analysis sheets are prepared for each accounting period and the totals of these statements are debited to Work-in-Progress Account or Overhead Control Account by credit to Wages Control Account. Amounts on account of overtime, idle time, shift differential and fringe benefits may also be included in the wages analysis sheet. Direct labour costs are posted on the respective cost sheets and indirect labour is treated in the manner indicated for indirect material.

- **Manufacturing Overhead:**

Overhead costs are accumulated against standing order numbers and against cost centres. Overhead rates, predetermined or actual as the case may be, are worked out for each such centre. The overhead applied to each job is obtained by multiplying the overhead rate by the actual base variable spent on the job.

➤ **Completion of Jobs:**

Postings of direct material, direct labour, direct expenses and manufacturing overhead costs to the cost sheet for a job or production order are made periodically throughout the run of the job or order. The completion report is an indication that the manufacturing operations are over and further expenditure on the job should cease so that the cost sheet may be closed.

➤ **Work-in-Progress:**

The cost of an incomplete job i.e., a job on which some manufacturing processes or operations are still due before it can be made into the finished product is termed Work-in-Progress or Work-in-Process. If a production order has been only partly completed by the end of an accounting period, it is essential that the closing stock of the work-in-progress be determined.

➤ **Limitations of Job Costing:**

The limitations of job costing are:

- (a) Job costing is comparatively more expensive as more clerical work is involved in identifying each element of cost with specific departments and jobs.
- (b) With the increase in the clerical processes, chances of errors are enhanced.
- (c) The cost as ascertained, even where they are compiled very promptly, are historical as they are compiled after incidence.
- (d) The cost compiled under job costing system represents the cost incurred under actual conditions of operation. The system does not have any scientific basis.

➤ **Reports in Job Costing System:**

Report on profits on completed jobs:

A statement may be prepared monthly to indicate the gross profit earned on all jobs completed during the month. This statement is useful for the management for evaluating past performances. Net profit analysis may also be made in a similar manner if administration, selling and distribution overheads for the job are included in the statement.

➤ **Report on cost variances:**

If cost estimates are developed, a cost variance report showing the deviations of actual costs from the estimated costs may be prepared in order that significant differences may be brought to light and investigated. The report may be prepared separately for a job, or for a department showing the variances in respect of all jobs undertaken by the department during a period.

➤ **Illustrations:**

Illustration 1:

As a newly appointed Cost Accountant, you find that the selling price of Job No. 9669 has been calculated on the following basis:

Particulars	Rs.
Materials	12.08
Direct Wages – 22 hours at 25 paise per hour	5.50
Department:	
A – 10 hours,	
B – 4 hours	
C - 8 hours	
	17.58
Plus 33% on Prime Cost	5.86
	23.44

An analysis of the previous year's profit and loss account shows the following:

Particulars	Rs.	Particulars	Rs.
Materials Used	77,500	Factor y Overheads:	
Direct Wages:		A	2,500
A	5,000	B	4,000
B	6,000	C	1,000
C	4,000	Selling Cost	30,000

You are required to:

- (a) Draw up a Job Cost Cost;
- (b) Calculate and enter the revised costs using the previous year's figures as a basis.
- (c) Add to the total job cost 10% for profit and give the final selling price.

Solution:

In order to draw up a Job Cost Sheet; the factory overhead rates of different departments and percentage of selling cost will have to be determined first on the basis of the previous year's figures as follows;

Factory Overhead Rates:

Particulars	Department		
	A	B	C
	Rs.	Rs.	Rs.
Factory Overheads	2,500	4,000	1,000
Direct Labour Hours (D.W.* 4)	20,000	24,000	16,000
Factory Overhead Rates Per Hour	0.125	0.167	0.063

$$\text{Percentage of Selling Cost to Works Cost} = \frac{\text{Rs.30000}}{\text{Rs.1,00,000}} * 100 = 30\%.$$

Cost Sheet:

Job No.0007

Period

Particulars		Rs.
Material		12.08
Direct Wages:		
Dept. A	2.50	
Dept. B	1.00	
Dept. C	2.00	5.50
		17.58

Factory Overheads:		
Dept. A (10 hrs.@ Rs.0.125phr.)	1.25	
Dept.B (4 hrs.@ Rs.0.167 phr.)	0.67	
Dept.C (8 hrs.@ Rs.0.063 phr.)	0.50	2.42
Works Cost		20.00
Selling Cost (30% of Works Cost)		6.0
Cost Of Sales		26.00
Profit (10% on Cost)		2.60
SELLING PRICE		28.60

Illustration 2:

The data pertaining to Highfi Fabricators Ltd. using job costing technique; are as under at the end of 31-03-2019. Direct Materials Rs.9,00,000; Direct Labour Rs.7,50,000; Selling Overheads Rs.5,25,000; Administration Overheads Rs.4,20,000; Factory Overheads Rs.4,50,000 & Profit Rs.6,09,000.

From the above prepare:

- A Cost Sheet showing all the relevant details; and
- For the next year i.e. 2019-20; the factory has received a work order. It is estimated that the direct materials would amount to Rs.12,00,000 and direct labour Rs.7,50,000. You are requested to price the work order; if the factory desires to earn the same % of profit to sales as last year. However; the selling overheads have increased by 15%; the factory recovers factory overheads as a % to direct wages; and administration & selling overheads as a % of the works cost, considering the cost details of the previous year.

Solution:

(a) Cost Sheet for 2018-19:

Particulars	Rs.
Direct Materials	9,00,000
Direct Labour	7,50,000
Prime Cost	16,50,000

Factory Overheads (60% of Direct Labour)	4,50,000
Works Cost	21,00,000
Administration Overheads (20% of works cost)	4,20,000
Cost of Production (Office)	25,20,000
Selling Overheads (25% of works cost)	5,25,000
Cost of Sales	30,45,000
Profit (20% or 1/5 of Cost of Sales)	6,09,000
SALES.	36,54,000

(b) Estimated Price of the Work Order (2019-20)

Particulars	Rs.
Direct Materials	12,00,000
Direct Labour	7,50,000
Prime Cost	19,50,000
Factory Overheads (60% of Direct Labour)	4,50,000
Works Cost	24,00,000
Administration Overheads (20% of works cost)	4,80,000
Cost of Production (Office)	28,80,000
Selling Overheads (40% i.e.(25+15)% of works cost)	9,60,000
Cost of Sales	38,40,000
Profit (20% or 1/5 of Cost of Sales)	7,68,000
SALES.	46,08,000

Illustration No. 3 : The following information for the year ended December 31, 2018 is obtained from the books and records of a job order factory:

	Completed jobs Rs.	Work-in-progress Rs.
Raw Materials supplied from stores	90,000	30,000
Wages	1,00,000	40,000
Chargeable Expenses	10,000	4,000

Materials transferred to work-in-progress	2,000	2,000
Materials returned to stores	1,000	--

Factory Overheads are 80% of wages and office overheads are 25% of Factory Cost. The price of the executed Contracts during 2018 was Rs. 4,10,000. Prepare (i) Consolidated Completed Jobs Account showing the profit made or loss incurred, and also Consolidated Work-in-progress Account.

Solution :

Consolidated Completed Jobs Account for the Year ending 31-12-2018

Dr.

Cr.

		Rs.		Rs.
To Materials	90,000		By Sales	4,10,000
Less Transfer to W.I.P. 2,000				
Returned to stores <u>1,000</u>	3,000	87,000		
To Wages		1,00,000		
To Chargeable Expenses		10,000		
PRIME COST		1,97,000		
To Factory Overheads (80% of wages)		80,000		
FACTORY COST		2,77,000		
To Office Overheads (25% of factory cost)		69,250		
COST OF PRODUCTION		3,46,250		
To Net Profit		63,750		
		4,10,000		4,10,000

Consolidated Work-in-progress Accounting for the year ending 31-12-2018

Dr.

Cr.

	Rs.		Rs.
To Materials	30,000	By Balance c/d	1,35,000
Add : Transfer to W.I.P.	2,000		
To Wages	40,000		
To Chargeable Expenses	4,000		
PRIME COST	76,000		
To Factory Overheads (80% of wages)	32,000		
FACTORY COST	1,08,000		
To Office Overheads (25% of factory cost)	27,000		
COST OF PRODUCTION	1,35,000		
To Balance b/d	1,35,000		

Check Your Progress:

A. Multiple Choice Questions:

1. Job costing is used in
 - a. Furniture making
 - b. Repair shops
 - c. Printing press
 - d. All of the above
2. In a job cost system, costs are accumulated
 - a. On a monthly basis
 - b. By specific job
 - c. By department or process
 - d. By kind of material used
3. The most suitable cost system where the products differ in type of material and work performed is
 - a. Operating Costing
 - b. Job costing
 - c. Process costing
 - d. All of these.
4. Cost Price is not fixed in case of

- a. Cost plus contracts
 - b. Escalation clause
 - c. De-escalation clause
 - d. All of the above
5. Most of the expenses are direct in
- a. Job costing
 - b. Batch costing
 - c. Contact costing
 - d. None of the above

B. State whether the following statements are True or False:

1. Job costing is applied only in small concerns.
2. For every Job; the cost is different.
3. Target Costing is used for the purpose of control of Job Costs.
4. Motor Garages used Contract Costing for cost determination.
5. The cost of all Jobs is same.

C. Fill in the Blanks:

1. For different _____; the cost is different.
2. The concept of Cost-Plus Contracts is used in _____ Costing.
3. Repair Workshops use _____ Costing system.
4. _____ of cost is an important activity in Job Costing.
5. To identify costs, all _____ are given an unique identification number.

D. Match the following:

Column A		Column B	
1.	Job Costing	a.	Target Costing
2.	Controlling Job Costs.	b.	Automobile garages
3.	Calculation of Job Cost.	c.	Job costing
4.	Job costing is used in	d.	Different Costs.
5.	Under job order cost system, each job is assigned a number for identifying jobs.	e.	Unique Job Number.

2.2.2 Contract Costing:

The principles of job costing are applicable to contract costing. A separate account is kept for each individual contract or job undertaken for the purpose of determining the profit or loss under each. Contract costing is employed by such concerns as firms of builders, civil engineering contractors, mechanical engineering firms, etc.

One aspect of contract costing is that most of the cost can be allocated direct to contracts. Under job and other costing systems expenditure is normally allocated first to the cost centre and secondly to the individual jobs, the nature of contract costing is such that only allocation required is direct to the contract. Overheads are limited to head office and central storage cost forming a small percentage of total cost of contracts are recovered on some arbitrary basis such as percentage of wages, material or prime cost.

2.2.2.1 Meaning of Contract Costing:

Contract costing, also known as terminal costing, is a variant of job costing. Contract means a big job in which work is done at site and not in factory premises. The cost of each contract is ascertained. Thus, in this method of costing, each contract is a cost unit and an account is opened for each contract in the books of contractor to ascertain profit/loss thereon.

Contract Costing is the activity of determining the cost of Contract like Construction of a house, building, bridge, road, ship etc. Thus, all the elements that go into the execution or completion of a Contract are captured in such a way that they facilitate the compilation of the Contract Cost.

2.2.2.2 Features:

Since each Contract is unique in itself; like in Job Costing; each Contract has its own Cost. Thus, the activity of calculation of the cost of the Contract comprises of an elaborate system for tracking all material that is issued for a contract, material transferred from or to a contract, material returned from a contract, material lost/stolen/destroyed etc. Similarly, details of labour deployed are kept for facilitating calculation of labour cost. Elements of overheads are charged as per the corporate policy so as that each Contract has its own fare share of cost thereof. Special adjustments are required in respect of incomplete contracts, amount

carried to the Profit and Loss Account in respect of contracts in progress, valuation of WIP etc. In order to protect the interest of the Contractor executing the contract, specific terms are laid in Contracts viz. escalation clause, cost plus contracts etc. Therefore, it is understood that the contract costing usually shows the following features:

1. Contracts are generally of large size and, therefore, a contractor usually carries out a small number of contracts at a particular point of time.
2. A contract generally takes more than one year to complete,
3. Work on contracts is carried out at the site of contracts and not in factory premises.
4. Each contract undertaken is treated as a cost unit.
5. A separate contract account is prepared for each contract in the books of contractor to ascertain profit or loss on each contract.
6. Nearly all labour cost will be direct.
7. Most expenses (e.g., electricity, telephone, insurance, etc.) are also direct.
8. Specialist subcontractors may be employed for say, electrical fittings, welding work, glass work, etc.
9. Plant and equipment may be purchased for the contract or may be hired for the duration of the contract.

2.2.2.3 Accounting Procedure:

The usual heads under which costs of individual contract are collected are as under:

1. **Material:** All material issued to a particular Contract is charged to that particular contract directly. All returns and transfers are credited to that particular contract.
2. **Labour:** All labour that is specifically engaged on a particular contract is directly debited to the concerned contract as regards its rates and charges. Other indirect wages may be charged to each contract on some suitable basis.
3. **Expenses:** All expenses directly incurred for particular contracts are directly debited to it e.g. hire charges of particular machinery.

4. Depreciation on Plant and Machinery: In case of machinery used for contract work, there are two methods for charging depreciation on it to the contract: -
 - a. The contract is debited with the value of the machinery and when the work is completed credited with the sale proceeds of it in case it is sold or otherwise credited with the value of it by way of revaluation,
 - b. The particular contract account is debited only with the depreciation which is allocable to that particular contract.
5. Sub-Contract Charges: In case any work relating to a contract is sub-contracted, the charges for the same are debited to that particular Contract a/c.
6. Other Expenses and Accrued Charges: All other expenses related to a Contract are directly debited to it. In respect of outstanding charges, the same are debited to the concerned Contract A/c.

2.2.2.4 Retention Money:

After the completion of the contract, the asset created is handed over to the contractee for its fruitful usage. Many times, during the course of the usage certain problems arise like, leakage from the roof of a house/building constructed, cracks in the walls of the construction, wear out of the layers of the road built etc. In order to protect the contractee from such quality related issues, there is a practice of retaining part of the consideration of the contract with the contractee as a performance guarantee. This amount retained is called as Retention Money; and is normally kept with the contractee during the guarantee/warranty period; and after its elapse is returned back to the contractor.

2.2.2.5 Escalation Clause:

‘Contracts with Escalation Clause’ is a provision by virtue of which the contractor gets the actual increase in the cost as a percentage of the contract price initially agreed by him. This feature was introduced due to the time span over which the execution of the contract stretches; which makes an accurate estimation of the contract costs for quotation purpose very difficult. Besides, this clause comes to the rescue of the contractor in situations of war or political uncertainty when prices of material fluctuate wildly.

2.2.2.6 Work in Progress:

In case of incomplete Contracts, the amount that is to be taken to the Balance Sheet as Work in Progress would be either of the two:

1. First Method:
 - a. If there is profit, then the amount taken to the credit of P&L A/c is added to the Cost of Contract, and from this cash received on the Contract is deducted. This is WIP for B/S purpose, and
 - b. If there is a loss, the amount of loss is deducted from the Cost of Contract, and from it is deducted the cash received on the Contract. This is the WIP. Take examples showing the preparation of the Contract A/c and the amount of Profit and Loss figure.
2. Second Method: WIP for Balance Sheet = [Work Certified + Work Uncertified] - [P&L A/c Reserve A/c + Cash Received].

2.2.2.7 Cost Plus Contract:

In many cases it so happens that it becomes difficult to quote the exact price for a Contract. This may be due to the fact that a Contract is a special one, or one which was not executed in the past or the circumstances are changing so fast that a fair estimate of the Contract Cost is not possible e.g. political crisis, war etc. In such cases contractors take help of the 'cost-plus contract' clause due to which they get not only the actual cost incurred by them on the contract but also a fair margin of profit on it. For this it is necessary to have a prior agreement with respect to proof of actual expenses to be produced, agreed wastages etc. Its disadvantage is that it has no way of controlling inefficiency.

2.2.2.8 Preparation of Contract Account:

➤ Recording of Cost of Contract:

All costs are recorded against the individual contract. The recording procedure of the following items may be noted carefully:

- 1) **Materials:** Materials required for a specific contract is debited to that contract account. Materials returned under materials returned note is credited to that contract. Materials transferred from one contract to another are recorded in the

usual way. At the end of the accounting period the value of materials on site is a carried forward as a charge against the next period.

- 2) **Wages:** Wages of all workers engaged on a particular contract are allocated direct to that contract regardless the work they perform. Where workers move from one contract to another, time sheets must be maintained and wages may be distributed on the basis of time spent on each contract. The wages of head office and central stores is considered as overhead and are charged to contracts on some equitable basis.
- 3) **Expenses:** All expenses except material and wages are charged to individual contracts as and when they are incurred.
- 4) **Plant and Machinery:** For use of plant and machinery depreciation may be charged in any of the following ways,
 - (a) When the plant is required to be used for a long time, the total cost of asset is debited to the contract in which they are used. When contract is completed or the plant is no long required it may be sold at site and the contract is credited with sale proceeds. If it is not sold the contract is credited with depreciated value. This method has a drawback that the debit side is unnecessarily inflated with the plant value and cost of contract at first sight appears to be very high. In order to overcome this problem, the difference between the original cost at commencement and depreciated value at the end of the period is obtained and is charged to the contract concerned as plant depreciation.
 - (b) When plant is sent to the contract site only for short time the revaluation method just described is not satisfactory, and it is usual to charge the contract for the use on a daily or hourly basis.
- 5) **Sub Contracts:** Sub-contract costs are also debited to the Contract Account.
- 6) **Extra Work:** this forms a separate charge and where the amount involved is large, a subsidiary contract is generally entered into with the contractee.
- 7) **Accrued Charges:** all accrued charges should be debited to the contracts concerned at the end of the accounting period and carried forward in the next period.

➤ **Recording of Value of Profit of Contract:**

- (1) **Certificate of Work Done:** In large contracts it is usual for the contractor to obtain sums, time to time from the contractee. As the time proceeds the surveyor appointed by the contractee issues certificates to the effect that so much portion is completed. The contractor will get money according to this certificate. In some cases the terms of contract provide that the whole amount covered by the surveyor's certificate will not be paid, but a certain portion thereof shall be retained by the contractee called as retention money. On receipt of each certificate any one of the following accounting methods may be adopted:
- (a) Credits the appropriate contract accounts with the value mentioned in the certificate and debit the personal account of the contractee. Cash received is credited to the Contractor's A/c and the balance is shown as debtor representing retention money.
 - (b) Alternatively, the contract account is credited with the value of certificate and the contractee account is debited with the amount payable immediately and a Special Retention Money account is debited with the amount so retained.
- (2) **Profit on Uncompleted Contracts:** Where a contract is large enough to extend over years it is usual to credit a part of the profit to the P&L account each year. If any loss is detected the whole of the loss so detected should be debited to P&L account. Unless a portion of the profit on incomplete contract is taken, the accounts may show low profits in years when no major contract is completed and exceptionally high profits in the year in which contract is completed. In these circumstances it is prudent to transfer a conservative part of the estimated profit on large contracts at the end of the year.

The determination of the amount of profit and proportion of profit to be taken to P&L account depends upon the practice and circumstances of the case. The rules may be summarized as follows,

- A. When work of contract has not been reasonably advanced. No profit is taken into account.
- B. When work on contract has been reasonably advanced and covered by contractees certificate. In this case the notional profit is ascertained by

deducting the cost of contract covered by surveyors certificate from the value of contract certified by surveyor. A portion of this profit is taken to P&L account and the balance is carried forward in the same contract as profit in suspense as a provision against future losses, increase in cost and other contingencies. The amount of profit to be credited to P&L account is ascertained from this popular formula:

$$\frac{2}{3} \times \text{Notional Profit} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

Illustration:

Illustration No. 1:

From the following amount suggest the amount of profit that may be taken on Contract X which has been completed nearly 70%:

Rs.

Total cost of contract to date	383000
Cost of contract not yet certified	23000
Value of contract certified	420000
Cash received to date	378000

Solution:

As the contract has reasonably advanced but not complete, the following formula may be used :

$$\frac{2}{3} \times \text{Notional Profit} \times \frac{\text{Cash Received}}{\text{Work Certified}}$$

Now, value of contract certified to date	Rs. 420000
Cost of contract certified i.e. [(3,83,000-23,000)]	Rs. 360000
Notional profit	Rs. 60000

(cost of contract certified = total cost of contract to date – cost of contract not yet certified = Rs. 383000 – Rs. 23000 = Rs. 360000)

$$\frac{2}{3} \times 60000 \times \frac{378000}{420000} = \text{Rs. 36000}$$

C. **Where the Contract is almost Complete:** In this case the notional profit is determined by deducting the aggregate of costs to date and additional expenditure to complete the contract from the contract price. A proportion of this estimated total profit is credited to P&L account. This proportion is ascertained by adopting any one of the following formula :

- (a) Estimated total profit $\times \frac{\text{Value of work certified}}{\text{Contract price}}$
- (b) Estimated total profit $\times \frac{\text{Value of work certified}}{\text{Contract price}} \times \frac{\text{Cash received}}{\text{Work certified}}$
- (c) Estimated total profit $\times \frac{\text{Cost of work to date}}{\text{Estimated total cost}}$
- (d) Estimated total profit $\times \frac{\text{Cost of work to date}}{\text{Estimated total cost}} \times \frac{\text{Cash received}}{\text{Work certified}}$

Illustration No. 2:

From the following information suggest the profit to be taken on a contract which is 95% complete. Illustrate the different methods of computing profit and compare the profit, had it not been nearly complete.

Rs.

Total cost of contract to date	190000
Estimated additional expenditure (including Provision for contingencies)	10000
Contract price	250000
Value of contract certified	230000
Cost of work not certified	5000
Cash received	215000

Solution:

As the contract is almost complete, the calculation of profit may be made as follows,

Estimated profit	Rs.
Contract price	250000
Estimated total expenditure	<u>200000</u>

Estimated total profit 50000

- (a) Estimated total profit $\times \frac{\text{Value of work certified}}{\text{Contract price}}$
 $= 50000 \times \frac{230000}{25000} = \text{Rs. } 46000$
- (b) Estimated total profit $\times \frac{\text{Value of work certified}}{\text{Contract price}} \times \frac{\text{Cash received}}{\text{Work certified}}$
 $= 50000 \times \frac{230000}{250000} \times \frac{215000}{230000} = \text{Rs. } 43000$
- (c) Estimated total profit $\times \frac{\text{Cost of work to date}}{\text{Estimated total cost}}$
 $= 50000 \times \frac{190000}{200000} = \text{Rs. } 47500$
- (d) Estimated total profit $\times \frac{\text{Cost of work to date}}{\text{Estimated total cost}} \times \frac{\text{Cash received}}{\text{Work certified}}$
 $= 50000 \times \frac{190000}{200000} \times \frac{215000}{230000} = \text{Rs. } 44402 \text{ (approx)}$

Assuming the contract has reasonably advanced but not almost complete, the computation of profit to be taken as follows:

	Rs.
Value of contract certified	230000
Cost of contract certified i.e. ` 1,90,000 – ` 5,000	<u>185000</u>
Notional profit	<u>45000</u>

Profit to be taken to P&L a/c $= \frac{2}{3} \times 45000 \times \frac{215000}{230000} = \text{Rs. } 28043 \text{ (approx)}$

- (3) **Valuation of work in progress:** the best way of finding out amount of work in progress for Balance sheet purpose is to add profit taken to P&L a/c to cost of contract to date and from this aggregate cash received is deducted. If there is a loss in a contract the loss should be deducted from cost of contract to date and from the amount thus arrived at cash received is deducted. This balance represents work in progress.

➤ **Cost Plus Contract, Target Price Contract and Escalator Clause:**

Where the probable cost of contract cannot be computed in advance with a reasonable degree of accuracy, a cost-plus contract is generally adopted whereby the

contractor receives his total costs plus a profit, which may be a percentage of cost or fixed by reference to a scale which is definitely related to total cost. Such cost plus or lime and line contracts are undertaken for production of special articles not usually manufactured, e.g, production of newly designed aircraft component, or in case of urgent repair of ships, vehicles, power house etc, or in case of constructions during war time. From the manufacturers point of view, this type of contract protects him from the risk of fluctuations in market price of material, labour and other services. In order to avoid disputes in future, manufacturer must settle the admissible costs such as, supervision, fixed expenses and losses, such as allowances for scrap, wastage, normal loss etc. Moreover, it provides for the stipulations as to documents to be put in evidence to prove the claim of the contractor and steps to be taken for reconciliation of difference of opinion between the contractor and contractee as regards cost ascertainment. The customer usually reserves the right of cost audit but he does not mind to pay more if there is genuine rise in cost. This contract ensures that price paid will depend on cost rather than on arbitrary commitment to a specific price. However, this system puts a premium on inefficiency and there is no incentive to reduce cost. A variation of this type of costing is target costing whereby the contractor receives an agreed sum of profit over his predetermined costs. In addition, a figure is agreed as the target figure, and if actual costs are below this target the contractor is also entitled to a bonus which is a proportion of savings thus made. In order to avoid the element of risk from both sides there may be an escalator clause in the contract providing for change in the price of contract due to the change in the price of raw materials and labour or change in the utilization of factors of production. Thus, in a contract with transport undertaking, the price per ton mile will increase or decrease for each rise or fall of price of petrol by 10% of the prevailing price. Here the contractor has to produce sufficient proof of excess cost before the customer agrees to re-imburse such costs.

Illustration No. 3:

Construction ltd is engaged on two contracts D & E during the year. The following particulars are obtained at the year-end:

	Contract D	Contract E
Date of commencement	April 1 Rs.	September 1 Rs.

Contract price	600000	500000
Materials delivered direct to site	120000	50000
Materials issued from store	40000	10000
Materials returned to store	4000	2000
Materials on site December 31	22000	8000
Direct labour payments	140000	35000
Direct expense	60000	30000
Architects' fees	2000	1000
Establishment fees	25000	7000
Plant installed at cost	80000	70000
Value of plant December 31	65000	64000
Accrued wages December 31	10000	7000
Accrued expenses December 31	6000	5000
Cost of contract not yet certified	23000	10000
Value of contract certified by architect	420000	135000
Cash received from contractee	378000	125000

During the period, material amounting to Rs. 9000 has been transferred from contract D to contract E.

You are required to show;

- contract accounts, contractee's accounts
- Extract from the balance sheet as at December 31, clearly showing the calculation of work in progress.

Solution:

Contract D account

Dr.

Cr.

Particular	Rs.	Particular	Rs.
To Materials direct	120000	By Materials returned to stores	4000
To Materials ex store	40000	By Materials transferred to	9000

		Contract E	
To Wages paid	140000	By Stock of materials c/d	22000
To Direct expenses	60000	By Cost of contract c/d	383000
To Plant depreciation	15000		
To Architects fees	2000		
To Establishment charges	25000		
To Wages accrued, c/d	10000		
To Direct expenses accrued, c/d	6000		
	418000		418000
To Cost of contract b/d	383000	By Value of contract certified	420000
To P&L a/c profit taken	36000	By Cost of contract not yet certified c/d	23000
To Profit in suspense a/c c/d	24000		
	443000		443000
To Stock of materials b/d	22000	By Wages accrued b/d	10000
To Cost of contract not yet Certified b/d	23000	By Direct expenses accrued b/d	6000
		By Profit in suspense b/d	24000

Contractee Account (D)

Dr.

Cr.

Particular	Rs.	Particular	Rs.
To Value of work certified	420000	By Cash	378000
		By Balance c/d	42000
	420000		420000
To Balance b/d	42000		

Contractee account E

Dr.	Rs.	Cr.	Rs.
Particular		Particular	
To Value of work certified	135000	By Cash	125000
		By Balance c/d	10000
	135000		420000
To Balance b/d	10000		

Dr.	Rs.	Cr.	Rs.
Particular		Particular	
To Materials, direct	50000	By Materials returned to store	2000
To Materials, ex-store	10000	By Stock of materials c/d	8000
To Materials from contract D	9000	By Cost of contract c/d	150000
To Wages paid	35000		
To Direct expenses	30000		
To Plant depreciation	6000		
To Architects fees	1000		
To Establishment charges	7000		
To Wages accrued c/d	7000		
To Expenses accrued c/d	5000		
	160000		160000
To Cost of contract b/d	150000	By Value of contract certified	135000
		By Cost of contract not yet	

		certified c/d	10000
		By P&L a/c—loss on Contract	5000
	150000		150000
To Stock of materials b/d	8000	By Wages accrued b/d	7000
To Cost not yet certified b/d	10000	By Expenses accrued b/d	5000

Balance sheet as at December 31 (extract only for contracts)

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
P&L a/c			Fixed assets:		
Profit of D	36000		Plant at cost	150000	
Loss of E	5000		Depreciation	21000	
		31000			129000
Sundry creditors			Current assets:		
Wages accrued	17000		Stock of materials	30000	
Expenses accrued	11000		Work in progress	61000	
		28000			91000

Calculation of work in progress	Rs.	Rs.
Contract D-		
Cost of contract to date	383000	
Add profit taken	36000	419000
Less cash received	378000	
		41000
Contract E.		
Cost of contract to date	150000	
Less loss incurred	5000	145000
Less cash received	125000	20000
Total work in progress		61000

Note: profit calculation of contract D:

$$\frac{2}{3} \times \text{Notional profit} \times \frac{\text{cash received}}{\text{value of work certified}}$$

$$= \frac{2}{3} \times 60000 \times \frac{378000}{420000} = \text{Rs. } 36000$$

Note: the method described just now is very popular and is helpful to students in answering questions. However, the following modified method is also extensively used by many contractors:

Illustration No. 4:

Assuming the same figures in respect of contract D of the problem above, prepare the contract accounts to show the position at December 31, retaining an adequate provision against possible losses before final acceptance of the contract.

Solution:

Contract D account

Dr.	Rs.	Cr.	Rs.
To Materials, direct	120000	By Materials returned to store	4000
To Materials, ex-store	40000	By Materials tfd to contract E	9000
To Wages paid	140000	By Stock of materials c/d	22000
To Direct expenses	60000	By Cost of contract not certified c/d	23000
To Plant depreciation	15000	By cost of contract certified up to date c/d	360000
	418000		418000
To Cost of contract certified b/d	360000	By Wages accrued b/d	10000
To Cost of contract not certified b/d	23000	By Direct expenses accrued b/d	6000
To Stock of material b/d	22000		

Contract D certificate account

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Balance c/d	420000	By Certificates up to date	420000
	420000		420000

Contract D retentions account

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Certificate account	42000	By Certificates up to date	420000

Contractee account (D)

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Certificate account	378000	By Cash at bank	378000

Contract D profit provision account

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Transfer to P&L a/c	36000	By Provision c/d	36000
	36000		36000
Balance b/d	36000		

N.B. the balance sheet position will remain the same.

Illustration No. 5 : The BBA Construction Company undertakes large contracts. The following particulars related to contract No. 125 carried out during the year ended on 31st March, 2015.

Particulars	Rs.	Particulars	Rs.
Work certified by architect	1,43,000	Wages accrued on 31 st March 2015	1,8000
Cost of work not certified	3,400	Direct expenditure	2,400
Plant installed at site	11,300	Materials on hand on 31 st March 2015	1,400
Value of plant on 31 st March 2015	8,200	Materials returned to store	400
Materials sent to site	64,500	Direct expenditure accrued on 31 st March 2015	200
Labour	54,800	Contract price	2,00,000
Establishment charge	3,250	Cash received from contractee	1,30,000

Prepare a Contract Account for the period ending 31st March 2015 and find out the profit. It was decided to transfer 2/3 of the profit on cash basis to Profit and Loss Account.

Solution :

Contract No. 125 Account for the year ending 31st March, 2015

Particulars	Rs.	Particulars	Rs.
To Materials sent to site	64,500	By Materials returned	400
To Labour	54,800	By Materials in hand	1,400
To Establishment charge	3,250	By Work-in-Progress:	
To Direct expenses	2,400	Certified	1,43,000
To Wages accrued	1,800	Uncertified	3,400
To Direct expenses accrued	200	By Plant at site	8,200

To Plant at site	11,300		
To Notional Profit c/d	18,150		
	1,56,400		1,56,400
To P & L A/c	11,000	By Notional Profit b/d	18,150
(18,150 x 2/3) x (1,30,000/1,43,000)			
To Reserve	7,150		
	18,150		18,150

Illustration No. 6 :

Simplex Construction Ltd. Agreed to take a contract for construction of a bridge on 01.07.2017. The contract price was Rs. 5,00,000. The company incurred following expenses up to 31.12.2017.

Particulars	Rs.
Materials consumed	1,10,000
Wages	40,000
Direct expenses	20,000
Plant purchased on 01.07.2017	1,00,000
Materials in hand on 31.12.2017	5,000

Additional information :

- * Depreciation on plant @10% per annum.
- * Charge other works expenses @20% of wages & office expenses @10% of works cost.
- * The amount certified by the contractee's engineer was Rs. 3,00,000, retention money being 20% of the certified value.

Prepare Contract A/c showing the amount of profit that the company can reasonably take to its P/L A/c.

Solution :

Simplex Construction Ltd.

Contract No. 126 Account for the year ending 31st March, 2015

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
31.12.2017		31.12.2017	
To Materials consumed	1,10,000	By Work-in-progress c/d (value of work certified)	3,00,000
To wages	40,000		
To direct expenses	20,000		
To depreciation on plant (6 months)	5,000		
To other works expenses (20% on wages)	8,000		
Works Cost	1,83,000		
To office expenses (10% on works cost)	18,300		
	2,01,300		
To Profit & Loss A/c (profit transferred) (WN:1)	52,640		
To Work-in-progress c/d (provision)	46,060		
	3,00,000		3,00,000
01.01.2018			
To Work-in-progress b/d: Value of certified work 3,00,000			
Less : Provision 46,060	2,53,940		

Working Notes:

1. Proportion of profit to be transferred to Profit & Loss A/c:

Accounting profit : Rs. (3,00,000 – 2,01,300) = Rs. 98,700

Profit on realized basis : 80% of Rs. 98,700 = 78,960

Proportion to be transferred to P/L A/c : 2/3 of Rs. 78,960 = Rs. 52,640

Illustration No. 7 :

S Ltd. Furnished the following information in respect of incomplete contract as on 31.3.2016.

Particulars	Contract A (Rs.)	Contract B (Rs.)
Contract Price	2,40,000	1,50,000
Work certified	2,16,000	1,00,000
Estimated cost of completion of contract	2,10,000	1,20,000
Cash received	1,16,000	80,000
Uncertified Work	10,000	7,000
Cost of contract (expenditure incurred up to 31.3.16)	1,80,000	95,000

Calculate the profit to be carried to P/L A/c for the year ended 31.3.16

Solution :

P Ltd.

Contract No. 127 Account for the year ending 31st March, 2015

Dr.

Cr.

Particulars	A	B	Particulars	A	B
To cost of contract	1,80,000	95,000	By works certified	2,16,000	1,00,000
To Notional profit c/d	46,000	12,000	By works uncertified	10,000	7,000
	2,26,000	1,07,000		2,26,000	1,07,000
To P/L A/c (WN:1)	22,716	6,400	By Notional profit b/d	46,000	12,000
To Reserve	23,284	5,600			
	46,000	12,000		46,000	12,000

Working Notes :

1. Proportion of profit to be transferred to Profit & Loss A/c:

$$\text{Accounting Profit} \times \frac{(\text{cash received})}{(\text{work certified})} \times \frac{2}{3}$$

Contract A :

$$46,000 \times \frac{1,60,000}{2,16,000} \times \frac{2}{3} = \text{Rs. } 22,716$$

Contract B :

$$12,000 \times \frac{80,000}{1,00,000} \times \frac{2}{3} = \text{Rs. } 6,400$$

Illustration 8 :

The following was the expenditure on a contract for Rs. 6,00,000

Particulars	Amount
Material	1,20,000
Wages	1,64,000
Plant	20,000
Overheads	8,600

Cash received on account of the contract was Rs. 2,40,000 being 80% of the work certified. The Value of material in hand was Rs. 10,000. The plant has undergone 20% depreciation.

Solution :**Dr.****Contract Account****Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Materials	1,20,000	By Material in hand	10,000
To Wages	1,64,000	By Plant on hand	16,000
To Plant	20,000	By Work-in-Progress	
To Overheads	8,600	Work Certified	3,00,000

To Notional Profit	13,400	(2,40,000x100/80)	
	3,26,000		3,26,000
To Profit and Loss A/c	7,147	By Notional Profit b/d	13,400
To Work-in-Progress	6,253		
	13,400		13,400

Illustration 9 :

The following is the condensed record of the transactions as on 31st December 2014 relating to special contract completed during the year.

Material bought from market	Rs. 1,500
Materials issued from the stores	Rs. 500
Wages	Rs. 2,440
Direct expenses	Rs. 294
Work on cost 25% of direct wages	
Office on cost 10% of prime cost	
Contract price	Rs. 6,000

You are required to prepare a contract account keeping in view that the material returned amounted to Rs. 240.

Solution :

Dr.

Contract Account

Cr.

Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
To Materials			By Material Returned		240
Purchased	1,500		By Contractee's Account		6,000
Issued from store	<u>500</u>	2,000			
To Wages		2,440			
To Direct Expenses		294			
To Work on Cost		610			

(2,440x25/100)		
To Office on Cost	450	
(10% of Rs. 4,494)		
To Profit and Loss A/c	446	
	6,240	6,240

Note:

1. Prime cost = (1,500 + 500 + 2,440 + 294) = -240 = Rs. 4,494
2. Since the contract has been completed in the first year itself hence, no reserve is required. The entire excess of credit in contract account called Notional Profit has been credited to the Profit & Loss A/c.

➤ **Check Your Progress:**

A. Multiple Choice Questions:

1. Contract Costing is used in
 - a. Paint Industry
 - b. Chemical Industry
 - c. Road Construction
 - d. Refinery.
2. In contract costing; costs are accumulated___
 - a. Yearwise
 - b. Quarterwise
 - c. Halfyearly
 - d. Contractwise.
3. Contract Costing while assessing the profit on incomplete uses the concept of
 - a. Total Profit
 - b. Super Profit
 - c. Notional Profit
 - d. Allocated Profit.
4. Contract Costing has its root in
 - a. Job Costing
 - b. Process Costing
 - c. Unit Costing
 - d. Target Costing.
5. Contracts with escalation clause become a necessity in
 - a. Normal times
 - b. Political uncertainty

c. Routine Activities

d. Construction Industry.

B. State Whether True or False:

1. All contracts are signed with an escalation clause.
2. Usually, all contracts conclude within one year.
3. Retention Money is an essential feature of a Contract.
4. When work on a contract has not substantially advanced, no amount of unrealized profit is credited to the Profit & Loss Account.
5. Notional Profit is the difference between the sum total of Work Completed & Certified + Work Completed but uncertified; and the Cost of Contract.

C. Fill in the Blanks:

1. Ship Builders use the concept of ____ costing in calculations of costs.
2. To protect the Contractor from unexpected increase in costs, contracts have an ____ clause.
3. Return of material is shown on the ____ side of the Contract Account.
4. Valuation of WIP becomes a necessity in case of ____ Contracts.
5. An architect's certificate is available in respect of ____.

D. Match the following:

Column A	Column B
1. Contract Costing.	a. Control of Costs.
2. Target Costing.	b. To guarantee quality of work.
3. Work In Process	c. Balance Sheet.
4. Retention Money.	d. Payment towards contract.
5. Contractee.	e. Construction of Houses.

2.3 Summary:

From the overall discussion it is understood that a Job refers to any specific assignment, contract or work order wherein work is executed as per customer's specific requirements. The output of the job generally consists of one unit or a

manageable number of units. Ascertainment of cost of each Job is called Job Costing. Job Costing is an attempt to calculate the cost of nonstandard, non-routine jobs. Furthermore, Contract Costing approaches the problems faced by contractors in the execution of contracts which spill over more than on accounting period. Contract costing, also known as terminal costing, is a variant of job costing. Contract means a big job in which work is done at site and not in factory premises. The cost of each contract is ascertained. Thus, in this method of costing, each contract is a cost unit and an account is opened for each contract in the books of contractor to ascertain profit/loss thereon.

2.4 Terms to Remember:

- **Job Costing:** Specific order costing involving accumulation of costs relating to a single cost unit-the 'job' - when each order is of comparatively short duration. It is also called job order costing.
- **Job Cost Sheet:** A statement showing cost and profit relating to a specific job a batch or a contract.
- **Contract Costing:** That form of specific order costing which applies where work is undertaken as per customer's special requirement.
- **Notional Profit:** it is an apparent profit.
- **Escalation:** increase/rise in an activity
- **Target Costing:** a bench mark for completion of a contract.
- **Retention Money:** amount kept towards assurance of quality of work executed.
- **Cost plus Contracts:** a condition which guarantees a contractor a fare consideration.

2.5 Answers to Check Your Progress:

Session A:

- A. Ans: d, b, b, a, c
- B. Ans: 1. False, 2. True, 3. True, 4. False, 5. False
- C. Ans: 1. Jobs, 2. Job, 3. Job, 4. Estimation, 4. Jobs
- D. Ans: 1-D, 2-A, 3-E, 4-B, 5-C.

Session B:

- A. Ans: c, d, c, a, b
- B. Ans.1. False, 2. False, 3. True, 4. True, 5. True
- C. Ans. 1. Contract, 2. Escalation, 3. Credit, 4. Incomplete, 5. Work Completed
- D. Ans.1-5, 2-1, 3-3, 4-2, 5-4

2.6 Exercise:

1. Define Job Costing and describe its essential features.
2. What is job costing? Explain the objectives of job costing.
3. What is job costing? Enumerate the objectives, features, advantages and disadvantages of job order costing system.
4. What is contract costing? Explain briefly the distinguishing features of contract costing.
5. Explain the term work certified.
6. Write short notes on:
 - (a) Cost plus contract
 - (b) Work certified
 - (c) Work uncertified
7. Contracts have their basis in Job Costing. Explain this sentence and give the essential features of Contract Costing.
8. A work order for 100 units of a commodity has to pass through four different machines of which the machine hour rates are: Machine P – Rs. 1.25, Machine Q – Rs. 2.50, Machine R – Rs. 3 and Machine S – Rs. 2.25 Following expenses have been incurred on the work order – Materials ` 8,000 and Wages ` 500. Machine - P has been engaged for 200 hours. Machine - Q for 160 hours, Machine - R for 240 hours and Machine - S for 132 hours. After the work order has been completed, materials worth ` 400 are found to be surplus and are returned to stores. Office overhead used to be 40% of works costs, but on account of all-round rise in the cost of administration, distribution and sale, there has been a 50% rise in the office overhead expenditure. Moreover, it is

known that 10% of production will have to be scrapped as not being upto the specification and the sale proceeds of the scrapped output will be only 5% of the cost of sale. If the manufacturer wants to make a profit of 20% on the total cost of the work order, find out the selling price of a unit of commodity ready for sale.

9. The data pertaining to Heavy Engineering Ltd. using are as follows at the end of 31.3.2017. Direct material Rs. 9,00,000; Direct wages Rs. 7,50,000; Selling and distribution overhead Rs.5,25,000; Administrative overhead Rs. 4,20,000, Factory overhead Rs.4,50,000 and Profit Rs. 6,09,000. (a) Prepare a cost sheet showing all the details. (b) For 2012-13, the factory has received a work order. It is estimated that the direct materials would be Rs. 12,00,000 and direct labour cost Rs. 7,50,000. What would be the price of work order if the factory intends to earn the same rate of profit on sales, assuming that the selling and distribution overhead has gone up by 15%? The factory recovers factory overhead as a percentage of direct wages and administrative and selling and distribution overheads as a percentage of works cost, based on the cost rates prevalent in the previous year.
10. A firm of Builders, carrying out large contracts kept in contract ledger, separate accounts for each contract on 30th June, 2017, the following were shown as being the expenditure in connection with Contract No. 555.

Materials purchased Rs.1,16,126 Materials issued from stores Rs.19,570
Plant, which has been used on other contracts Rs. 25,046 Additional plant Rs.
7,220 Wages Rs.1,47,268 Direct expenses Rs.4,052 Proportionate establishment
expenses 17,440

The contract which had commenced on 1st February, 2017 was for Rs.6,00,000 and the amount certified by the Architect, after deduction of 20% retention money, was Rs. 2,41,600 the work being certified on 30th June, 2017. The materials on site were Rs.19,716. A contract plant ledger was also kept in which depreciation was dealt with monthly the amount debited in respect of that account is Rs. 2260. Prepare Contract Account showing profit on the contract.

11. A contractor commenced the work on a particular contract on 1st April, 2016 he usually closes his books of accounts for the year on 31st December of each year.

The following information is revealed from his costing records on 31st December, 2016.

Materials sent to site Rs. 43,000 Jr. Engineer Rs. 12,620 Labour Rs. 1,00,220 A machine costing Rs. 30,000 remained in use on site for 1/5th of year. Its working life was estimated at 5 years and scrap value at Rs. 2,000 A supervisor is paid Rs. 2,000 per month and had devoted one half of his time on the contract. All other expenses were Rs.14,000 the materials on site were Rs. 2,500. The contract price was Rs. 4,00,000. On 31st December, 2016 2/3rd of the contract was completed however, the architect gave certificate only for Rs. 2,00,000. On which 80% was paid. Prepare Contract Account.

12. XY Ltd undertook a contract, the following was the expenditure on a contract for Rs. 3,00,000

Material issued to contract	Rs. 51,000
Plant issued for contract	Rs. 15,000
Wages	Rs. 81,000
Other expenses	Rs. 5,000

Cash received on account of contract up to 31st March, 2014 amounted to Rs. 1,28,000 being 80% of work certified. Of the plant and material charged to the contract plant costing Rs. 1,500 and material costing Rs. 2,000 were lost. On 1st March 2014, plant which cost Rs. 1,000 was returned to the store, the cost of work done but not certified was Rs. 1,500 and material costing Rs. 1,250 were in hand on site. Provide 10% depreciation on plant, reserve 1/3 of profit received and prepare contract account from the above particulars.

13. Mr. A has undertaken several contract works. He maintains a separate record for each contract. From the records for the year ending 31-12-14, prepare contract account for Contract No. 50 and find the amount transferred to profit and loss account.

	Rs.
Direct purchase of material	90,000
Material issued from stores	25,000

Wages	1,22,000
Direct expenses	12,000
Machinery purchased	80,000
Establishment charges	27,000

The contract price was Rs. 7,50,000. Cash received up to 31-12-2008 was Rs. 3,00,000 which is 80% of work certified. Material at site Rs. 8,000. Depreciation for Machine Rs. 8,000.

2.7 References for Further Study:

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Unit-3

Process Costing and Service Costing

Index :

3.0 Objectives

3.1 Introduction

3.2 Presentation of Subject Matter

3.2.1 Process Costing

3.2.1.1 Meaning and Definition

3.2.1.2 Application of Process Costing

3.2.1.3 Concept of Equivalent Production

3.2.1.4 Preparation of Process Accounts

3.2.1.5 Concepts of Joint Products and By Products

3.2.2 Service Costing

3.2.2.1 Meaning and Definition

3.2.2.2 Application of Service Costing

3.2.2.3 Determination of Service Cost in Transport Industry

3.3 Summary

3.4 Terms to Remember

3.5 Answers to Check Your Progress

3.6 Exercise

3.7 References for Further Study

3.0 Objectives:

After studying this unit, students will be able:

1. To know the meaning of Process Costing and its importance.
2. To understand the accounting procedure of process costing including normal loss and abnormal loss (or) gain.
3. To acquire knowledge for determination of services in view of the growing importance of the Service Sector in the Indian Economy.
4. To understand the concept of Operating or Service Costing in enabling the determination of cost units in various service scenarios; and the calculation of costs thereof.

3.1 Introduction:

Process costing is used when there is mass production of similar products, where the costs associated with individual units of output cannot be differentiated from each other. In other words, the cost of each product produced is assumed to be the same as the cost of every other product. Process Costing refers to a method of accumulating cost of production by process. It represents a method of cost procedure applicable to continuous or mass production industries producing standard products. Costs are compiled for each process or department by preparing a separate account for each process. Process costing can be applied in chemical works, oil refining, food manufacturing, paint works, canning, textiles, paper, dairy, sugar, bakeries, breweries, mining industries, public utility services etc. When a product is manufactured through various processes, the output of each process is transferred to the subsequent process and that of the last process is transferred to the finished stock. Process Costing is an attempt to arrive at the cost of products which by the very nature of the material and the consequent activity involved are required to pass through various stages called as processes before the final product emerges. Here the cost units involved are homogeneous and hence costs are identical. In view of this Process Costing is said to be applying the basic principles of Unit Costing. Since Processes involve losses and there can be a situation when part of the input may be under process; special adjustments/treatment is required to be given in order to arrive at the cost of the cost units.

Moreover, Service Costing or operation costing is normally used in service sector. It is a method of costing applied to undertakings which provide services rather

than production of commodities. Service may be performed internally and externally. The term service costing or operating costing refers to the computation of the total operational cost incurred on each unit of the intangible product. These intangible products or services can be either in the form of internal services that are carried out by industries as supporting activities for the manufacturing of goods. Or in the way of external services that are offered as a significant product to the customers by the service sector companies. Service costing is an essential concept since every service organization needs to ascertain its business overheads. It is to ensure fair pricing of the products, i.e., services; and for keeping a control over its fixed and variable costs.

3.2 Presentation of Subject Matter:

3.2.1 Process Costing:

Process costing refers to costing of one or more processes involved while converting a raw material into finished output. Process costing is usually employed in paint works, chemical plants, food manufacturing, oil refining, paper mills, textile mills, canning, dairy etc. this method is applied where it is not possible to trace the items of prime cost to a particular order, because its identity is lost in the volume of continuous production. In oil refining factory, for example we cannot trace the prime cost of a specific order for, say, 200 liters of refined oil where thousands of liters of oil are being produced at the same time. Accordingly, the procedure would be to divide the cost of production during a certain period by the total number of liters produced during the period in order to ascertain the cost per liter of oil.

In deciding the costing system to be adopted in an industry, consideration must be given to the nature of industry, the method of production and the nature and variety of goods produced. In general job costing is suitable where the goods are made to customers' orders, production is intermittent and customers' orders can be identified in the volume of production. On the other hand, process costing is suitably employed where goods are made for stock and production is continuous, or goods although made to customers order are owing to continuous nature of production, lost sight of in the volume of production.

The fundamental principles of process costing are:

- (a) cost of materials, wages and expenses are collected for each operation or process in a period.

- (b) Adequate records are kept in respect of output and scrap of each operation or process during the period.
- (c) The cost per finished output of each process is obtained by dividing the total cost incurred during a period by the number of units produced during that period after giving due regard to losses and amount recovered from scrap.
- (d) As products pass from one process to another the accumulated cost of output of a process is transferred to the next process just like raw materials of that process.
- (e) Computation of process cost on the basis the above fundamental principles is easy where there is neither any WIP at various stages of completion nor any process loss. However, existence of WIP & process loss is very common & as a result of which the problems met by a cost accountant in relation to process costing are –
- (f) Normal & abnormal process losses or gains.
- (g) Opening & closing WIP at various stages of completion as regards material, labour & overhead. Moreover, there may be process losses or gains.
- (h) Inter process profits.

3.2.1.1 Meaning and Definition:

Process costing is that aspect of operation costing which is used to ascertain the cost of the product at each process or stage of manufacture. This method of accounting used in industries where the process of manufacture is divided into two or more processes. The objective is to find out the total cost of the process and the unit cost of the process for each and every process. Usually, the industries where process costing used are textile, oil industries, cement, pharmaceutical etc.

3.2.1.2 Application of Process Costing:

Process Costing principles are applied in all those industries where the raw material is required to pass through various processes before the final/finished product comes into being. Thus, gainful employment of Process Costing is observed in Oil Refineries, Sugar Factories, Chemical Manufacturing Units, Fertilizer Plants, Pharmaceutical Units etc.

3.2.1.3 Concept of Equivalent Production:

This represents the production of a process in terms of completed units. In other words, it means converting the incomplete production units into its equivalent of complete units. In each process an estimate is made of the percentage completion of any work-in-progress. A production schedule and a cost schedule will then be prepared. The work-in-progress is inspected and an estimate is made of the degree of completion, usually on a percentage basis. It is most important that this estimate is as accurate as possible because a mistake at this stage would affect the stock valuation used in the preparation of final accounts. The formula for equivalent production is: $\text{Equivalent units of work-in-progress} = \text{Actual no. of units in process of manufacture} \times \text{Percentage of work completed}$ For example, if 20% work has been done on the average of 1,000 units still in process, then 1,000 such units will be equal to 200 completed units. The cost of work-in-progress will be equal to 200 completed units. Calculation of Equivalent Production: The following steps are worth noting in its calculation: (a) State the opening work-in-progress in equivalent completed units by applying the percentage of work needed to complete the unfinished work of the previous period. If the opening work-in-progress is 100 units which is 40 percent completed, then the equivalent units of this will be $100 \times 60\%$ i.e. 60 units. (b) Add to (a), the number of units started and completed during the period. This can be found out by deducting the units in the closing work-in-progress from the number of units put into the process. (c) Add to the above, the equivalent completed units of closing work-in-progress. This can be found out by applying the percentage of work done on the finished units at the end of the period. There are mainly three methods of calculating cost per unit, out of which FIFO method and Weighted Average Method is used in equivalent production.

3.2.1.4 Preparation of Process Accounts:

Recording Of Cost Under Process Costing

The factory is divided into distinct processes or operations & an account is kept for each process, to which are debited all costs of materials, labour & overhead.

- (1) **Material:** Raw materials required for each process are drawn from stores by the issue of material requisitions. Where materials are issued in bulk, the department in charge of the process should intimate the quantity of such materials consumed during a particular period. With the help of these data the cost of raw materials

are debited to process concerned.

- (2) **Labour:** Wages paid to workmen & supervisory staff engaged in particular process are allocated to the process. Where, workers are engaged in more than one process, the gross wages are distributed to different process on basis of time spent.
- (3) **Direct expenses :** Expenses such as cost of electricity, depreciation & hire charges of equipments are determined easily for each process & allocated to the process concerned.
- (4) **Overhead:** Where expenses are incurred for two or more process the total of such expenses may be apportioned to different process on a suitable basis. Sometimes overhead is recovered at predetermined rate based on direct wages, prime cost, etc.

A. Process Costing having No Process Loss:

The procedure of keeping process cost accounts where there is no process loss is very simple & presents no difficulty. All materials, wages & overheads are debited to the process concerned, while the accumulated costs are transferred to the next process as raw materials of that process.

ILLUSTRATION:

Illustration 1:

Product Z is produced after three distinct processes. The following information is obtained from the accounts of a period -

Items	Total Rs.	Process - 1 Rs.	Process -2 Rs.	Process - 3 Rs.
Direct material	2200	1800	300	100
Direct wages	400	100	200	100
Direct expenses	500	300	---	200

Production overhead incurred is Rs. 800 & is recovered on 200% of direct wages. Production during the period was 100kg there were no opening or closing stocks. Prepare process cost accounts.

Solution:

Weekending

Process – 1 Account: Output–100kg.

Dr

Cr

Particular	Cost per kg. (Rs)	Amount (Rs)	Particular	Cost per kg. (Rs)	Amount (Rs)
To Direct material	18	1800	By Output transferred to process -2	24	2400
To Direct material	1	100			
To Direct wages	3	300			
To Prod. overhead	2	200			
	24	2400		24	2400

Process- 2 Account: Output–100kg.

Dr

Cr

Particular	Cost per kg. (Rs)	Amount (Rs)	Particular	Cost per kg. (Rs)	Amount (Rs)
To Output from Process-1	24	2400	By Output transferred to process - 3	33	3300
To Direct material	3	300			
To Direct wages	2	200			
To Prod. overhead	4	400			
	33	3300		33	3300

Process – 3 Account: Output–100kg.

Dr

Cr

Particular	Cost per kg. (Rs)	Amount (Rs)	Particular	Cost per kg.	Amount
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				(Rs)	(Rs)
To Output from Process-2	33	3300	By Output transferred to Process Finished Stock	39	3900
To Direct material	1	100			
To Direct wages	1	100			
To Direct Expenses	2	200			
To Prod.overhead	2	200			
	39	3300		39	3900

Illustration 2 :

A product passes through three processes to completion. These processes are Process A, Process B and Process C respectively. During the week ending 30th June 2015, 2000 units are produced. The following information is obtained.

	Process A (Rs.)	Process B (Rs.)	Process C (Rs.)
Material	12,000	6,000	4,000
Labour	10,000	8,000	10,000
Direct expenses	2,000	400	2,000

The indirect expenses for the period were Rs. 5,600 apportioned to the process on the basis of labour cost. Prepare process account showing total cost and cost per unit.

Solution :

Dr. **Process A Account (Output 2000 Units)** Cr.

Particulars	Total (Rs.)	Per unit (Rs.)	Particulars	Total (Rs.)	Per unit (Rs.)
To Materials	12,000	6	By output transferred to Process B	26,000	13
To Labour	10,000	5			
To Direct expenses	2,000	1			

To Indirect expenses	2,000	1			
	26,000	13		26,000	13

$$\begin{aligned} \text{Indirect expenses as a percentage of labour} &= \frac{5,600}{10,000+8,000+10,000} \times 100 \\ &= \frac{5,600}{28,000} \times 100 \\ &= 20\% \end{aligned}$$

Dr. **Process B Account (Output 2000 Units)** Cr.

Particulars	Total (Rs.)	Per unit (Rs.)	Particulars	Total (Rs.)	Per unit (Rs.)
To Process A (Tfr.)	26,000	13	By output	42,000	21
To Materials	6,000	3	transferred to		
To Labour	8,000	4	Process B		
To Direct expenses	400	0.20			
To Indirect expenses	1,600	0.8			
	32,000	21		42,000	21

Dr. **Process C Account (Output 2000 Units)** Cr.

Particulars	Total (Rs.)	Per unit (Rs.)	Particulars	Total (Rs.)	Per unit (Rs.)
To Process A (Tfr.)	42,000	21	By output	60,000	30
To Materials	4,000	2	transferred to		
To Labour	10,000	5	Finished Stock		
To Direct expenses	2,000	1			
To Indirect expenses	2,000	1			
	60,000	30		60,000	30

B) Process Costing Having Process Loss (Normal Loss, Abnormal Loss & Abnormal Gains):

In the previous illustration it was assumed that there was no loss, scrap or wastage. However, some loss, scrap or wastage is inevitable in process industries. If

the loss is inevitable & within limit, it is called normal process loss. Where the loss is caused by unexpected or abnormal conditions, such as sub standard materials, bad design, etc, it is called abnormal process loss. The treatment of normal & abnormal losses differ in process accounts. All normal losses should be absorbed by good units produced, whereas abnormal losses should be valued just like good units & transferred to a separate abnormal loss account. The cause of such abnormal losses is detected for control purposes and the amount is charged to P&L account. Where the normal loss represented by scrap has some realizable value, the process account is credited with the amount realized from sale of normal scrap. The relevant process account is credited & abnormal loss account is debited with abnormal loss valued at full cost of finished output. The abnormal loss, if represented by scrap, may have similar realizable value. The amount realized from sale of scrap represented abnormal loss is credited to the abnormal loss account & the balance in the abnormal loss account is transferred to costing P&L a/c. Where however, the loss is less than the normal loss expected, we may assume that there is an abnormal gain. The abnormal gain is valued in the same manner as abnormal loss & is credited to abnormal gain account. The amount of scrap which would otherwise have been realized had there been normal loss & no abnormal gain is debited to abnormal gain account & balance is credited to costing P&L a/c.

In valuing the cost per finished output, we require the following data:

- a. Normal production, i.e. input less normal loss.
- b. Normal cost of production i.e. all costs incurred less the amount realized from normal scrap only.

The ratio b/a is the cost per output. The rate is applied in valuing abnormal gain or loss as well as finished output. The following illustration explains the treatment of normal & abnormal losses as well as abnormal gains:

Illustration 3:

Product Y is produced after three distinct processes. The following information is obtained from the accounts of a period-

Items	Total Rs.	Process - 1 (Rs.)	Process - 2 (Rs.)	Process - 3 (Rs.)
Direct material	7542	2600	1980	2962

Direct wages	9000	2000	3000	4000
Production Overhead	9000	---	---	---

1000 units at Rs. 3 each were introduced to process 1. there was no stock materials or WIP at the beginning or end of the period. The output of each process passes direct to the next process & finally to finished stores. Production overhead is recovered on 100% of direct wages. The following additional data is obtained –

Process	Output during the week	% of Normal loss to Input	Value of Scrap Per unit
1	950	5%	Rs. 2
2	840	10%	Rs. 4
3	750	15%	Rs. 5

Prepare process cost accounts & abnormal gain or loss accounts.

Solution:

Week ending

Process - 1 Account: Output – 950 unit

Dr

Cr

Particular	Units	Cost per kg. (Rs)	Amount (Rs)	Particular	Units	Cost per kg. (Rs)	Amount (Rs)
To units introduced	1000	3	3000	By Normal loss	50	2	100
direct material							
direct wages							
prod. overhead							
Direct material			2600	By Output Transfer to Process -2	950	10	9500
Direct wages			2000				

Production Overhead			2000				

Week ending

Process - 2 Account: Output – 840 unit

Dr

Cr

Particular	Units	Cost per kg. (Rs)	Amount (Rs)	Particular	Units	Cost per kg. (Rs)	Amount (Rs)
To Output from Process -1	950	10	9500	By Normal Loss	95	4	380
To Direct material			1900	By abnormal Loss	15	20	300
To Direct wages			3000	By Output	840	20	16800
To Prod. overhead			3000	Transfer to Process -3			
	950		17480		950	24	17480

Week ending

Process - 3 Account: Output – 750 unit

Dr

Cr

Particular	Units	Cost per kg. (Rs)	Amount (Rs)	Particular	Units	Cost per kg. (Rs)	Amount (Rs)
To Output from Process -2	840	20	16800	By Normal Loss	126	5	380
To Direct material			2992	By Output	750	38	16800
To Direct wages			4000	Transfer to Finished Stock			
To Prod. overhead			4000				
To Abnormal Gain	36	38	1368				
	876		29130		876		29130

Finished stock account:

Dr

Cr

Particular	Units	Cost per kg. (Rs)	Amount (Rs)	Particular	Units	Cost per kg. (Rs)	Amount (Rs)
To Output from Process -3	750	38	28500	By Closing Balance	750	38	28500
			28500				28500

Abnormal Loss Account

Dr

Cr

Particular	Units	Cost per kg. (Rs)	Amount (Rs)	Particular	Units	Cost per kg. (Rs)	Amount (Rs)
To Abnormal loss from Process - 2	15	20	300	By Debtor (sale of scrap) P&L a/c	15	4	60
			300				240
							300

Abnormal Gain Account

Dr

Cr

Particular	Units	Cost per kg. (Rs)	Amount (Rs)	Particular	Units	Cost per kg. (Rs)	Amount (Rs)
To Abnormal loss from Process - 3	36	05	180	By Process -3	36	38	1368
To Profit and Loss			1188				

A/c						
	36		1368			1368

Working note –

1) Calculation of cost per unit of output:

Process 1 – a) normal production = 1000- 5% of 1000 = 950 units.

b) normal cost = cost incurred - amount of normal scrap

= Rs. 9600 – Rs. 100 = Rs. 9500

Cost per output = 9500 / 950 = Rs. 10

Process 2 -- a) normal production = 950 – 10% of 950 = 855 units. b) normal cost =

Rs. 17480 – Rs. 380 = Rs. 17100

cost per output = Rs. 17100 / 855 = Rs. 20

Process 3 -- a) normal production = 840- 15% of 840 = 714 units

b) normal cost = cost incurred – cost of normal scrap

= Rs. 27762 – Rs. 630 = Rs. 27132

Cost per output = Rs. 27132 / 714 = Rs. 38

2) Valuation of Loss or Gain:

Normal loss – these are represented by scrap & have been valued on their realized value. Abnormal losses or gain – these are valued like the cost per unit of output of the process in which they are occurred.

3) Abnormal Loss Account:

The amount of loss Rs. 300 is debited to this account & credited to the process 2 account. As this loss is represented by scrap & has a realizable value like the normal scrap, the amount realized from such scrap is units × Rs. 4 = Rs. 60. thus the net cost of the abnormal loss is Rs. 240, which is transferred to P&L a/c.

4) Abnormal Gain Account:

The amount of gain Rs. 1368 is credited to this account & debited to process 3 accounts. However, had there been no such gain, there would have been a total

normal loss of 126 units realizing Rs. 630 from sale of scrap. As the actual loss is only (840- 750) 90 units realizing Rs. 450. So, the balance of Rs. 180 (i.e. Rs. 630-450) being not realized from scrap should be debited to abnormal gain account in order to reduce the gain & bring the system under normal conditions. The net gain of Rs. 1188 is credited to P&L a/c.

Illustration 4 :

A chemical company produces a product with 2% of weight loss in each process and 10% of scrap loss in each process for which Rs. 100 p.u. for process 1 and 2 is realised and Rs. 20 p.u. for process 3 is realised.

The input quantity for each process is 1,000 units, 140 units and 1,348 units respectively.

	Process 1	Process 2	Process 3
Direct Material	1,20,000	28,000	1,07,840
Manufacturing wages	20,500	18,520	15,000
General expenses	10,300	7,240	3,100
Stock kept for sale	25%	50%	100%
Passed to next process	75%	50%	Nil

Solution :

Dr.

Process 1 A/c

Cr.

Particulars	Total (Rs.)	Per unit (Rs.)	Particulars	Total (Rs.)	Per unit (Rs.)
To DM (RM Introduced)	1,000	1,20,000	By Normal loss		
To Manufacturing wages		20,500	(a) Weight loss	20	Nil
To General Expenses		10,300	(2% of 1000)		
			(b) Scrap	100	
			(10% of 1000		
			100 x ₹ 100		10,000
			By Output c/d	880	1,40,800
			(C.P.U. = 160)		
	1,000	1,50,800		1,000	1,50,800

To Output b/d	880	1,40,800	By Sales (220 x ₹ 160)	220	35,200
			By Output transferred to P-2 A/c (C.P.U. = ₹160)	660	1,05,600
	880	1,40,800		880	1,40,800

Note : When the question is silent, the goods sold will be recorded at cost price. Alternatively, it is recorded at COST + PROFIT = SALES.

Dr.

Process 2 A/c

Cr.

Particulars	Qty	Amount	Particulars	Qty	Amount
To Input from Process 1 A/c	660	1,05,600	By Normal loss		
To DM	140	28,000	(a) Weight loss	16	Nil
To Manufacture wages		18,520	(2% of 800)		
To General expenses		7,240	(b) Scrap		
			(10% of 800)	80	
			80 x 100		8,000
			By Output c/d	704	1,51,360
			(C.P.U. = 215)		
	800	1,59,360		800	1,59,360
To Output b/d	704	1,51,360	By Sales (352 x 215)	352	75,680
			By Output transferred to P-3 A/c (C.P.U. = 215)	352	75,680
	704	1,51,360		704	1,51,360

Dr.

Process 3 A/c

Cr.

Particulars	Qty	Amount	Particulars	Qty	Amount
To Input from Process 2 A/c	352	75,680	By Normal loss:		
To DM	1,348	1,07,840	(a) Weight loss	34	Nil
To Manufacture wages		15,000	(12% of 1,700)		
To General expenses		3,100	(b) Scrap		

			(10% of 800 80 x 100 By Output c/d (C.P.U. = 132.5)	170	3,400
	1,700	2,1,620		1,700	2,1,620
To Output b/d	1,496	1,98,220	By Sales A/c (100 Sold) (1,497 x 132.5)	1,496	1,98,220
	1,496	1,98,220		1,496	1,98,220

Working Note 1 :

(P-1) Output 880

25% 75%
 sold process 2
 220 600
 (at cost price)

(P-2) output 704

50% 50%
 352 352
 (Sold Process 3
 at cost price)

(P-3) output 14%

↓
 100% Sold
 (at cost price)

C) Processes having WIP at different stages of Completion in Respect of Material and Labour (FIFO Method)

So far we have ignored the existence of WIP in processes. But in continuous process there must be some WIP in the end of the period & the degree of completion of closing WIP may be quite different from the the degree of completion of opening WIP. This problem can be solved by calculating the equivalent production. Equivalent or effective production represents the production in terms of completed units. From the schedule showing the stage of completion, equivalent production should be ascertained. Suppose, the closing stock is 200 units 40% complete in respect of material, labour & overhead. This is equivalent to 80 units which are 100% complete.

a) First In First Out (FIFO) Method:

Process costs can be mainly computed either by FIFO method or by average method. Under the FIFO the cost added in each process during the current period is prorated to the production necessary to complete the opening WIP, to complete the

units introduced & completed during the period & to partially completed units in closing WIP. The costs added in each process during the current period are divided by equivalent production during the period. The objective of FIFO method is to value the inventory at current costs & as such the main problem is to calculate the equivalent production under this method.

Where there is closing WIP, the work done up to the stage of completion should be considered while computing equivalent production. The computation of equivalent production will be understood from the following illustrations –

Illustration 5:

In process 1, 1000 units were introduced during January. 200 units 40% complete in all respects remained as closing WIP at the end of the month. Compute the equivalent production & obtain cost of closing WIP if total process cost during the period be Rs. 1760.

Solution:

Statement of Equivalent Production

Output		Equivalent Production		
Items	Units	Units	Prod. (%)	Remarks
Introduced & completely	800	800	100%	
Work on closing WIP	200	80	40%	
Total	1000	880		

Cost per equivalent production = Rs. 1760 / 880 = Rs. 2. Value of closing stock = 80 × Rs. 2 = Rs. 160.

Note: although 800 units were completed during the period, equivalent production was 880 units.

Under the FIFO method where there is opening as well as closing WIP, greater care must be taken in determining equivalent production. If the opening WIP be 40% complete, 60% work must be taken into account during the current period to complete the opening WIP under the FIFO method.

Illustration 6 :

A product passes through 3 process before being finally transferred to Finished Stock A/c 10,000 units @ ₹ 5 was introduced in Process 1 A/c.

No.	Particulars	1	2	3
1	Sundry Material (₹)	5,000	8,000	6,000
2	Direct Labour (₹)	10,000	12,000	15,000
3	Direct Expenses (₹)	4,000	5,000	7,000
4	Actual output (unit)	9,000	8,550	8,210
5	Normal wastage	10%	5%	4%
6	Value of scrap per unit	5	6	5

Production Overheads are charged at 60% of the DL for each process. Semi-finished product of each process being saleable 1/3 of the output of process 1 and 2/3 of the output of process 2 was sold in the market at the profit of 20% and 25% on cost respectively. Remaining output was transferred to the next process. Output of last process was sold at ₹ 30 per unit. Calculate cost per unit for each process.

Solution :

Dr.		Process 1 A/c		Cr.	
Particulars	Qty	Amt	Particulars	Qty	Amt
To R/M Introduced (10,000 x 5)	10,000	50,000	By Normal loss: Scrap (10% of 10,000)	1,000	5,000
To DM		5,000	(1,000 x 5)		
To DL		10,000	By Output c/d	9,000	70,000
To DE		4,000	(C.P.U. = 7.78)		
To Production Overheads (60% of DL)		6,000			
	10,000	75,000		10,000	75,000
To Output b/d	9,000	70,000	By Sales (3,000x9.34)	3,000	28,020
To Costing P & L A/c (3,000 x 1.56)		4,680	By Output transferred to	6,000	46,660

			Process 2 A/c		
			(C.P.U. = 7.78)		
	9,000	74,680		9,000	74,680

Dr.

Process 2 A/c

Cr.

Particulars	Qty	Amt	Particulars	Qty	Amt
To Input from Process 1 A/c	6,000	46,660	By Normal loss:		
To DM		8,000	Scrap (5% of 6,000)	300	1,800
To DL		12,000	(300 x 68)		
To DE		5,000	By Output (c/d)	8,550	1,15,590
			(C.P.U. = 13.52)		
To Production Overheads (60% of DL)		7,200			
to Abnormal Gain	2,850	38,530			
		(Formula)			
	8,850	1,17,390		8,850	1,17,390
To Output b/d	8,850	1,15,590	By Sales	5,700	96,330
To Closing P&L A/c (5,700 x 3.38)		19,266	(5,700 x 16.90)		
			By Output transferred to Process 3 A/c (C.P.U. = 13.52)	2,850	38,526
	8,850	1,34,856		8,550	1,34,856

Dr.

Process 3 A/c

Cr.

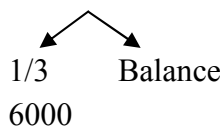
Particulars	Qty	Amount	Particulars	Qty	Amount
To Input from Process 2 A/c	2,850	38,526	By Normal loss:		
To DM		6,000	Scrap	114	570
To DL		15,000	(4% x 2,850)		
To DL		7,000	(114 x 5)		

To Production Overheads (60% of DL)		9,000 (Formula)	By Output c/d (C.P.U.= 27.40)	8,210	2,24,923
To Abnormal Gain	5,474	1,49,967			
	8,324	2,25,493		8,324	2,25,493
To Output b/d	8,210	2,24,932	By Sales A/c	8,210	2,46,300
To Costing P & L A/c (Balancing figure)		21,377			
	8,210	2,46,300		8,210	2,46,300

Note : In this question, first time closing the Quality column of Process 1 A/c, the quantity column tallies. Therefore, there is no balancing figure in Qty column. Hence, no abnormal loss or abnormal gain.

Working Note 1 : process 1

Output = 9000

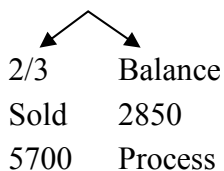


Sold Process 2
3000 (at S.P.)
C 7.78
+P 1.56 (20%)
= Sales 9.34

Working Note 2 : Process 2 A/c

$$\begin{aligned}
 \text{Abnormal Gain (Amt)} &= \frac{\text{Dr-Cr (Amt column)}}{\text{Dr-Cr (Qty column)}} \times \text{Abnormal Gain (Qty)} \\
 &= \frac{78,860-1,800}{6,000-300} \times 2,850 \\
 &= \frac{77,060}{5,700} \times 2,850 = ₹ 38,530
 \end{aligned}$$

Output = 8,550



(at S.P.)	
C	13.52
+P	3.38 (25%)
<hr/>	
S	16.90

Working Note 3: Process 3 A/c

$$\begin{aligned} \text{Abnormal Gain (Amt)} &= \frac{\text{Dr-Cr (Amt column)} \times \text{Ab.Gain (Qty)}}{\text{Dr-Cr (Qty column)}} \\ &= \frac{75,526-570}{2,850-114} \times 5,474 = ₹ 1,49,967 \end{aligned}$$

Process 3

Output – 8210	
↓	
Assume 100% sold	
= 8210 (at S.p.)	
C	27.40
+ P	2.60
<hr/>	
S	30.00 (Given)

Illustration 7:

In process A, opening WIP in February was 200 units 40% complete. 1050 units were introduced during the period, 1100 completed units were transferred to process B & 150 units remained as closing WIP 70% complete. Compute equivalent production & apportion the total process costs of Rs. 2250 to production & WIP inventories under FIFO method.

Solution:

Process A	Process Cost Sheet	Period – February
units (40%)	(FIFO Method)	Opening WIP – 200
Introduced – 1050 units		
Statement of Equivalent Production		
Input	Output	Equivalent production

Items	Units	Items	Units	Units	% completion	Remarks
Opening WIP	200	Work on WIP Introduced & completed during the period Transfer to process B Work on closing WIP	200	120	60%	
Introduced	1050		900	900	100%	
			1100	105	70%	
Total	1250		1250	1125		

Cost per unit equivalent production = Rs. 2250 / 1125 = Rs. 2

Statement of Apportionment of Process Cost

Items	Equivalent production	Cost per unit	Cost
Opening WIP (for completion)	Units 120	Rs. 2	Rs. 240
Introduced & completed during the period	900	2	1800
Closing WIP	105	2	210
Total process cost during the period			2250

Note: Although 1100 units were completed & transferred to process B, the equivalent production during the month was 1125 units.

- (b) **Average Cost Method:** This method is useful when price fluctuate from period to period. The closing valuation of work-in-progress in the old period is added to the cost of new period and an average rate obtained. In calculating the equivalent production opening units will not be shown separately as units of work-in-progress but included in the units completed and transferred.
- (c) **Weighted Average Cost Method:** In this method no distinction is made between completed units from opening inventory and completed units from new production. All units finished during the current accounting period are treated as if they were started and finished during that period. The weighted average cost

per unit is determined by dividing the total cost (opening work-in-progress cost + current cost) by equivalent production.

3.2.1.5 Concepts of Joint Products and By Products:

In several industries more than one product emerges from the manufacturing process. These products are sometimes produced intentionally while in some cases they emerge out of the main manufacturing process. Such products are termed as either joint products or by-products. Though sometimes these terms are used interchangeably, there is a major difference between the two and therefore it is necessary to understand clearly the difference between them. Similarly, there is a difference between the accounting of the two and hence it is essential to define clearly the concepts of joint products and by-products. In CIMA Terminology defines joint products as “two or more products separated in the course of processing each having a sufficiently high value to merit recognition as a main product”. Joint products imply that they are produced from the same basic raw material, are comparatively of equal importance, are produced simultaneously by a common process and may require further processing after the point of separation.

The term ‘by-products’ is sometimes used synonymously with the term ‘minor products’. The by-product is a secondary product, which incidentally results from the manufacture of a main product. By-products are also produced from the same raw material and same process operations but they are secondary results of operation. The main difference between the joint product and by-product is that there is no intention to produce the by-product while the joint products are produced intentionally. The relationship between the by-product and the main product changes with changes in economic or industrial conditions or with advancement of science. The by-product of an industry may become a main product and main product may become a by-product subsequently. For example, (a) in sugar industry, sugar is a main product and molasses is a by-product (b) in coke ovens, gas and tar are incidentally produced in addition to the main product coke. Gas and tar are, therefore, treated as by-products. These minor secondary products have saleable or usable value and are incidentally produced in addition to the main product. In CIMA Terminology, By-product is “a product which is recovered incidentally from the material used in the manufacture of recognized main products such as having either a net realizable value or a usable value which is relatively low in comparison with the saleable value of the main products. By products may further be processed to increase their realizable

value”. Thus the term ‘by-product’ is generally used by businessmen and accountants to denote one or more products of relatively small value that are produced simultaneously with a product of greater value.

Check Your Progress

A) Select the right option:

1. Process Costing is applied when__products are produced.
 - a. Unique
 - b. Special
 - c. Homogeneous
 - d. Basic.
2. When the manufacturing process is_____principles of process costing are made applicable.
 - a. Random
 - b. Intermittent
 - c. Homogeneous
 - d. Continuous
3. In process costing; the finished product emerges at the__stage.
 - a. Last
 - b. Middle
 - c. First
 - d. Specified
4. Any loss over and above the normal loss is termed as__loss.
 - a. Total
 - b. Abnormal
 - c. Actual
 - d. Notional
5. _____ concept is used while calculating the equivalent units.
 - a. Proportion
 - b. Mathematical
 - c. Percentage Completion
 - d. Rational

B) Fill in the blanks:

1. Units in process are valued using either the_____method or the Weighted Average Method.
2. Products having equal economic importance are referred to as____products.
3. _____ Costing is applied when the products emerging from a process are of unequal importance.
4. A loss inherent to a process is called as_____loss.
5. _____arises when the actual process loss is less than what is anticipated.

C) Match the following:

- | | |
|--------------------------------------|---------------------------------------|
| 1. Cost per unit. | A. Output transferred with a mark up. |
| 2. Inter process profit. | B. Part of Process Costing. |
| 3. Joint and By Product. | C. Output of earlier process. |
| 4. Abnormal Gain. | D. Total Cost/Units Produced. |
| 5. Input for the subsequent process. | E. Output more than expected. |

3.2.2 Service Costing:

Cost Accounting has been traditionally associated with manufacturing companies. However, in the modern competitive market, cost accounting has been increasingly applied in service industries like canteens, telecom service providers, banks, insurance companies, transportation organizations, electricity generating companies, hospitals, passenger transport and railways, hotels, road maintenance, educational institutions, road lighting, canteens, port trusts and several other service organizations. The costing method applied in these industries is known as ‘Operating Costing’.

The products available in the market can be in tangible or intangible form. The intangible products are popularly known as “Services”. We have learnt various costing methods like unit costing, job costing, batch costing etc. which are applicable for the tangible manufacturing output. A service undertaking has to follow a different kind of costing method known as “Operating or Service Costing”. A service can be internal or external. Internal services are those services which are rendered internally to another department for a transfer price. For example, a maintenance department is providing repair services to the factory, canteen providing catering services to the factory labour etc. External services are those services which are rendered to the external customers for a selling price. There are many service undertakings offering services like transport service by transport company carrying goods/passengers, food service by canteens/caterers, electricity service by power house companies, hospitality service by hotels and motels, health care service by hospitals etc. All these undertakings are required to calculate the cost of rendering a service unit for which they use “Operating or Service Costing.”

Nature of Operating Costing:

The main objective of operating costing is to compute the cost of the services offered by the organization. For doing this, it is necessary to decide the unit of cost in such cases. The cost units vary from industry to industry. For example, in goods transport industry, cost per ton kilometer is to be ascertained while in case of passenger transport, cost per passenger kilometer is to be computed. Cost units used in different service units are explained in detail later in chapter. The next step is to collect and identify various costs under different headings.

The headings used are,

- (a) Fixed or standing charges
- (b) Semi-fixed or maintenance charges
- (c) Variable or running charges.

One of the important features of operating costing is that mostly such costs are fixed in nature. For example, in case of passenger transport organization, most of the costs are fixed while few costs like diesel and oil are variable and dependent on the kilometers run or operated. Because of the diverse nature of activities carried out in service undertakings, the cost system used is obviously different from that of manufacturing concern. Let us discuss the method of computing costs in various service organisations.

Service Costing is also referred to as Operating Costing. Thus, Service Costing is, 'that form of operating costing which applies where standardized services are provided either by an undertaking or by a service cost centre within an undertaking'. With the contribution of the Services Sector increasing in the total Gross Domestic Product, this facet of costing has assumed considerable amount of importance from the point of view of Cost Compilation and Cost Control. Here it is important to determine the Cost Unit with respect to which the costs are to be calculated and expressed.

3.2.2.1 Meaning and Definition:

Operating costing is concerned with the ascertainment of operating cost for rendering a unit of service. It is a method of costing for the enterprises producing services rather than tangible commodities.

According to CIMA [London] operating costing is, 'that form of operating costing which applies where standardized services are provided either by an undertaking or by a service cost center within an undertaking'.

The calculation of cost-of-service unit is not a complex job. The various cost associated with the costing services for a particular period are ascertained and grouped under appropriate heads. The total cost is then divided by the total number of service units to determine the cost per unit of service. This costing method helps the enterprise to fix the selling price for their services. In case of operating costing, the determination of unit of cost is a major chore which would be discussed in the next section. Major Service organizations that use operating costing are, transport Companies, electricity Companies, hospitals, canteens/Catering Businesses, hotels and educational Institutions, etc.

3.2.2.2 Application of Service Costing:

Service Costing is made applicable in those concerns which do not manufacture physical goods; but are mainly service oriented. Business establishments like; banks, insurance companies, telecom service providers, goods and passenger service concerns, hospitals, hotels etc. are all prominent instances of service rendering organizations.

3.2.2.3 Determination of Service Cost in Transport Industry:

Transport Organisation:

Costing in a transport industry consists of determining the operating cost of each vehicle and applying this cost to find out the cost per unit of service rendered by a vehicle. The cost unit is selected with proper care keeping in view of the needs of each concern, the weight, bulk, volume and type of goods carried and distance covered in each trip. Transport undertakings include goods transport organizations as well as passenger transport organizations. The cost unit is either ton kilometer or passenger kilometer. The meaning is; the cost of carrying one ton over a distance of one kilometer or cost of carrying one passenger over a distance of one kilometer.

Collection of Costs: A log book is maintained for each vehicle to record details of trips made by the vehicle during a specified period of time. Log book is maintained usually on a daily basis. The details shown in the log book enables the management to make suitable allocation of vehicles, to avoid the duplicate trips, or to

avoid idle running capacity. The log book also provides the information relating to the fuel consumed, distance travelled, no. of hours travelled, chargeable kilo meters etc. The log books provide the data for proper allocation of cost and in this respect these may be compared with the production details available in a manufacturing concern.

Classification of Costs:

The costs of a transport organisation can be classified and accumulated under the following heads:-

- (a) **Fixed or stand-by costs:** These costs which include garage charges, insurance, taxes, licence, depreciation, wages of drivers, cleaner's salary, establishment cost of workshop and office. Out of the above some of the costs are directly identifiable for each vehicle such as licence fee and some are apportioned such as office expenses
- (b) **Maintenance Charges:** These costs are in the nature of semi-variable nature includes expenditure on maintenance, repairs, tyres, tubes and other charges.
- (c) **Operating and Running costs:** These costs are variable in nature, includes fuel, lubricating oil, wages of drivers / cleaners (if paid on per trip / kilometer). These costs can be easily identifiable with each of the vehicles.

Significance of Operating or Running Costs:

1. Control of operating and running cost and avoidance of waste of fuel and other consumable material.
2. Cost of running own vehicles may compared with the hired or other forms of transport.
3. Facilitates quotation of hiring rates to outside parties who ask for the transport service.
4. If transport service is treated as a separate department or service cost centre, the costs to be charged to the requesting department may be easily determined.
5. Suitable information is obtained for efficient routing of vehicles.
6. Cost of idle vehicles and lost running time is easily obtained.

Illustration:

Illustration 1: A truck starts with carrying 40 tonnes from station X to station Y. It unloads 20 tonnes at station Y and carried 20 tonnes to station Z. From station Z to Station X, it carries 30 tonnes. The distance between station X and Y, Y and Z and from Z to X is 15 km, 20 km and 30 km respectively. Calculate absolute and commercial tonne-km.

Solution:

$$\begin{aligned}\text{Absolute tonne-km} &= 40 \times 15 + 20 \times 20 + 30 \times 30 \\ &= 600 + 400 + 900 \\ &= 1900 \text{ tonne-km}\end{aligned}$$

$$\begin{aligned}\text{Commercial tonne-km} &= \text{Average tonnes} \times \text{Total distance travelled} \\ &= (40+20+30)/3 \times 65 \\ &= 1950 \text{ tonne-km}\end{aligned}$$

Illustration 2:

There are two warehouses for storing finished goods produced in a factory. Warehouse 'A' is at a distance of 10 kms. and Warehouse 'B' is at a distance of 15 kms from the factory. A fleet of 5 tonne lorries is engaged in transporting the finished goods from the factory. The records show that the lorries average a speed of 30 kms. per hour when running and regularly take 40 minutes to load at the factory. At warehouse 'A' unloading takes 30 minutes per load while at warehouse 'B' it takes 20 minutes per load.

Drivers' Wages, depreciation, insurance and taxes amount to Rs.18 per hour operated. Fuel oil, tyres, repairs and maintenance cost Rs. 2.40 per kilometer. You are required to draw up a statement showing the cost per tonne kilometre of carrying the finished goods to the two warehouses.

Solution:

Statement showing computation of total cost and cost per tonne Kilometer of carrying finished goods to warehouses:

Particulars	A	B
Time for travelling (to & fro)	40 min	60 min
Time for loading	40 min	40 min
Time for unloading	30min	20 min
TOTAL TIME	110 min	120 min
Cost of Insurance, wages, tax etc. (110/60*18) (120/60*18)Rs.	33.00	36.00
Fuel & Oil etc.(20*2.40) (30*2.40) Rs.	48.00	72.00
TOTAL COST Rs.	81.00	108.00
Tonne Kms. (5tons*10kms.) (5*15)	50	75
COST PER TONNE KILOMETER Rs.	1.62	1.44

Illustration 3:

A transport service company is running 4 buses between two towns which are 50 miles apart. Seating capacity of each bus is 40 passengers. The following particulars were obtained from their books for April, 2015.

	Rs.
Wages of Drivers, Conductors and Cleaners	2,400
Salaries of Office and Supervisory Staff	1,000
Diesel and oil and other oil	4,000
Repairs and Maintenance	800
Taxation, Insurance, etc.	1,600
Depreciation	2,600
Interest and Other Charges	2,000
TOTAL	14,400

Actual passengers carried were 75% of the seating capacity. All the four buses ran on all days of the month. Each bus made one round trip per day. Find out the cost per passenger mile.

Solution:

Computation of Cost per Passenger Mile:

Passenger miles = No. of buses x Distance x Round trip x No. of Passengers x No. of days in month x Capacity.

$$= 4 \times 50 \times 2 \times 40 \times 30 \times 75\%$$

$$= 3,60,000 \text{ passenger miles.}$$

$$\text{Cost per passenger mile} = 14,400 / 3,60,000 = \underline{\underline{\text{Rs.0.04}}}$$

Illustration 4:

Mr. Sohan Singh has started transport business with a fleet of 10 taxies. The various expenses incurred by him are given below:

- (i) Cost of each taxi Rs.75,000
- (ii) Salary of office Staff Rs.1,500 p.m.
- (iii) Salary of Garage Supervisor Rs.2,000 p.m.
- (iv) Rent of Garage Rs. 1,000 p.m
- (v) Drivers Salary (per taxi) Rs. 400 pm.
- (vi) Road Tax and Repairs per taxi Rs. 2,160 p.a.
- (vii) Insurance premium @ 4% of cost p.a.

The life of a taxi is 3,00,000 km. and at the end of which it is estimated to be sold at Rs. 15,000. A taxi runs on an average 4,000 Km. per month of which 20% it runs empty, petrol consumption 9 Km. per litre of petrol costing Rs. 6.30 per litre. Oil and other sundry expenses amount to Rs.10 per 100 Km.

Calculate the effective cost of running a taxi per kilometre. If the hire charge is Rs. 1.80 per Kilometre, find out the profit that Mr.Sohan may expect to make in the first year of operation.

Solution:**Statement Showing Computation of Effective Cost and Profit for the Year**

Particulars	Amount Rs.	Amount Rs.
Fixed Expenses:		
Salary of Staff	1500	
Salary of Garage Supervisor	2,000	
Rent of Garage	1,000	
Driver Salary (10*400)	4,000	
Road Tax & Repairs (2160*10/12)	1,800	
Insurance Premium (75000*4%*10/12)	2,500	12,800
Fixed Cost of 10 taxies per month: Cost Per Taxi = Rs.12800/10=Rs.1280 Cost Per Km. = Rs.1280/4000 = Rs.0.32		0.32
Running Costs:		
Depreciation (Rs.75000-15000)/300000		0.20
Petrol (Rs.6.30/9)		0.70
Oil & Sundry Expenses (Rs.10/100)		0.10
TOTAL CONSIDERING 100% UTILISATION		1.32
EFFECTIVE COST PER KM. CONSIDERING 80% UTILISATION = Rs. 1.32*(100/80)		1.65

Profit for the year = Rs.(1.80-1.65)*10Taxies*3200kms.*12months= Rs.57600.00

Illustration No. 5 :

The following are the details of tonnes of good transported by M/s. Gurinder Enterprises on certain days of February 2015:

Dates	Tonners	Kilometre Travelled
4 th February 2015	60	40
6 th February 2015	35	100
14 th February 2015	50	20
28 th February 2015	20	35

You are required to calculate the cost per tone-km, if the total cost for the enterprise is Rs.4,18,000 for the above mentioned month.

Solution:

Total cost units and cost per Tonne -km:		
4 th February 2015	= 60X40	= 2400 Tonne-Km
6 th February 2015	= 35X100	= 3500 Tonne-Km
14 th February 2015	= 50X20	= 1000 Tonne-Km
28 th February 2015	= 20X35	= 700 Tonne-Km
Total cost units in February		= 7600 Tonne-Km
Cost per Tonne-Km is		= 4,18,000 / 7600
		= 55 Rs per Tonne-Km

Illustration 6 :

Laghuram Pvt Ltd. operates 2 busses between Delhi and Karnal which are 120 Km apart. Seating capacity of each bus is 40 passengers. Following particulars were obtained from their books for April, 2015:

Particulars	Amount(Rs.)
Wages	2,00,000
Monthly salaries of office staff	4,00,000
Diesel	50,000
Insurance premium	20,000

Repairs and overhauling	56,000
Depreciation	35,000
Interest and other charges	25,000

Both the busses ran all the days of the month. Each bus made one round trip per day. You are required to find out the cost per passenger km.

Solutions:

Number of Busses	= 2
Capacity of Bus	= 40
Capacity of Fleet	= 2 X 40, i.e. 80 Passengers
Number of Trips per Day	= 2
Number of Days	= 30
Distance Run per Trip	= 120 Km
Service Rendered	= 120 X 2 X 30 X 80 = 5,76,000 Passenger- Km

Raghuram Pvt. Ltd
Operating Cost Sheet
For the month ending April 2015

Particulars	Amount (Rs.)	Per passenger - Km
Standing Cost		
Monthly salaries of office staff	4,00,000	
Insurance premium	20,000	
Depreciation	35,000	
Interest and other charges	25,000	
Total Standing Cost	4,80,000	0.833
Maintenance Cost		
Repairs and overhauling	1,34,000	
Total Maintenance Cost	1,34,000	0.232
Running Cost		
Wages	2,00,000	

Diesel	50,000	
Total Running Cost	2,50,000	0.434
Total Cost	8,64,000	1.500

Illustration 7 :

Prepare an operating cost sheet for the period 2013-14 for M/s. Pandit Enterprises which is into transport business running 5 busses in Delhi. Following are the details extracted from the books of accounts:

The cost of 5 passenger busses, are Rs. 25,00,000 (Rs. 5,00,000 each). Yearly fuel expenses is Rs. 5,00,000. Annual Repair and maintenance is 70% of fuel cost. 1500 passengers were carried over 5,000 kms during the year by the fleet of busses. Other information is as follows:

Particulars	Amount(Rs.)
Wages of 10 cleaners	5000 each per month
Wages of 5 drivers	10,000 each per month
Yearly interest cost	10% on capital
Office salaries	60,000 per month
Rent of 5 garages	5,000 each per month
Tax and licences	1,00,000 annual
Office establishment	3,50,000 annual
Cost recovery by sale of old tyres	20,000 annual

Solutions:

M/s. Pandit Enterprises
Operating Cost Sheet
For the year ending 31st March 2014

Particulars	Amount (Rs.)	Per passender - Km
Annual Fixed Cost		
Interest (10% of 25,00,000)	2,50,000	
Rent for garage (5 X 5,000 X 12)	3,00,000	
Office salaries (60,000 X 12)	7,20,000	

Tax and licences	1,00,000	
Wages of driver (5 X 10,000 X 12)	6,00,000	
Wages of cleaner (10 X 5,000 X 12)	6,00,000	
Total Annual Fixed Cost	29,20,000	0.389
Annual Variable Cost:		
Fuel cost	5,00,000	
Repair and maintenance	3,50,000	
Total Annual Variable Cost	8,50,000	
Total Cost:	37,70,000	
Less recovery from old tyres	(20,000)	(0.0002)
Net Total Cost	37,50,000	0.500

Working notes: Total Service units are:

1,500 passengers X 5,000 Kms = 75,00,000 Passenger-Kms

Check Your Progress:

A) Multiple Choice Questions:

- Cost of service under operating costing is ascertained by preparing:
 - Cost sheet
 - Process account
 - Job cost sheet
 - Production account
- Operating costing is applicable to:
 - Hospitals
 - Cinemas
 - Transport undertaking
 - All of the above
- Passenger Transport cost unit :
 - Weight
 - Distance
 - Route
 - Seat
- Goods Transport; cost unit :
 - Ton Mile
 - Weight
 - Distance
 - Load
- Telecom Companies use :
 - Job Costing
 - Operating Costing
 - Process Costing
 - Unit Costing

B) State whether the following statements are True or False:

1. Operating costing is applied to ascertain the cost of products.
2. Cost of operating the service is ascertained by preparing job account.
3. The problem of equivalent production arises in case of operating costing.
4. Passenger Transport Undertakings charge fare based on weight.
5. Goods Transport undertakings charge freight considering weight to be carried and the distance over which it is to be carried.

C) Fill in the Blanks:

1. In electricity companies, the cost unit is _____.
2. The method of costing used in undertaking like gas companies, cinema houses, hospitals etc is known as _____.
3. In motor transport costing two example of fixed cost are ____ and ____.
4. Telecom Companies use _____ costing system for cost determination.
5. Target Costing concept is used to control the cost of _____.

D) Match the following:

Column A		Column B	
1.	Passenger Transport.	F	Per bed
2.	Goods Transport	G	Kilowatt
3.	Hotels.	H	Passenger Miles.
4.	In hospital the cost unit is	I	Cost per service.
5.	In electricity companies, the cost unit is	J	Tonne Mile.

3.3 Summary:

From the overall discussions it can be seen that the process costing is that aspect of operation costing which is used to ascertain the cost of the product at each process or stage of manufacture. This method of accounting is used in industries where the process of manufacture is divided into two or more processes. The objective is to

find out the total cost of the process and the unit cost of the process for each and every process. Usually, the industries where process costing used are textile, oil industries, cement, pharmaceutical etc. Moreover, it is understood that the main objective of operating costing is to compute the cost of the services offered by the organization. For doing this, it is necessary to decide the unit of cost in such cases. The cost units vary from industry to industry. For example, in goods transport industry, cost per ton Kilometer is to be ascertained while in case of passenger transport, cost per passenger Kilometer is to be computed. Cost units used in different service units are different. Because of the diverse nature of activities carried out in service undertakings, the cost system used is obviously different from that of manufacturing concern.

3.4 Term to Remember:

- **Input:** Material introduced for manufacture of finished product
- **Output:** The final outcome of the manufacturing process.
- **Normal Loss:** Inevitable process loss
- **Abnormal Loss:** Loss over and above the normal loss
- **Abnormal Gain:** Output exceeding the normal benchmark
- **Inter Process Profit:** Profits earned by individual processes
- **Equivalent Units:** Units expressed in terms of completed units.
- **Services:** The intangible offering by a commercial organization is popularly known as Services.
- **Service Provided:** Any activity involving mainly labour
- **Transport Costing:** Transport costing is the operating costing method used for transport business.
- **Cost Units:** Any expression of output of a service concern for the purpose of determining the cost there of.
- **Tone km:** Carrying 1 ton of material over a distance of 1 km.
- **Seat km:** Carrying a passenger in 1 seat over a distance of 1 km.

3.5 Answers to Check Your Progress:

Section A:

- A. 1 - c, 2 - d, 3 - a, 4 - b, 5 - c,
- B. 1- First in First Out, 2 - Joint, 3 - By Product, 4 - Normal, 5 - Abnormal Gain.
- C. 1 - d, 2 - a, 3 - b, 4 - e, 5 - c.

Section B:

- A. 1 - a, 2- d, 3 - d, 4 - a, 5 - b.
- B. False - 1, 2, 3, 4 and True - 5
- C. 1 - Kilowatt, 2 - Operating costing, 3 - Insurance and Depreciation, 4 - Operating, 5 - Jobs.
- D. 1 - H, 2 - J, 3 - I, 4 - F, 5 - G

3.6 Exercise:

1. Define Process Costing and give examples of its application in industries. How does it differ from Job Costing?
2. What are Joint and By Products? How are they evaluated considering the principles of Process Costing?
3. Define Service or Operating Costing. How does it differ from Job and Process Costing?
4. Give examples of concerns applying the principles of Service or Operating Costing. Why is the determination of cost unit important in a Service rendering organization?
5. A product passes through three processes - A, B and C. 10,000 units at a cost of Rs.1.10 were issued to Process A. The other direct expenses were as follows:

	Process-A	Process-B	Process-C
	Rs.	Rs.	Rs.
Sundry materials	1,500	1,500	1,500
Direct labour	4,500	8,000	6,500
Direct expenses	1,000	1,000	1,503

The wastage of process 'A' was 5% and in process 'B' 4% The wastage of process 'A' was sold at Rs.0.25 per unit and that of 'B' at Rs. 0.50 per unit and that of C at Rs. 1.00. The overhead charges were 160% of direct labour. The final product was sold at Rs.10 per unit fetching a profit of 20% on sales. Find out the percentage of wastage in Process 'C'.

6. SM Ltd., furnished you the following information relating to process B for the month of October, 2017.
- (i) Opening work-in-progress- NIL
 - (ii) Units introduced - 10,000 units @ Rs.3 per unit
 - (iii) Expenses debited to the process; Direct materials Rs.14,650; Labour Rs.21,148; Overheads Rs.42,000 (iv) Finished output - 9,500 units
 - (v) Closing work-in-progress 350 units; Degree of completion : Material 100%; Labour and overheads 50%
 - (vi) Normal loss in process- one percent of input
 - (vii) Degree of completion of abnormal loss: Material 100% ; Labour and Overheads 80%
 - (viii) Units scrapped as normal loss were sold at Rs.1 per unit
 - (ix) All the units of abnormal loss were sold at Rs.2.50 per unit. Prepare:
 - a. Statement of Equivalent Production
 - b. Statement of Cost
 - c. Process - B Account
 - d. Abnormal Loss Account.
7. From the following data, PREPARE process accounts indicating the cost of each process and the total cost. The total units that pass through each process were 240 for the period.

	Process I (₹)	Process II (₹)	Process III (₹)
Materials	1,50,000	50,000	20,000
Labour	80,000	2,00,000	60,000
Other	26,000	72,000	25,000

Indirect expenses amounting to ₹ 85,000 may be apportioned on the basis of wages. There was no opening or closing stock.

8. RST Limited processes Product Z through two distinct processes – Process- I and Process- II. On completion, it is transferred to finished stock. From the following information for the year 20X8-X9, PREPARE Process-I, Process-II and Finished Stock A/c:

Particulars	Process I	Process II
Raw materials used	7,500 units	--
Raw materials cost per unit	₹ 60	--
Transfer to next process/ finished stock	7,050 units	6,525 units
Normal loss (on inputs)	5%	10%
Direct wages	₹ 1,35,750	₹ 1,29,250
Direct Expenses	60% of Direct wages	65 % of Direct wages
Manufacturing overheads	20% of Direct wages	15 % of Direct wages
Realisable value of scrap per unit	₹ 12.50	₹ 37.50

6,000 units of finished goods were sold at a profit of 15% on cost. Assume that there was no opening or closing stock of work-in-process.

9. Opening work-in-process 1,000 units (60% complete); Cost ₹ 1,10,000. Units introduced during the period 10,000 units: Cost ₹ 19,30,000. Transferred to next process- 9,000 units.

Closing work- in - process - 800 units (75% complete). Normal loss is estimated at 10% of total input including units in process at the beginning. Scraps realize ₹ 10 [er unit. Scraps are 100% complete.

Using FIFO method, COMPUTE equivalent production and cost per equivalent unit. Also evaluate the output.

10. Janata Transport Co. has been given a route 20 km. long for running buses. The company has a fleet of 10 buses each costing Rs. 50,000 and having a life of 5

years without any scrap value.

From the following estimated expenditure and other details calculate the bus fare to be charged from each passenger. (i) Insurance charges 3 % p.a. (ii) Annual tax for each bus Rs.1,000 (iii) Total garage charges Rs.1,000 (iv) Drivers' salary for each bus Rs.150 p.m (v) conductor's salary for each bus Rs.100 p.m (Vi) Annual repairs to each bus Rs.1,000 (vii) Commission to be shared by the driver and conductor equally: 10% of the takings (viii) Cost of stationary Rs.500 p.m. (ix) Manager's salary Rs.2,000 p.m. (x) Accountant's salary Rs.1,500 p.m. (xii) Petrol and oil Rs.25 per 100 km.

Each bus will make 3 round trips carrying on an average 40 passengers on each trip. The bus will run on an average for 25 days in a month. Assuming 15% profit on takings, calculate, the bus fare to be charged from each passenger.

11. Union Transport Company supplies the following details in respect of a truck of 5 tonne capacity :

Cost of truck Rs. 90,000

Estimated life 10 years

Diesel, oil, grease Rs. 15 per trip each way

Repairs and maintenance Rs500 p.m.

Driver's wages Rs. 500 p.m.

Cleaner's wages Rs. 250 p.m.

Insurance Rs. 4,800 per year

Tax Rs.2,400 per year

General supervision charges Rs.4,800 per year

The truck carries goods to and from the city covering a distance of 50 kms. each way. On outward trip freight is available to the extent of full capacity and on return 20% of capacity. Assuming that the truck runs on an average 25 days a month, work out:

- a. Operating cost tonne-km.
- b. Rate for tonne per trip that the company should charge if a profit of 50% on

freight is to be earned.

12. A transport company is running 2 busses between town A and town B which are 100 kms apart. Seating capacity of each bus is 50 passengers. Actual passengers carried were 80% of the seating capacity. Both the busses run for all the days of the month and each bus made one round trip per day. Find out the total passenger kilometre.
13. A transport service company is running five buses between two towns which are 50 kms apart. Seating capacity of each bus is 50 passengers. The following particulars were obtained from their books:

	Amount (Rs.)
Wages of driver, conductors and cleaners	24,000
Salaries of office staff	10,000
Diesel oil and other oil	35,000
Repair and maintenance	8,000
Taxation, insurance etc.	16,000
Depreciation	26,000
Interest and other expenses	20,000

Actually, passengers carried were 75% of seating capacity. All buses ran on all days of the month. Each bus made one round trip per day. Find out the cost per passenger-km.

14. The following are the details of tonnes of goods transported by M/a. Raghu Enterprises for the month of January 2015.

Dates	Tonnes	Kilometer Travelled
3 rd January 15	200	30
12 th January 15	350	80
16 th January 15	480	40
20 th January 15	100	25
29 th January 15	120	50

You are required to calculate the cost per tonne-km, if the total cost for the enterprise is Rs. 12,20,000 for the January month.

3.7 References for Further Study:

1. Khan and Jain (2007). *Cost Accounting*, New Delhi: India, Tata McGraw hill. 2nd edition, ISBN: 0-07-0440224-8, pp -1.1-1.8
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4. S. N. Maheshwari and CA Sharad K. Maheshwari (). *Accounting for Management*. 3rd revised and enlarged edition, Sultan Chand & Sons.
5. M. N. Arora (2013). *Cost Accounting: Principles and Practice*. Noida: 12th edition, Vikas Publishing House, pp1.1-13.30.



Unit-4

Reconciliation of Cost and Financial Accounts

Structure

- 4.0 Objectives
- 4.1 Introduction
- 4.2 Presentation of Subject Matter
 - 4.2.1 Need for reconciliation
 - 4.2.2 Reasons/causes for disagreement in profit or loss
 - 4.2.3 Procedure of Reconciliation
- 4.3 Summary
- 4.4 Terms to Remember
- 4.5 Answers to Check Your Progress
- 4.6 Exercise
- 4.7 References for Further Readings

4.0 Objectives

After studying this unit, students will be able:

- To understand the meaning and need of reconciliation of cost accounts and financial accounts
- To know the meaning of financial profit and cost profit.
- To know the need of reconciliation of financial profit and cost profit.
- To understand the reasons for disagreement in financial profit and cost profit.
- To know the procedure of reconciliation of cost and financial profit.
- Problems on reconciliation.

4.1 Introduction

When in an organization cost accounts and financial accounts are separately maintained in two different sets of books, separate profit and loss accounts will be prepared one for costing books and the other for financial books. In integrate

accounting system both cost and financial accounts are maintained in one set of books. The profit or loss disclosed by these two records is same. But in non integrated system of accounting separate set of books are maintained for cost and financial transactions with different items and amounts. Thus the profit disclosed by cost account and financial account does not match with each other and the need for reconciliation of cost and financial account arises.

4.2 Presentation of Subject Matter

4.2.1 Need for reconciliation

1. Reconciliation reveals the reasons for difference in profit or loss shown by cost and financial accounts.
2. It also helps in testing the arithmetical accuracy of costing data.
3. It promotes coordination and cooperation between financial accounting data and cost accounting data.
4. It helps in formulating the policies regarding over heads, depreciation and valuation of stock.

4.2.2 Reasons / Causes for disagreement in profit / loss

Difference in profit or loss between cost and financial account may arise due to the following reasons.

1. Items shown in financial accounts only.

There are number of items which appear in financial accounts but not in cost accounts. These items are classified into following three categories.

A. Purely financial charges (Only considered in financial accounting)

1. Loss on sale of capital asset.
2. Loss
3. Loss due to theft, pilferage etc.
4. Discount on bonds & debentures
5. Preliminary expenses written off.
6. Interest on debentures.
7. Goodwill written off
8. Interest on bank loan

9. Fines and penalties
10. Bad debts
11. Provision for bad debts
12. Damages payable at law
13. Underwriting commission written off
14. Loss due to scrap of machinery
15. Expenses of the company's share transfer office

B) Purely financial income

1. Profit on sale of fixed assets
2. Rent receivable
3. Interest and dividend received on investment
4. Interest received on bank deposits
5. Receipt of transfer fee
6. Refund of income tax.

C) Appropriation of profit-

1. Dividend
2. Transfer to reserves
3. Donations to charitable institutions
4. Payment of income tax
5. Other items appearing in P & L appropriation account.

2. Items shown in cost accounts only

There are few items which are considered in cost accounts but not in financial accounts.

For example:

- a) Notional rent of owned premises
- b) Notional interest on capital employed
- c) Notional salary of proprietor or/ manager
- d) Depreciation on fully depreciated asset still in use

3. Under absorption and over absorption of overheads

In cost accounts overheads are charged at predetermined rate where as in financial accounts these are recorded at actual cost. If the amount in cost account is less than the actual amount (i.e. shown in financial account), the shortfall is called under absorption, on the other hand, if the amount in the cost account is more than the actual amount, the excess amount charged is called over absorption. If overheads charged in cost accounts are not equal or different to the actual amount of overhead incurred, the difference gives rise to under or over absorption of overheads and leads to difference in cost profit and financial profit. Therefore, it becomes necessary to take into account this under / over absorption while reconciling the two accounts.

4. Different Bases of valuation of stock -

The different basis is applied for valuation of inventory in cost and financial account which may cause to difference in two profits. In cost accounts inventory is valued according to the method adopted in stores department e.g. FIFO, LTFO, simple average or weighted overage etc. whereas in financial account inventory is valued at cost or market price whichever is less. Different values of inventory results in difference in amount of two profits.

5. Different charges for Depreciation –

The rates and methods of charging depreciation may be different in cost and financial account. The financial account depreciation may be charged according to fixed instatement method or reducing balance method but in cost accounts machine hour rate or other method may be used. This will also cause a difference in these two profits.

4.2.3 Procedure of Reconciliation

The cost and financial accounts are reconciled by following two methods.

1. Reconciliation statement
2. Memorandum reconciliation statement

Reconciliation Statement –

Reconciliation statement is prepared in vertical form to reconcile the profit / loss shown by the financial and cost accounts. This method is very commonly used on bank reconciliation statements in financial accounts. In preparation of reconciliation

statements, profit shown by one set of accounts is taken as base profit and items of difference are either added to it or deducted from it to arrive at the figure of profit shown by other set of accounts. The following procedure is recommended for preparing reconciliation statements.

1. Ascertain the points of difference between cost accounts and financial accounts.

2. (A) If profit as per cost accounts is taken as starting point.

Add – i) items of expenditure or losses overcharged in cost accounts as compared to financial accounts.

ii) Items of income and gains under recorded or not recorded in cost accounts as compared to financial accounts.

iii) Amount of overvaluation of opening stock in cost accounts.

iv) Amount of undervaluation of closing stock in cost accounts.

Less i) Items of expenses and losses undercharged in cost accounts as compared to financial accounts.

ii) Items of incomes and gains over recorded in cost accounts as compared to financial accounts.

iii) Amount of under valuation of opening stock in cost accounts.

iv) Amount of over valuation of closing stock in cost accounts.

3. After making all the above additions and deductions in costing profit, the resulting figure shall be the profit as per financial books.

4. If loss as per cost accounts is taken as starting point –

Add the items which are deducted in ‘A’ above and deduct the items which are added in ‘A’ above, the resulting figure will be profit or loss as per the financial accounts.

Performa Reconciliation Statement

Profit as per cost account	Amount	Amount
Add –		
i) Expenditure and losses overcharged in cost accounts	xxx	
ii) Expenditure and losses charged in cost accounts only	Xxx	

iii) Income and gains included in financial accounts only	xxx	
iv) Income and gains undercharged in cost accounts	xxx	
v) Over valuation of opening stock in cost accounts	xxx	
vi) Undervaluation of closing stock cost accounts.	xxx	
Total		Xxx

Profit as per cost account	Amount	Amount
Less -		
i) Expenditure and losses included in financial account only	xxx Xxx	
ii) Expenditure and undercharged in cost accounts	xxx	
iii) Income and gains not included in financial accounts	xxx	
iv) Income and gains overcharged in cost accounts	xxx	
v) Undervaluation of opening stock in cost accounts	xxx	
vi) Over valuation of closing stock in cost accounts		
Profit as per financial accounts		Xxx

Memorandum Reconciliation Account

This is an alternative to Reconciliation statements. The only difference is that the information which is given in reconciliation statement is shown in the account form. In this statement, profit under one set of account is taken as opening balance and all items of difference required to be deducted are debited and those to be added are credited to this account. The balancing figure of this account is the profit shown by the other set of accounts.

Memorandum Reconciliation Account

Particular	Rs.	Particular	Rs.
To Expenditure & losses included in financial but not in cost a/c	xxx	By Profit as per cost account	Xxx
		By Expenditure & losses	Xxx

To Expenditure & Losses undercharged in cost a/c compared to financial A/c	xxx	included in cost a/c but not in financial a/c	
To income & gains included in cost a/c s but not in financial a/c	xxx	By Expenditure & Losses overcharged in cost a/c compared to financial a/c	Xxx
To income & gains overcharged in cost a/c compared to financial a/c	xxx	By Income & gains included in financial a/c but not in cost a/c	Xxx
To under valuation of opening stock in cost account	xxx	By Incomes & gains undercharged in cost a/c compared to financial a/c	Xxx
To over valuation of closing stock in cost accounts	xxx	By Overvaluation of opening stock in cost accounts.	Xxx
To profit as per financial accounts (Balancing figure)	xxx	By undervaluation of closing stock in cost accounts.	xxx
Total	xxx	Total	xxx

Illustrations 1 : ABC ltd, is maintaining separate books for cost financial account. The net profit shown by financial accounts of a company amounted to Rs. 3.71,000 while the profits disclosed by the company's cost account for that period amounting to Rs. 5,73,200. On verification of both the accounts the following discrepancies are disclosed.

1. Bank interest credited in financial accounts only Rs. 600
2. Directors fee not charged in cost accounts Rs. 13000.
3. A provision for bad & doubtful debt in financial account only Rs. 11400.
4. Income tax charged in financial account only Rs. 166000.
5. Overhead charged as per financial account Rs. 166400 while as per cost accounts estimated at RS. 170000.
6. Depreciation not provided in cost accounts Rs. 16000.

Prepare a statement of reconciliation and ascertain the profit as per financial accounts.

Solution

Reconciliation Statement

	Rs.	RS.
Profit as per cost account		5,73,200
Add- i) Bank interest	6,00	
ii) Over absorption of overheads	3,6,00	
in cost account (170000-166400)		4,200
Total		5,77,400
Less- i) Director's Fees	13,000	
ii) Provision for bad & doubtful debts	11,400	
iii) Income Tax	1,66,000	
iv) Depreciation	16,000	2,06,400
Profit as per financial accounts		3,71,000

Illustrations 2 :

Form the following particulars prepare a Reconciliation statements

Net profit as per costing books	6,67,600
Factory overheads under recovered in costing	57,000
Administrative overheads recovered in excess	42,500
Depreciation charged in financial books	36,600
Depreciation charged in costing books	39,500
Interest credited in financial books only	4,500
Income tax provided in financial books	6,000
Dividend received credit in financial books	2,300
Stores adjustment credited in financial books	4,200
Depreciation of stock charged in financial books	8,600
Appropriation of dividend in financial books	12,000

Loss due to fire provided in financial books	2,600
Net profit as per financial books	6,37,800

Solution

Reconciliation Statement

	Rs.	Rs.
Net profit as per cost account		6,67,600
Add-		
i) Administrative overheads recovered	42,500	
ii) Depreciation overcharged in costing	2,900	
iii) Bank interest not included in costing	4,500	
iv) Dividend credited in financial account only	2,300	
v) Stores adjustment credited in financial account only	4,200	
Total		56,400
Less –		7,24,000
i) Factory overhead under recovered		
ii) Income tax provided in financial account	57,000	
iii) Appropriation of dividend in fin. Account	6,000	
iv) loss due to fire provided in fin. Books	12,000	
v) Depreciation of stock charged in fin. Books	2,600	
	8,600	
Net profit as per financial books		8,6200
		6,37,800

Illustrations 3 :

From the following particulars prepare a Reconciliation statements find out profit or loss as per financial account.

	Rs.
Net loss as per costing records	1,72,400
Work overhead under recovered in costing	3,120
Administrative overhead recovered in excess	1,700
Depreciation charged in financial account	11,200
Depreciation recovered in costing	12,500
Interest received not included in costing	8,000
Obsolescence charged in financial records	5,700
Income tax provided in financial books	40,300
Bank interest credited in financial books	750
Stores adjustment (credit) in financial books	475
Value of opening stock – financial record	54,000
Cost record	52,600
Value of closing stock – financial record	49,600
Cost record	52,000
Interest debited in cost accounts but not in financial account	6,000
Preliminary expenses written off in financial accounts	800
Provision for doubtful debts in financial accounts	150

(Ad opted)

Solution

	Rs.	Rs.
Net loss as per costing records		1,72,400
Add –		
1) Work overhead under recovered in costing	3,120	
2) Obsolescence charged in financial record	5,700	
3) Income tax provided in financial books	40,300	
4) Under valuation of opening stock in costing (54000-52600)	1,400	
5) Over valuation of closing stock in cost account (52000-49600)	2,400	
6) Preliminary expenses w/o in financial account	800	
7) Provision for doubtful debts in financial account	150	
		53,870
Total		2,26,270
Less –		
1) Administrative expenses recovered in excess	1,700	
2) Depreciation over recovered in costing (12500-11200)	1,300	
3) Interest received not included in costing	8,000	
4) Bank interest credited in financial books	750	
5) Stores adjustment (credit) in financial books	475	
6) Interest charged in cost account but not in financial account	6,000	
		18,225
Loss as per financial account		2,08,045

Illustration 4 :

During the year ending 31/03/2009, the profit of ABC Ltd. as per financial P&L A/C was Rs. 66496/- as shown below. Prepare a reconciliation statement and arrive at the profit as per cost Account using the additional information given.

Profit & Loss Account for the year ending 31/03/2009

Particular	Rs	Particular	Rs
To opening stock	9,88,716	By Sales	1,38,6000
To purchases	3,28,616	By Sundry Income	1,264
To direct wages	92,532	By Closing Stock	3,00,484
To Factory overhead	83,304		
To Administrative overhead	39,380		
To Selling expenses	88,704		
To net profit	66,496		
	16,87,748		16,87,748

Costing records shows:

- 1) Closing stock Rs. 3,09,600/-
- 2) Direct wages observed Rs. 96,764/-
- 3) Factory overhead observed Rs. 76,276/-
- 4) Administrative expenses calculated at 3% of sales
- 5) Selling expenses absorbed @ 5% of sales.

Solution -**Reconciliation Statement**

	Rs.	Rs.
Profit as per financial accounts		66,496
Add-		
1) Difference in stock valuation	9,116	
2) Under absorbed factory overhead	7,028	
3) Under absorbed selling expenses	19,404	35,548
		1,02,044
Less-		
1) Over absorbed direct wages	4,232	
2) Over absorbed admn. Expenses	2,200	
3) Sundry income not credited in cost a/c	1,264	7,696
Profit as per cost accounts		94,348

Illustrations 5 :

The following information is available from the financial books, of company having a normal production capacity of 60000 units for the year ended 31st March 2005.

- I. Sales Rs. 10,00,000 (50000 units)
- II. There was no opening or closing stock of finished units.
- III. Direct materials and direct wages cost were Rs. 50000/- and Rs. 25000 respectively.
- IV. Actual factory expenses were Rs. 150000 of which 60% are fixed.
- V. Actual administration expenses were Rs. 45000 which are completely fixed.
- VI. Actual selling and distribution expenses were Rs. 30000 of which 40% are fixed.
- VII. Interest and dividend received Rs. 15000.

You are required to

- A. Find out profit as per financial books for the year ended 31/03/2005
- B. Prepare the cost sheet and ascertain the profit as per cost accounts. For the year ended 31/03/2015 assuring that the indirect expenses are absorbed on the basis of normal production capacity and
- C. Prepare a statement reconciling profit shown by financial and cost books.

Solution -

Financial Profit & Loss Account for the year ending 31/03/2005

Particular	Rs	Particular	Rs
To Direct Material	5,00,000	By Sales (50000 Units)	10,00,000
To Direct Wages	2,50,000	By Interest & Dividend	15,000
To Factory expenses	1,50,000		
To admn. Expenses	45,000		
To selling & distribution exps.	30,000		
To net Profit	40,000		
	10,15,000		10,15,000

Cost Sheet for the year ending 31/03/2005

Particular	Rs.
Direct material	5,00,000
Direct wages	2,50,000
Prime cost	7,50,000
Add- Factory Expenses – Variable - 60000	
Fixed (90000x5/6) - 75000	1,35,000
Work Cost	8,85,000
Add- Administration expenses- (45000 x 5/6)	37,500
Cost of production	9,22,500

Add- Selling & Distribution expenses –	
Variable - 18000	
Fixed (12000 x 5/6)- 10000	28,000
Total Cost –	9,50,500
Profit -	49,500
Sales	10,00,000

Reconciliation Statement

Particular	Rs.
Profit as per cost Account	49,500
Add- Interest and dividend	15,000
	64,500
Less- Under absorbed Factory Expense.- 15000	
Admn. Expense – 7500	
Selling expense - <u>2000</u>	24,500
Profit as per financial account	40,000

Illustrations 6 :

In a factory works overheads are absorbed @ 60% of labor and office expenses @20% works cost. The total expenditure is as follows

Particular	Rs.
Material	2,00,000
Labor	1,50,000
Factory Expenses	98,000
Office Expenses	85,000
Total	5,33,000

10% of the output is in the stock and sales total up to Rs. 5,10,000/- per pare a cost sheet and a reconciliation statement (Adopted)

Solution - Profit and loss Account

Particular	RS	Particular	Rs
To Material	2,00,000	By Sales	5,10,000
To Labor	1,50,000	By Closing Stock	44,800
To Factory Expenses	98,000		
TO Office Expenses	85,000		
To Net Profit	21,800		
	5,54,800		5,54,800

Closing stock is valued at works cost i.e. 10% of (2,00,000 + 1,50,000 + 98,000)

Cost Sheet for the period

Particular	Rs.
Material	2,00,000
Labor	1,50,000
Prime cost	3,50,000
Works overheads (60% of labor i.e. 1,50,000)	90,000
Work Cost	4,40,000
Office Overheads (20% of Works cost i.e.440000 of production	Cost 88,000
	5,28,000
Less – Closing Stock (10% of cost of Production)	52800
Cost of goods sold	4,75,200
Profit -	34,800
Sales	5,10,000

Reconciliation Statement

Particular	Rs.	Rs.
Profit as per cost Account		34,800
Add- office expenses over absorbed (88000 -85000)		3,000
		37,800
Less- works Overhead under absorbed (98000-90000)	8000	
Difference in closing stock (52800-44800)	8000	16000
Profit as per financial account		21,800

Illustration 7

The following details are ascertained on comparison of cost and financial accounts

Particular	Cost Amount Rs	Financial A/c Rs.
Opening stock		
Materials	2,00,000	3,00,000
Finished Goods	3,60,000	3,20,000
Closing stock		
Material	2,40,000	2,60,000
Finished Goods	4,00,000	3,40,000
Interest Charged	2,00,000	-
Preliminary Expenses W/O	-	10,000
Goodwill Written off	-	30,000
Dividend Received	-	20,000
Indirect Expenses	15,10,000	16,00,000
Net Profit	3,00,000	?

Find out profit as per financial accounts by preparing memorandum reconciliation account.

Solution.

Memorandum Reconciliation Account

Particulars	Rs	Particulars	Rs
Undervaluation of opening Stock of material in cost a/c (300000-200000)	1,00,000	By profit as per cost a/c	33,00,000
To overvaluation of closing stock Of finished goods in cost a/c (400000-340000)	60,000	By overvaluation of opening Stock of finished goods in Cost a/c (360000-320000)	40,000
To prelim expenses w/o recorded in financial a/c In financial a/c only	10,000	By undervaluation of closing stock Of material in cost a/c (260000-240000)	20,000
To Good will w/o recorded in Financial a/c only	30,000	By Interest charged in cost Accounts only	22,00,000
To indirect expenses under recovered in cost accounts (1600000-1510000)	90,000	By Dividend received recorded in Financial a/c only	220,000
To profit as per financial a/c (balancing figure)	290,000		
	55,80,000		55,80,000

Illustration 8

During the year 2013/14 the auditors certified that the financial accounts showing a profit of Rs 168000 where as per the costing books, profit as Rs.240000. From the following prepare memorandum Reconciliation Account.

Trading Profit & Loss Account

Particulars	Rs	Particulars	Rs
To Opening Stock	8,20,000	By Sales	34,65,000
To Purchases	24,72,000		
To Direct Wages	2,30,000	By Closing Stock	7,50,000
To Factory Over heads	2,10,000		
To Gross Profit	4,83,000		
	42,15,000		42,15,000
To Administrative exps.	95,000	By Gross Profit	4,83,000
To selling expenses	2,25,000	By Sundry Income	5000
To Net Profit	1,68,000		
	4,88,000		4,88,000

The Costing Records Show:

- 1) Book value of closing stock Rs 7,80,000.
- 2) factory overheads Rs 1,89,800.
- 3) Sundry income is not considered
- 4) Administrative expenses 3% of sales
- 5) Total direct wages 2,46,000.
- 6) selling expenses 5% on sales

Solution-**Memorandum Reconciliation Account**

Particulars	Rs	Particulars	Rs
To overvaluation of closing stock	30,000	By profit as per cost account	2,40,000
In cost a/c (7,80,000-7,50,000)	51,750	By Sundry Income	5,000
To Under absorption of selling expenses in cost a/c (225000-173250)	2,0200	By over absorption of administrative exp. in cost account (103950-95000)	8,950
To under absorption of factory exp. In cost a/c (210000-189800)	1,68,000	By over absorption of wages in cost a/c (246000-230000)	16,000
To Profit as per financial account			
Total	22,69,950	Total	22,69,950

Working Note:

- 1) Administrative overheads as per cost account 3% of Rs. 3465000 i.e. 103950.
- 2) Selling expenses as per cost accounts 5% of Rs 3465000 i.e. 173250.

Illustration 9

From the following information prepare statement of cost considering factory overheads at 25% of prime cost and office overheads 75% of factory overheads. Selling price is fixed at cost plus 25%. Also prepare trading and profit and loss account and memorandum reconciliation Account.

Particulars	Rs
Opening Stock	
Raw Material	80,000
Finished Goods	1,60,000

Purchase of Raw Material	4,80,000
Wages	2,00,000
Sales	13,00,000
Office expenses	1,22,000
Works expenses	1,55,000
Closing Stock	
Raw Materials	1,20,000
Finished Goods	40,000

Solution –

Statement of Cost

Particulars	Rs.	Rs.
Opening Stock Raw Materials	80,000	
Add – Purchase of raw material	4,80,000	
	<hr/>	
	5,60,000	
Less- Closing Stock of raw material		
Raw material consumed		4,40,000
Add- Wages		2,00,000
		<hr/>
Prime cost –		6,40,000
Add- Factory overheads. 25% of prime cost (i.e. 25% of Rs . 6,40,000)		1,60,000
		<hr/>
Factory Cost-		8,00,000
Add- Office Overheads 75% of Factory overheads (i.e 75% of 1,60,000)		1,20,000
		<hr/>
Cost of Production		9,20,000
Add- opening stock of finished goods		1,60,000
Less- Closing Stock of Finished Goods		(40,000)
		<hr/>

Cost of Goods Sold	10,40,000
Profit 25% of Cost goods sold i.e.25% of 10,40,000	2,60,000
Sales	13,00,000

Trading and Profit and Loss Account

Particulars	Rs	Particulars	Rs
To opening stock		By Sales	13,00,000
Raw Martial	80,000	By Closing Stock	
Finished Goods	1,60,000	Raw Materials	1,20,000
To Purchase of Raw Martial	4,80,000	Finished Goods	40,000
Wages	2,00,000		
Factory Overheads	1,55,000		
To Gross Profit	3,85,000		
	14,60,000		14,60,000
To office expenses	1,22,000	By Gross Profit	
To Net Profit	2,63,000		3,85,000
Total	3,85,000	Total	33,85,000

Memorandum Reconciliation Account

Particulars	Rs	Particulars	Rs
To Under absorption of Office expense in cost a/cs (12200-120000)	2,000	By Profit as per cost account	2,60,000
To Profit as per Financial Account	2,63,000	By Over absorption of factory over heads in cost a/cs (160000-155000)	5,000
	2,65,000		2,65,000

Illustration 10 : AKG ltd has furnished you the following information from the financial books for the year ended 31st March 2028

	Rs.
Opening Stock	
Finished goods 875 units	74,375
Work in progress	32,000
Summery during 01/04/2017 to 31/03/2018	
Raw material consumed	7,80,000
Direct Labour	4,50,000
Factory Overheads	3,00,000
Goodwill written of	1,00,000
Administrative overheads	2,95,000
Dividend Paid	85,000
Bad Debts	12,000
Selling & Distribution Overheads	61,000
Interest Received	45,000
Rent Received	18,000
Sales 14,500 units	20,80,000

The Costing records provided as under

Factory overheads are absorbed at 60% of direct wages

Administrative overheads are recovered at 20% of factory cost

Selling & Distribution Overheads are charged at Rs. 4 per unit sold

Opening stock of finished goods is valued at Rs. 104 per unit

The company values work in progress at factory cost for both financial & cost profit reporting

You are required to prepare for the year ended 31/03/2018:

1. The profit as per Financial records.
2. The profit as per Cost records.
3. Statement of reconciliation of financial Profit & Cost Profit.

Solution :

**Calculation of Financial Report
Financial Profit & Loss Account**

Particulars	Amount	Particulars	Amount
To Opening Stock		By Sales	20,80,000
Finished Goods	74,375	By Closing Stock	
Work in progress	32,000	Finished Goods	41,250
To Raw material consumed	7,80,000	Work in progress	38,667
To Direct Labour	4,50,000	By Rent Received	18,000
To Factory Overheads	3,00,000	By Interest Received	45,000
To Goodwill written off	1,00,000		
Administrative overheads	2,95,000		
To selling & Distribution Overheads	61,000		
To Dividend Paid	85,000		
To Bad Debts	12,000		
To Profit	33,542		
	22,22,917		22,22,917

	Rs.
Calculation of Cost Profit of Production	
Raw Material	7,80,000
Direct Labour	4,50,000
Factory Overheads (60% of direct wages)	2,70,000
Factory Cost	15,00,000
Add : Opening work in progress	32,00,000
	15,32,000
Loss : Closing work in progress	38,667
Factory cost of goods produced	14,93,333

Add : Administrative overheads (20% Factory Cost)		2,98,667
	Production Cost	17,92,000
Per Unit = $\frac{\text{Total Cost Production}}{\text{No. of units Produced}}$	$\frac{17,92,000}{14,000}$	Rs. 128
Statement of Costing Profit		
Opening stock 875 Units @ Rs. 104		91,000
Production 14000 units @ Rs. 128		17,92,000
	Total	18,83,000
Loss : Closing stock 375 units @ Rs. 128		48,000
	Production cost of goods sold	18,35,000
Add : Selling & Distribution overheads 14500 units @ Rs. 4 per unit		58,000
	Cost of Sales	18,93,000
	Sales Revenue	20,80,000
	Costing Profit	1,87,000

Reconciliation of Financial & Cost Accounts

Particulars	Amount Rs.	Amount Rs.
Profit as per cost accounts		1,87,000
Add: Adm. Overheads over recovery	3,667	
Opening stock over valued	16,625	
Interest Received	45,000	
Rent	18,000	83,292
		2,70,292
Less : Factory Overheads under recovered	30,000	
Selling & Distribution Overheads under recovery	3,000	
Closing Stock Overheads	6,750	
Goodwill W/O	1,00,000	
Dividend paid	85,000	

Bad Debts	12,000	2,36,750
Profit as per Financial Accounts		33,542
Working Note		
Calculation of units produced : Sale		14,500 Units
Add : Closing Stock		3.75 Units
	Total	14,875 Units
Less : Opening Stock		8.75 Units
	Unit Produced	14,000 Units

Illustration 11 :

A manufacturing company disclosed a Net loss of Rs. 5,72,000 as per their cost accounts for the year ended March 31, 2020. The Financial accounts however disclosed a Net loss of Rs. 8,84,000 for the same period.

The following information was revealed as a result of scrutiny of the figures of both the set of books.

i) Factory Overheads Over absorbed	16,000
ii) Administrative overheads under absorbed	24,000
iii) Depreciation charged in financial accounts	2,20,000
iv) Depreciation charged in cost accounts	2,45,000
v) Interest on investment not include in cost A/c	64,000
vi) Income Tax Provided	1,54,000
vii) Interest on loan funds in financial A/c	2,63,000
viii) Transfer fees (Credit in financial A/c)	16,000
ix) Stores Adjustment (Credit in financial books)	8,000

Prepare a Memorandum Reconciliation Account

Solution

Memorandum Reconciliation Account

Particulars	Amount	Particulars	Amount
To Net Loss as per costing Books	5,72,000	By Factory overheads over absorbed in cost accounts	16,000
To Administrative overheads under recovered in cost books	24,000	By Interest on investment not included in cost accounts	64,000
To Income tax not provided in cost accounts	1,54,000	By Depreciation over charged in cost accounts	25,000
To interest on loan fund not included in cost accounts	2,63,000	By Transfer fees in financial books	16,000
		By store adjust credit in financial books	8,000
		By Net loss as per financial book	8,84,000
	10,13,000		10,13,000

Alternative Method

Memorandum Reconciliation Account

Particulars	Amount Rs.	Amount Rs.
Net loss as per financial book		8,84,000
Add : Factory overheads over absorbed in cost accounts	16,000	
Interest on investment not included in cost accounts	64,000	
Depreciation over charged in cost accounts	25,000	
Transfer fees in financial books	16,000	
Store adjust credit in financial book	8,000	1,29,000

Less : Administrative overheads under recovered in cost books	24,000	10,13,000
Income tax not provided in cost accounts	1,54,000	
Interest on loan fund not included in cost accounts	2,63,000	4,41,000
Net Loss as per Cost Accounts		5,72,000

Check Your Progress

A. Fill in the Blanks

1. Dividends paid are excluded from..... but included in.....
2. Items of pure financial character are.....from cost ascertainment.
3. In..... there is always a need of reconciling the profits shown by financial
4. accounts and cost accounts.
5. Income tax is recorded in.....books.
6. Instead of a reconciliation statement, a may be prepared.

B. True or False Statements:

1. The requirement for reconciliation of costing profits and financial profits arises if cost accounts are maintained independent of financial accounts.
2. Income tax is provided only in financial accounts and not in cost accounts.
3. Rent on owned building is included in cost: accounts.
4. Purely financial incomes are included in Profit and Loss Account but are excluded from the cost sheet.
5. Under-absorption of overheads decreases profit in costing books.

4.3 Summary

In business concern where Non-integrated Accounting System is followed, cost and financial accounts are maintained separately, the difference between the end result of these two are required to be reconciled. Reconciliation of cost and financial accounts mean tallying the profit or loss revealed by both set of accounts. The chief aim is to find out the reasons for the difference between the results shown by Cost Accounts and Financial Accounts. The reconciliation statement can be prepared either with profit/loss as per cost accounts as the starting point or with profit/loss as per financial amounts as the starting point. In both cases, the amount of profit or loss as per the other set of books is arrived at by making adjustments in respect of all items responsible for the difference. The reconciliation of two figures of profit can also be done by preparing a Memorandum Reconciliation Account. The preparation of Reconciliation Statement or Memorandum Reconciliation Account helps in cross-checking the arithmetical accuracy of both sets of accounting records and thus makes them more reliable.

4.4 Terms to Remember:

- **Memorandum Reconciliation Account:** The formal way of reconciling the profit/loss shown by the two sets of books in the form of a ledger account.
- **Overabsorption of Overheads:** The recovery of overheads in excess of the actual expenditure.
- **Reconciliation Statement:** The formal way of reconciling the profit/loss shown by two sets of books in the form of a statement.
- **Under absorption of Overheads:** The short-fall in recovery of overheads.

4.5 Answers to Check your progress

Section A :

1. Cost accounts, financial accounts
2. Excluded
3. Non-integral system
4. Financial
5. Memorandum reconciliation account

Section B :

1. True 2. True 3. True 4. True
5. False. Under-absorption of overheads results in more profits.

4.6 Exercise

a) Theoretical Questions

1. Why it is necessary to reconcile cost and financial account?
2. Mention major items of expenses or income, which will appear in financial accounts but will not normally appear in cost accounts.
3. What is meant by reconciliation of cost and financial profit?
4. What are the expenses appearing in cost books only ?
5. What is “ Memorandum reconciliation statement”
6. What do you understand by integral accounts?
7. Explain the advantages of integral accounting system.
8. State the difference between integral accounts and non integral accounts.
9. Write short Notes.
 - i) Importance of reconciliation of cost and financial Profit
 - ii) Under and over absorption of overheads.
 - iii) Memorandum Reconciliation Statement
 - iv) Integral Accounting system
 - v) Advantages of Integral Accounting System
10. The Profit disclosed by cost books and financial books were Rs. 85,000/- and Rs.89,000/- respectively. The causes for differences in these profit figures have been ascertained as under

Particulars	Rs.
1) Over recovery of administration overheads in cost accounts	10,000

2) Loss due to obsolescence charged in financial accounts.	30,000
3) Depreciation charged in cost accounts.	12,000
4) Depreciation charged in financial accounts.	8,000
5) Loss due to decrease in stock value	2,000
6) Interest received on Investment.	40,000
7) Income tax paid	5,000
8) Bank interest received	5,000
9) Stock adjustment credited in financial accounts	2,000
10) Works over head under recovered in cost account prepare a statement of reconciliation	20,000

11. The profit disclosed by company's cost accounts for the year 2013-14 was Rs. 30,11,400 while the net profit shown by the financial accounts amounted to Rs. 19,76,00. On reconciling the figures the following differences are brought to notice.

- a) Depreciation at 5% was provided for in the financial accounts on the new factory valued at Rs. 12,00,000
- b) Overhead charged in financial accounts Rs. 6,93,200. Whereas items estimated at Rs. 7,50,000 in cost accounts.
- c) Directors fees not charged in the cost accounts RS, 75,000/-
- d) The company has made a provision of Rs. 60,000 for bad & Doubtful debts.
- e) Received transfer fee Rs. 2800/-
- f) Income Tax charged Rs. 9,00,000.

Prepare a Memorandum Reconciliation Statement.

12. The profit shown in the financial accounts was Rs. 112870 and for the same period the cost accounts showed a profit of Rs. 27,040/-

Examination of the accounts showed the following differences

Particulars	Cost Accounts	Financial Accounts
	Rs.	Rs
Depreciation	98,260	1,05,200
Stock Valuation		
Opening Stock	2,75,100	2,55,000
Closing Stock	1,82,180	1,87,500
Profit on sale of Asset	-	8,500
Dividend received	-	26,350
Imputed rent charge	32,500	-

Reconcile the profit figures.

13. From the following details, compute profit or loss as per financial accounts and as per cost accounts and reconcile the profit showing clearly the reasons for the variation in the two profits.

Particulars	Rs	Particulars	Rs
Purchase of Material	1,20,000	Direct Wages	40,000
Indirect Wages	20,000	Indirect expenses	80,000
Selling expenses	80,000	Distribution on expenses	40,000
Bad Debts	4,000	Interest on Overdrafts	2,000
Profit on sale of assets	40,000	Closing Stock	20,000
Sale	8,00,000		

In cost accounts overheads are recovered as under

- 1) Manufacturing overheads at 300% of direct wages
- 2) Selling overheads Rs. 60,000/-
- 3) Distribution overheads Rs. 28,000/-
- 5) From the following data prepare reconciliation statement

Particular	Rs.
Profit as per cost account	1,45,500
Works overhead under recovered	9,500
Administrative Overhead under Recovered	22,750
Selling Overheads Over recovered	19,500
Overvaluation of opening stock in cost accounts	15,000
Overvaluation of closing stock in cost accounts	7,500
Interest earned during the year	3,750
Rent received during the year	27,000
Bad debts written off during the year	9,000
Preliminary expenses written of during the year	18,000

14. Form the accounts of Shankar & Co. Ltd, Manufacturing trading and profit and loss Accounts are reproduced below.

Particular	Dr. Amount	Particular	Cr. Amount
To Raw Material		By work in Progress	
Opening Stock	29,500	Material	4,000
Purchases	1,86,500	Wages	5,500
To Wages	2,98,000	Works expenses	3,300
To Works expenses	1,90,750	By Cost of goods manufactured	6,59,950
		Closing stock of raw material	32,000
	7,04,750		7,04,750
To Cost of goods sold	6,59,950	By sales (7600 Units)	9,12,000
To Administrative exps.	1,22,500	By Finished Stock (1400 Units)	1,17,600
To Selling & distribution Expenses	1,64,000	By Interest on investment	6,800
To Bad debts W/O	17,500		

To Net Profit	72,450		
	10,36,400		10,36,400

The following information is also available

- 1) Accrued wages of Rs. 17,000/- included in wages.
- 2) Works expenses are allocated to production at 60 percent of direct labor cost.
- 3) Administrative expenses are allocated at RS. 12 per unit of production
- 4) Selling and distribution expenses are allocated so as to work out at 20 percent of selling price

Prepare a costing profit and loss account and statement of reconciliation between the two accounts (cost and financial)

15. A radio manufacturing company, which commenced business on April 1, supplies you with the following information and asks you to prepare a statement showing the profit per radio sold. Wages and materials are to be charged at actual cost. You are also required to prepare a statement reconciling the profit as shown by the cost accounts with the profit as shown by the profit and loss account for the current year.

There were no radio sets in stock or in course of manufacture on March 31, and the number of radio sets sold during the year was 540. The particular given are as under.

Materials per set	Rs. 240
Wages per set	Rs. 80
Selling Price per Set	Rs. 600

Prepare the necessary statements showing the actual profit for the year, if the works expenses were Rs. 32,160/- and the office expenses Rs, 61,800/-

16. From the following particulars pass the journal entries in on integrated accounting system. 1 Issued materials Rs. 3,00,000 of which Rs. 2,80,000 (Standard Rs. 2,40,000) is direct material.

- 1) Net wages paid, Rs. 70,000, deductions being Rs. 12,000 (Standard Rs. 75,000)
- 2) Gross salaries payable for the period are Rs. 26,000 (Standard Rs. 25000) deductions Rs. 2000.

- 3) Sales (Credit) Rs. 8,00,000
- 4) Discount allowed Rs, 5000
- 5) Salaries and wage allocation Rs. 60,000(Standard Rs. 62,000) and out of the balance 50 percent production, 30 percent administration and 20 percent selling and distribution overheads.

4.7 References for Further Readings

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