



Financial Accounting-2

CERTIFICATE IN ACCOUNTING TECHNICIANS

Paper-III

STUDY NOTES



Directorate of CAT

The Institute of Cost Accountants of India

(Statutory body under an Act of Parliament)

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CAT SYLLABUS 2021

Summary of the Course:

CAT Course Part-I (160 Hrs)

Paper I	:	Fundamentals of Financial Accounting
Paper II	:	Applied Business and Industrial Laws
Paper III	:	Financial Accounting - 2
Paper IV	:	Statutory Compliance

Delivery Strategy

Class Room oral coaching

Learning Strategy

Class Room Learning

On-line/off-line self paced studies through Online self assessment/study module.

ASSESSMENT STRATEGY

On line/off line periodical self-assessment

Course end examination- Multiple Choice Questions

To be answered on-line

Competency Level -Part-II (140 Hrs)

- Computer Fundamentals by Microsoft and Computerized Accounting- Tally ERP 9.0 – 35 hours
- SAP End User Program of 25 hours
- Cambridge - Generic Skills for Employability – 20 hours
- eFiling by experts from Industry – 20 hours
- Introduction to Costing Principles & Preparation of Cost Statements- 40 hours
- 5-days Orientation Programme



PAPER III: FINANCIAL ACCOUNTING-2

OBJECTIVES

To train the students on Pay Roll Accounting, Store Accounting, Sales Accounting and Asset Accounting enable them to gain skills in these areas.

Sl. No.	Course	Weightage
A	Pay Roll Accounting	20%
B	Store Accounting	20%
C	Sales Accounting	20%
D	Asset Accounting	20%
E	Accounting for Special Transactions	20%

(A) Pay Roll Accounting :

1. Concept of Pay Roll Accounting
2. Process of Pay Roll Accounting
 - Pay/Salary, Gross-earnings, deductions- statutory and non-statutory deductions-responsibility of the employers
3. Statutory Deductions- EPF/ESI/Income Tax/Professional Tax/other and its accounting.
4. Accounting of Bonus and Gratuity

(B) Store Accounting

1. Pricing of purchase of materials
2. Issue of materials from stores.
3. Pricing of returned materials
4. Issue of materials to other formations
5. Issue of materials for disposals

(C) Sales Accounting

1. Recognize revenue items at the proper time on the income statement.
2. Account for cash and credit sales.



3. Compute and interpret sales returns and allowances, sales discounts, and bank credit card sales.
4. Manage cash and its importance to the company.
5. Estimate and interpret uncollectible accounts receivable balances.
6. Assess the level of accounts receivable.
7. Develop and explain internal control procedures.

(D) Asset Accounting

1. Meaning of Asset Accounting
2. Current Asset Accounting
3. Fixed Asset Accounting
4. Project Accounting

(E) Accounting for Special Transactions

1. Bills of Exchange
2. Consignment
3. Joint Venture
4. Sale of goods on approval or return basis



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STUDY NOTE – 1

PAYROLL ACCOUNTING

This Study Note includes:

- Concept of Pay Roll Accounting
- Process of Pay Roll Accounting
- Statutory Deductions
- Accounting of Bonus and Gratuity
- Wages and Direct Expenses

1.1 CONCEPT OF PAYROLL

Payroll refers to the earnings of the employees for a particular period (say a month) for their services rendered to the organisation. It refers to sum of all financial records of salaries for an employee, wages, allowances, retires and deductions. The term "Payroll" applies to the employees on the rolls of the company.

It is prepared based on the time card (i.e. attendance). It also includes various other incentives that are paid to the employee based on the employment agreement.

1.1.1 Objectives of Payroll:

The objectives of the payroll are:

- ensure that all employees are paid accurately and timely with the correct recoveries and deductions.
- ensure the recoveries and deductions are remitted to the statutory authorities in a timely manner.
- ensure the proper accounting of salary expenses in the books of accounts.

1.1.2 Components of Payroll

1. Employee Earnings
2. Deductions / Withholdings from the Employee Earnings

1.1.3 Employee's Earnings:

Employee's earnings are based on the contract of the employment. In case of salaried employees the earnings are defined as a fixed amount. In case of wages for Labourers, the wages may be related to the production levels.



Employee's Earnings generally include

1. Basic Salary,
2. Allowances,
3. Incentives,
4. Commission,
5. Overtime Pay,
6. Holiday Wages etc.,

1.1.4 Deductions/ Withholdings from employee earnings:

It refers to the deductions to made from the employees' earnings for Statutory Social Security Savings (example Provident Fund), Insurance ,Employment/ Professional Tax, Income tax etc.,

The Employees' deductions are recovered from the employee's salary and the deductions are remitted to the respective statutory authorities as per the existing laws. In certain cases, there would a matching contribution paid by the employer.

Employees Deductions/Withholdings includes

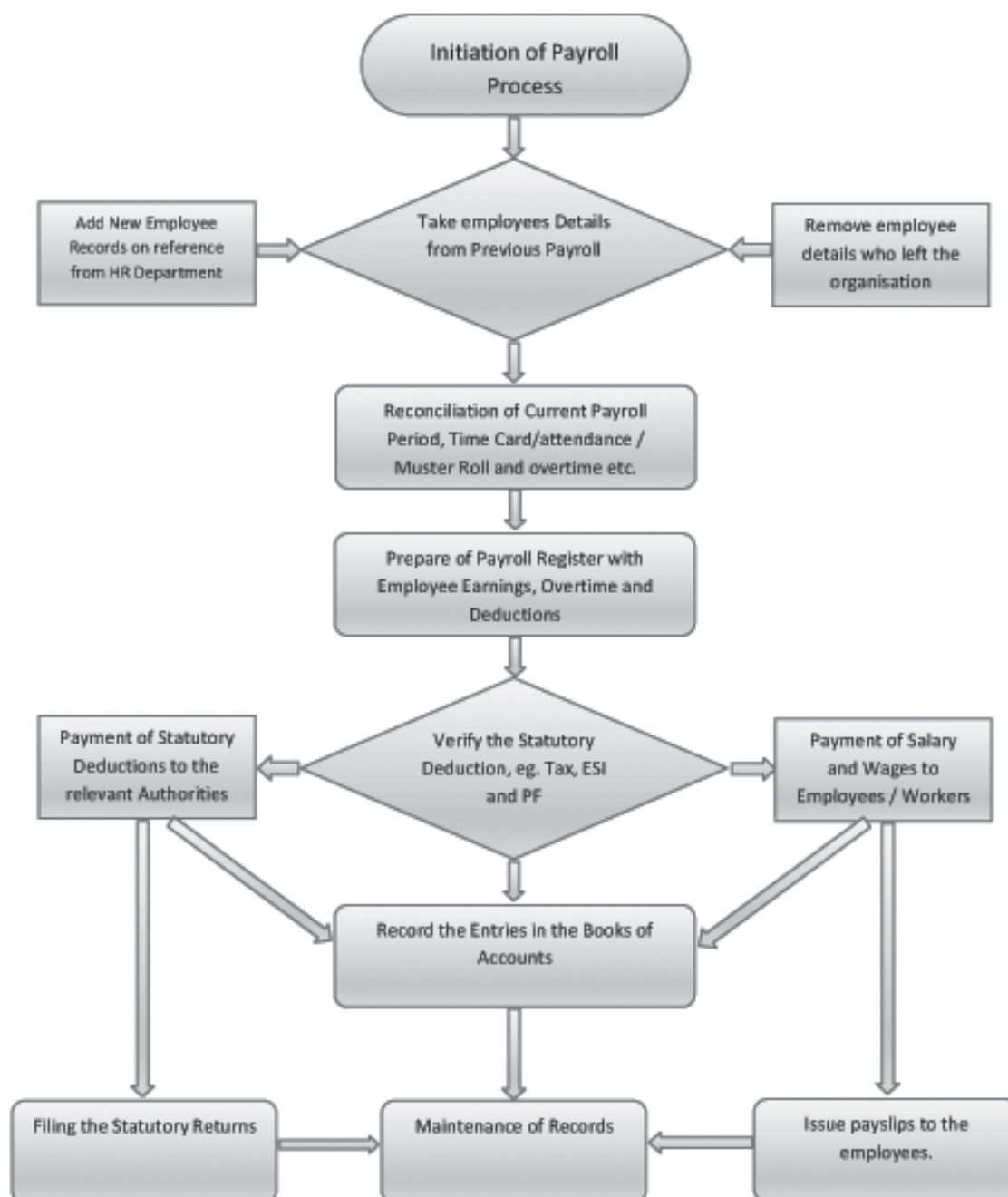
- 1) Social Security Deductions (Provident Funds, ESI contribution)
- 2) Employment/Professional Tax to be paid by the employee
- 3) Income Tax to be paid by the employee
- 4) Any other deductions made by the employer at the request of the employee

(e.g. Salary Advance Adjustment, Life Insurance Premium payment, Canteen Recovery, Transport Recovery, Housing/Vehicle Loan and any other recovery etc.,)

Study Note-1 : Payroll Accounting

1.2 PROCESS OF PAYROLL :

The payroll process is a sequence of actions that are carried out in any organisation. The payroll process can be diagrammatically depicted as follows:





1.2.1 Components of Payroll :

Employee Earnings :

- | | | |
|-----|------------------------------------|---|
| 1 | Basic Pay | It represents the basic salary of the employee. |
| 2 | Dearness Allowance | This allowance is given by the employer to the employee to compensate the rise in prices. Normally, it is calculated as a percentage on Basic Pay.

e.g. 72% of Basic |
| 3 | House Rent Allowance - HRA | Allowance granted by an employer to his employee to meet the expenditure incurred on payment of rent. |
| 4 | City Compensatory Allowance – | Allowance given to the employees to compensate the high cost of living in metro cities. |
| 5 | Children Education Allowance | Normally this allowance is given by employer to employees for study of their children up to 2 children |
| 6 | Medical Allowance | Other allowance granted by the employer to the employees. |
| 7 | Professional Development Allowance | |
| 8 | Special Allowance | |
| 9. | Transport Allowance | |
| 10. | Conveyance Allowance | |

Employee Deductions:

- | | | |
|-----|--|---|
| 10. | Deductions for PF Contribution | Employee's Share of PF contribution. It normally forms a percentage on basic and Dearness pay
e.g . 12 % of Basic and DA |
| 11 | Deduction for ESI (Employee State Insurance) | Employees' Share of contribution towards ESI. ESI deduction is made only when the gross salary of an employee is below specified amount. (e.g. Below Rs.15,000), (Presently the percentage of ESIC deduction is 1.75 % on salary of employee) |
| 12 | Professional Tax | It represents the amount of Prof. Tax to be |



Study Note-1 : Payroll Accounting

paid by the employee. It is to be deducted by the employer and to be paid to the statutory authority. Professional tax is to be paid by bi-annually, Quarterly or monthly, it depends on state to state.

13 Income Tax Deducted at source

It is the deduction for the payment of income tax by the employee. The taxable income of the employee is calculated and deductions are made at specified rates. In India, the income tax of the employees is to be calculated for the financial year April – March.

1.2.2 Creation of Payroll:

1) Creation of Employee Information.

The payroll details of the employees should be recorded with the Payroll (Finance) department by the Recruitment- HR team for monthly processing of the payroll and other benefits. The Compensation details of the employee, as decided by the HR (Personnel) team would be accepted and acknowledged by the employee and the same would be forwarded to the Payroll team for further processing.

2) Collection of the timecard information:

Every month the payroll department would require the timecard (attendance) information of the employees for calculation of the "salaries due" to the employees. The timecard information containing the leave details, overtime information, and Holiday wages would be forwarded by the department concerned to the payroll team for preparation of the Payroll for the respective month.

3) Preparation of the Payroll Register:

Based on the employee compensation records and the time card information, the Payroll for the month is prepared by calculating the Employee Earnings (Such as Basic Pay, Dearness Allowance, Incentives) and Employee Deductions (EPF, ESI, Tax deductions) etc., Any allowances such as overtime premium, holiday wages is added to employee's earnings and loss of pay for the period charged to the deductions. The net pay to the employees is determined.

4) Verification of the tax amounts and statutory deductions:

The values of statutory deductions such as EPF, ESI are to be checked with the previous month values and any difference other than those caused change in the salaries should be examined and verified. Similarly the tax deductions should be verified.



5) Record the entries in the Books of Accounts.

Once the Payroll register is completed for the respective month, the necessary due entries for the salaries due and salaries payment can be made in the Books of Accounts.

6) Payment of the Salaries:

Once the Payroll process is complete and approved the finance manager, the salaries can be paid out by way of crossed (A/c Payee) cheques or bank transfers to the individual employees to their respective bank accounts.

7) Payment of Statutory Deductions and Withhold Taxes:

Once the salaries are credited to the employee accounts, the statutory deductions such as EPF deductions, ESI deductions and the taxes due to the Government be paid within the due date prescribed to the statutory authorities by way of cheques or bank transfers.

8) Issue of Payslips to the employees

Once the salaries are released to the employees, the Payroll team would prepare the Individual payslips and forward it to the employees and get a copy of the same acknowledged by the employees. This is required to ensure that the pay particulars are correct for the employees. Payslips are generally issued to Salaried/Regular employees.

9) Preparation of the Statutory Reports:

Once the payroll process is complete and payments are completed within the due date, the statutory reports (EPF returns, ESI Returns and TDS Returns) are to be filed in the required forms with the statutory authorities within the due date.

1.2.3 Methods of Payroll Process:

Payroll process can be performed in an organisation by using any of the three methods. The methods are given below:

A. Internal Methods:

- 1) Manual Payroll Processing
- 2) Computerised Payroll Processing (Automated / Non – automated)

B. External Methods:

- 3) Payroll Outsourcing

1.2.3.1 Manual Payroll Processing:

It is the traditional methods of payroll processing. It is time consuming and it is prone to clerical errors. It is suitable for small firms.

1.2.3.2 Computerised Payroll Processing:



Study Note-1 : Payroll Accounting

When the payroll processing is carried on with the help of computer systems and software's it is termed as a computerised payroll processing system. When the other systems such as attendance tracking, payment processing system are integrated with the payroll processing system it is termed as automated computerised payroll system. When the other system are not interlinked and integrated it is termed as non-automated payroll system.

1.2.3.3 Payroll Outsourcing:

When the payroll process is outsourced to a third party professional, it is known as Outsourced Payroll system. It is cost-effective and it has provides efficient operational level results. Many Multi-nationals corporations outsource the payroll and its related activities to a third party professional client, in order to achieve better results and also to maintain the confidentiality within the organisation.

1.2.4 Payroll Records:

Payroll records includes the

- Advice/Communication received from HR Department about additions/deletion in the payroll.
- Payroll registers (either hard copy or soft copy)
- PF returns and PF challans
- Insurance payment receipts
- Tax Remittance Challans and Returns,
- ESIC Challans and Returns
- Other related vouchers.

1.2.4.1 Payroll Registers:

The Payroll accounting requires maintenance of payroll registers and documents. It is mandated in India by the Employee's Provident Fund Act and other related labour legislations. From the point of view of Internal Control and Audit, it also serves as a voucher. Many organisations term the payroll register as "Salary Acquaintance". It forms as evidence in the court of law. In India, the Payroll registers and other related documents are preserved by the organisations for a minimum period by 5 years. As a result of computerisation, the records can be maintained for a longer period. The particulars that are to be recorded generally in the payroll registers are:

- Name of the employee
- Date of joining the organisation
- Job Title and Designation, Department and grade



Paper III: Financial Accounting-2

- Salary particulars such as Basic Pay, Dearness Allowances, Other allowances, deductions, Net Pay etc.,
- Mode of Payment of Salary (Cheque/Cash/Bank Transfer)
- Provident Fund Registration Number (Social Security Number)
- Consolidated Leave Particulars (Total No. Of absence, No. Of days available for leave, etc.,)
- Details of deductions such as, EPF, ESIC, Income Tax and other recovery etc.

There is no prescribed format for maintaining the above particulars. The corporate maintain the particulars based on their operations and requirement.

Many organisations in India maintain a "Payroll Acquaintance" in hard bound register and the employees are required to affix a "Revenue Stamp" and acknowledge by signing across the

Payroll for the Month of

Employees Earnings (Dr.)							Deductions from Employee Earnings (Cr.)			
Sl. No.	Name	Employee ID	Basic	DA	CCA	Gross Earnings	Employees PF	Other Deduction	Net Pay	Stamp & Sign (only in case of cash payment)
1										
2										
3										
Total										

Illustration 1: (Preparation of Payroll for Employees)

Prepare the payroll of ABC & Co. A partnership firm, based on the particulars below:

Sl. No	Employee Name	Basic (Rs.)	DA	Grade / Designation
1	Shri. Anand	16,500		Supervisor - Gr . 4
2	Shri. Ram	33,240		Dy. Manager-Gr.3
3	Shri. Laxman	28,900	54% of	Group Leader- Gr.2
4	Shri. Vyas	12,100	Basic	Worker - Gr. 5
5	Shri. Balaji	13,750		Worker - Gr.5



Study Note-1 : Payroll Accounting

House Rent Allowance:

Group 1 to Group 3 are eligible for House Rent Allowance @ Rs.3,500 per month

Group 4 to Group 6 are eligible for House Rent Allowance @ Rs.2,550 per month.

City Compensatory Allowance:

Employees are eligible for a CCA of Rs.500 per month

Medical Allowance:

Employees – Gr. 1 to Gr.4 are eligible for a medical allowance of Rs. 450 per month.

Employees PF – Deduction – 12% of Basic Salary

Professional Tax Deductible – Gr . 1 & 2 – Rs.550 per month

Gr. 3 & 4 – Rs.350 per month

Gr. 5 Rs. 150 per month

Solution :

Payroll for the Month of _____

Employee Earnings (Dr.)								Deductions (Cr.)			Net Pay
Sl. No	Name	Grade	Basic	DA	CCA	HRA	Medical Allowance	Gross Earnings	PF @12%	Prof. Tax	
1	Anand	4	16,500	8,910	500	2,550	450	28,910	1,980	350	26,580
2	Ram	3	33,240	17,950	500	3,500	450	55,640	3,989	350	51,301
3	Laxman	2	28,900	15,606	500	3,500	450	48,956	3,468	550	44,938
4	Vyas	5	12,100	6,534	500	2,550	--	21,684	1,452	150	20,082
5	Balaji	5	13,750	7,425	500	2,550	--	24,225	1,650	150	22,425

Illustration 2 : (Preparation of Payroll for Wages)

Smith, an employee of ABC Manufacturers, is paid wages @ Rs.70.25 per hour. For work over 40 hours in a week (i.e. for more than 8 hours a day) , the company paid him one-half the times the regular rate. The company has a pay policy of payment of wages at twice the normal rate, for working on Saturdays, Sundays and holidays. During the month of January 2020, Smith worked for 22 working days of 8 hours each, 16 overtime hours and 1 weekend. Calculate the amount of wages due to him.

Solution :

ABC Manufacturers

Payroll for the Month of January, 2020

Sl. No	Name	Normal	Hours	Weekend	Normal	Wages Overtime	Weekend	Total Pay
1	Smith	176	16	48	12,364	1,686	2,248	16,298



Normal Hours = 22 Days x 8 hours = 176 hours x Rs.70.25=Rs.12,364

Overtime = (Rs.70.25 x 1.5 times) x 16 hours = Rs.1,686

Weekend = 1 Weekend = 2 days x 8 hours = 16 hours x (Rs.70.25x 2) =Rs.2,248

1.2.5 Internal Control for Payroll procedures:

Controls play a very important role in processes, where there is a frequent possibility of occurrence of an error. Controls points help us in achieving the desired results effectively and efficiently. At most of the times, the controls help in avoidance of errors and frauds. The need for the control depends on various factors such as cost and impact of interference of such controls in the process. The controls can be either

- 1) Preventive controls
- 2) Deductive Controls.

Preventive controls are those which have been inbuilt in the process, so as to enable the smooth and proper functioning of the entire system. It would facilitate in the preventing the occurrence of the errors.

Deductive controls are those which are introduced to measure the quality of the transactions/ operations in the process. It is similar to that of "Quality Check" and it helps in detection of errors and rectification of those errors.

Some of the controls to be implemented in Payroll Accounting are:

- 1) Employee's Advances
- 2) Change to payroll records
- 3) Access Control and Change Control – Tracking Log
- 4) Time Card/Attendance automation controls
- 5) Reimbursement of Expenses
- 6) Recovery – Remittance Control

1.2.5.1 Employee's Advances:

In any organisation, employees seek advances against salary. These advances are to be deducted from the employee's salary over a period of time. (e.g the advances may be adjusted in 5 equal instalments). It is better to always a control over the employee's advance as there is a possibility of advance not being adjusted in the subsequent payrolls. It is always better to have a control over the employee's advance and it is possible by

- Periodical review and reconciliation of the salary advance, so as to enable proper tracking and accounting of the salary advance.



Study Note-1 : Payroll Accounting

- Sanctioning advance after due authorisation and approvals.

1.2.5.2 Change to the payroll records:

Any change or modifications to the employee's payroll records should be requested by the employee himself or by an authorised officer. The request should be properly requested and approved by the Human Resources (Personnel) Department. The following are the types of change requests received:

- 1) Change to employee's personal records such as Marital Status, residential address etc.,
- 2) Change to employee's compensation package such as Increase in Salary, Payment of additional incentive/allowance etc.,

It would be better to separate the duties of preparation and maintenance of payroll database between the personnel department and payroll department.

1.2.5.3 Access Control and Change Control – Tracking Log:

In case of in-house processing of payroll it would be better to have access control in order to avoid unrestricted access. Maintenance of Change control log would help in tracking down or detection of erroneous and fraudulent entries to the payroll system.

1.2.5.4 Time Card/Attendance automation controls:

The process of computerization of timecard information would lead to automation of timecard information and this would lead to avoidance of missing timesheets, calculation incorrect working days and incorrect payroll calculations. Also, the overtime hours worked should be properly authorized, so as to enable correct and accurate payment of overtime premium.

1.2.5.5 Reimbursement of Expenses:

For reimbursement of expenses, the reimbursement should be requested by the employee, should be authorised by the supervisor and approved by the finance department and then it should be forwarded to the payroll department for payment. Each and every request for reimbursement of expenses should be properly tracked with serial number, employee id, etc.,

1.3 STATUTORY DEDUCTIONS

All the recoveries and withholdings such as PF deductions, ESI deductions, Tax deductions should be remitted to the respective statutory authorities within the due date. There should be separate tracking register to ensure that the amount recovered has been correctly remitted to the statutory authorities, within the due date. Due dates for Statutory Remittances are;

Income Tax (TDS)	:	07th of the *Subsequent Month
Provident Fund	:	15th of the Subsequent Month
ESIC	:	15th of the Subsequent Month



* Subsequent month: means the next month of the month on which the expenses has been incurred. For instance, if salary for the month of March is accounted in the books on dated 31st March 2020 the subsequent month for March salary will be April 2020 and Income tax will due for the March month will be on 7th April 2020.

1.3.1 Glossary of Terms used in Payroll:

Allowance: It refers to a payment made to an employee. It may be a fixed Allowance or a variable allowance.

Fixed Allowance: Decided by the employer and Fixed e.g. House Rent Allowance of Rs.5000 per month.

Variable Allowance: It varies based on the performance of the employee in the business operations. It is also termed as "Incentive". e.g. Sales Allowance @ 2% on the Total sales made by the employee.

Holiday Wages: It refers to the wages paid to an employee for working on an holiday or festival. The holiday may be weekly holiday or a Government declared holiday. In India, Holiday wages are paid at double the rate. E.g. When the employee works on May 1, (May Day), the employee shall be paid wages for that day at double rate.

Overtime Allowance: When the employee works more than the specified period in a week or during a period, the additional time worked is termed as "Overtime" and it is paid at a special rate. Such payment is known as overtime allowance or overtime premium. E.g. If the employee works for more than specified hours of 40 hours in a week, it is termed as overtime worked and the extra hours shall be compensated separately.

Gross Earnings: It refers to the total of all the amounts that are earned by the employee during a payroll period. It is before all deductions.

Loss of Pay: Loss of pay refers to the days for which the earnings are deducted for unauthorized absence for work, shortage of leave available to the credit of the employee. It is shortly termed as "LOP".

Statutory Deductions : It refers to the mandatory deductions to be made from the employee's as per the prevailing legislations. For E.g. Employee's Provident Fund contribution shall be deducted @ 12% from Basic Salary and DA forming for Retiral benefits.

Employee's State Insurance Corporation Insurance Contribution shall be 0.75% of the gross salary.

Professional Tax is a tax deduction to be made to the Local authority/State Government at the prescribed rates.

Retrials: Deduction for Gratuity is known as "Retirals". Gratuity is an ex-gratia payment made to an employee for serving the employer for a longer period of time. Normally, Gratuity shall be



Study Note-1 : Payroll Accounting

paid to an employee who has served a minimum period of 5 years under an employer.

Net Pay: It is termed as "Take Home" pay for the employee. It is the earnings after all deductions. It is amount paid to employee.

Net Pay = Gross Earnings - Total Deductions.

1.3.2 Pay Slip:

Pay slip also termed as "Pay Statement" would be provided to the employees by his employer at the pay period (i.e. every month) disclosing his earnings and deductions etc., the general format of the Payslip is given below.

PAYSLIP FOR THE MONTH OF

Name of the Employee :	Designation :
Employee Number :	Department :
Date of Joining :	Grade/Level :
Bank Account No. :	No. of Paid Days :
PAN :	Loss of Pay Days
Provident Fund Account No :	
ESIC Number :	

Employees Earnings		Employees Deduction	
Basic Salary	xx	Provident Fund	xx
Dearness Pay	xx	Professional Tax	xx
House Rent Allowance	xx	Income Tax	xx
CCA	xx	Retirals Deductions	xx
Transport Allowance	xx	Other Deductions	xx
Holiday Wages	xx		
Overtime Pay	xx		

Other Earnings

Gross Earnings

Total Deductions

Net Pay (Rs.XXXX) and in Words

This is a computer generated statement, hence signature is not required

Illustration 3 : Preparation of Payslip:

Mark (Emp ID – 0987) is working as an Assistant Manager, Finance in TPS India Limited. He worked



for 29 days in the month. During to lack of leave credit, he has availed 2 days loss of pay. The Salary for Jan . 2013 particulars are given below:

Basic Salary	– Rs.38,976	Dearness Allowance (Forming part)	– 71% of basic
House Rent Allowance	– Rs.5,100	City Compensatory Allowance	– Rs.2,450
Conveyance Allowance	– Rs.800	Medical Reimbursements	– Rs.1,500

Deductions:

PF Deductions	– 12% of basic & DA Forming.		
Income Tax Recovery	– Rs.4,000.	Professional Tax Deduction	– Rs.250

Prepare the Pay Slip of Mark.

TPS India Limited
PAYSLIP FOR THE MONTH OF JANUARY, 2020

Name of the Employee	:	Mark	Designation	:	Assistant Manager
Employee Number	:	0987	Department	:	Finance
Date of Joining	:		Grade/Level	:	
Bank Account No	:		No.of Paid Days	:	29
PAN	:		Loss of Pay Days	:	02
Provident Fund Account No	:				

Employees Earnings	Rs.	Rs.	Employees Deductions	Rs.
Basic Salary	38,976	38,976	Provident Fund	7,998
Dearness Pay	27,673	27,673	Professional Tax	250
House Rent Allowance	5,100	5,100	Income Tax	4,000
CCA	2,450	2,450	Loss of Pay	4,839
Conveyance Allowance	800	800	(Rs.74,999 x 2/31)	
Medical Reimbursement		1,500		
Gross Earnings	74,999	76,499	Total Deductions	17,087
Net Pay		59,412		

1.3.3 Accounting for Payroll:

The payroll is prepared on the last working day in the month.

- Salaries and Wages is an "Indirect Expenses" and it is debited to Profit and Loss Account.
- All the recoveries such as PF deductions, ESI payable, Insurance Recoveries payable are to be shown on the "Liabilities" Side of Balance Sheet, until it is paid.



Study Note-1 : Payroll Accounting

- The Employees' Share of retirals is an "Indirect Expense" and it is debited to the Profit and Loss Account.

The Accounting Entries would be

Date	Particulars		Debit	Credit
Due Date	Salaries and Wages A/c	Dr.		
	To Employees' Provident Fund Payable A/c			
	To Workmen's Insurance Payable A/c			
	To Professional Tax Payable A/c			
	To Net Pay / Salary Payable (Being Salary accrued for the month of)			
Due Date	Employer's Contribution of Prov. Fund A/c	Dr.		
	Employer's Share of Insurance A/c	Dr.		
	To Retirals Payable A/c (Being Employer's Share of Provident Fund and Insurance Payable for the month of)			
Pay rate	Net Pay/Salary Payable A/c			
	To Cash / Bank A/c (Being Net Salary credited to the employees account for the month of)			
Remittance Date	Employee's Provident Fund Payable A/c	Dr.		
	Workmen's Insurance Payable A/c	Dr.		
	Professional Tax Payable A/c	Dr.		
	Retirals Payable A/c	Dr.		
	To Bank A/c (Being Employee's Withholding and Employer's Contribution paid for the month of)			

Illustration 4:

Pass journal entries in the books of Friends Company for the month of Feb 2013

	(Rs.)
Total Gross Salary and Wages	1,54,67,789
Employee's PF Deductions	1,35,678
ESI Payable	67,876
Prof.Tax Recovery	13,200
Income Tax Receovery	75,400



Employer's Contribution to PF	1,23,457
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Salary becomes due on the last day of the month and it is paid to the employees on 1st of every month. The company remitted the recovered tax on 3rd March, 2013 and PF and ESI was remitted on 4th March, 2013

Date	Particulars		Debit	Credit
2013 Feb 28	Salaries and Wages A/c	Dr.	1,54,67,789	
	To Employees' PF Payable A/c			1,35,678
	To Employee's ESI Payable A/c			67,786
	To Prof. Tax Recovery Payable A/c			13,200
	To Income Tax Recovery Payable A/c			75,400
	To Net Salary Payable A/c (Being Salary due for the month of Feb. 13)			1,51,75,725
2013 Feb 28	Employer's Share of PF A/c	Dr.	1,23,457	
	To Retirals payable A/c (Being Employer's Share of PF Due for Feb)			1,23,457
2013 Mar 1	Net Salary Payable A/c	Dr.	1,51,75,725	
	To Bank A/c (Being Salary paid released for Feb 2013)			1,51,75,725
2013 Mar 3	Prof. Tax Payable A/c	Dr.	13,200	
	Income Tax Payable A/c	Dr.	75,400	
	To Bank A/c (Being taxes recovered remitted)			88,600
2013 Mar 4	Employee's PF Payable A/c	Dr.	1,35,678	
	Employee's ESI Payable A/c	Dr.	67,786	
	Retirals Payable A/c		1,23,457	
	To Bank A/c (Being Employer's & Employee's Share of retirals paid)			3,26,921

1.4 : ACCOUNTING FOR BONUS AND GRATUITY

1.4.1 Bonus:

Bonus also refers to a ex-gratia payment made voluntarily without any obligation. In India, Bonus is governed by the Payment of Bonus Act, 1965. Each and every establishment covered under the act shall pay bonus to its employees at the prescribed rate as specified u/s.11 of the act. There are certain rules and regulations governing the payment of bonus.



Study Note-1 : Payroll Accounting

The accounting Entries would be

Date	Particulars		Debit	Credit
Pay Date	For Payment of Bonus :			
	Employees Bonus A/c	Dr.		
	To Bank A/c (Being Bonus paid to)			

Illustration 5 :

Rajesh Co. Paid bonus of Rs.35,95,460 to its employees on occasion of new year celebrations. Pass necessary entry.

Solution :

Journal Entry

Date	Particulars		Debit	Credit
	Employee's Bonus Expense A/c	Dr.	35,95,460	
	To Bank A/c (Being bonus paid to employees on occasion of new year)			35,95,460

1.4.2 Gratuity:

Gratuity refers to ex gratia payment made to an employee for rendering service to the organisation for a longer period of time. It is offered to employees as a retirement or super-annuation benefits. The quantum of gratuity payable depends on the policies and procedures of the employers. Normally, contribution for gratuity is recovered from the employee's Gross earnings and the employer also contributes a similar amount to the Gratuity. Gratuity fund is accumulated and paid to an organisation such as LIC in the form of "Gratuity Premium". Whenever, gratuity is to be payable to the employee's, the amount is received from Gratuity fund from the company and it is paid to the employee.

The accounting Entries shall be

Date	Particulars		Debit	Credit
Pay date	For Payment of Gratuity Premium :			
	Gratuity Premium A/c	Dr.		
	To Bank A/c (Being gratuity premium paid to)			
Receipt date	For Receiving amount from Gratuity Fund :			
	Bank A/c	Dr.		
	To Gratuity Fund A/c (Being Amount for Gratuity received from)			



Pay date	For amount paid to employee			
	Gratuity Fund A/c	Dr.		
	To Bank A/c (Being Gratuity paid to the employees)			

Note : Gratuity Premium would be treated as expenses and charged to P & L A/c.

1.5 WAGES AND DIRECT EXPENSES

Wages is another important component, payment of remuneration to any worker for his services, especially remuneration on hourly, daily or weekly basis or by the piece is called wages.

In a manufacturing set-up where there is a larger proportion of workers and existence of trade unions, there has to be a cordial relationship between management and union to ensure motivated performance. In the service sector, wages bears the highest percentage to the total.

In these days of growing economy and dearth of quality human resources, management of wages becomes very crucial.

Employee attendance & time recording: In smaller organisations a manual register is maintained, where each employee has to mark his attendance. In larger organisation, electronic tools of recording attendance are used. An electronic card is swiped to record daily entry and exit. Some organisations use the finger print savvy cards as well. The good old days of time keeping office at the factory gate are no more in existence.

1.5.1 Direct Wages and Indirect Wages

Direct wages is the remuneration paid to workers for time spend directly on production unit, If a worker directly spending his to the production line it will be treated as direct wages otherwise it will fall under the category of indirect wages. A worker working in the production department may not necessarily be directly identified with a cost unit. E.g. a foreman or a supervisor or a production planning officer cannot be linked with a production unit and therefore will be indirect labour. Hence just because a person works in production department does not mean he is a direct labour. Also, if a person working on jobs directly spends some time on repair of a machine, cost of that time should be taken as indirect wages.

1.5.2 Remuneration methods & Incentive schemes

The employees working in any organisation are compensated by way of salaries, wages and other benefits. These payments are made in return of the services rendered by the employees. These services could be:

- Engaging in the process of transformation of raw material into finished product or
- Supporting the process of transformation by doing other functions



Study Note-1 : Payroll Accounting

The salaries, wages and statutory benefits put together are called as remuneration. The incentives are payments and benefits given to stimulate better performance or paid in return for a better performance. The incentives could be in monetary as well as non-monetary terms. While the remuneration is always individual based, incentives could be based on group performance.

Characteristics of a sound Remuneration system:

- a) It should be easy to understand for everyone and easy to implement.
- b) It should provide for a reward for good work and penalty for bad workmanship
- c) It should help keeping labour turnover within stable limits
- d) It should be able to attract talent and retain them
- e) It should minimize absenteeism
- f) It should reflect a fair return to employees in consistence with efforts put in by them
- g) It should boost productivity and performance
- h) It should be flexible enough to factor in effects of changes in cost of living, and systems of similar companies in the same industry.

The payments could be broadly classified into

- Those paid on the basis of time spent by an employee irrespective of output produced by him, called Time Rate.
- Those paid on the basis of output given by the employee irrespective of the Time spent by him, called Piece Rate

Based on these two basic payment methods, many variants thereof have been developed over the last couple of centuries. Many of these systems were developed keeping in view the manufacturing industry, where measurement of physical performance is relatively easier. In modern times, especially for indirect workers, many of these plans will not work. Indirect workers and staff & managers are usually paid on time basis only.

Let us see these methods in brief with regard to their logic, calculation and application.

Time based payments: These are basically called as Time Rates. Under this method, payment is made on time basis like daily, weekly or monthly irrespective of the results achieved during the time period. These payments are in conformity with the applicable laws such as Minimum Wages Act.

- i. **Flat Time rate:** The rates and time are fixed in advance per day, week or month. If worker work overtime, they are compensated at one and half or two times the ordinary rate. The earning therefore will vary as per the time worked. If a time rate is fixed as Rs 100 per day of 8 hours, and the worker works for four hours; he will get Rs 50. The merits and demerits are same as explained above.



- ii. **High Wages System:** This method is similar to the above except the fact that the time rate is fixed at a higher level compared to the rates prevailing in the industry. This is done to attract efficient and high performance workers and also to induce them to improve productivity as they would be satisfied with high level of earnings. However, the level of performance cannot be guaranteed over a longer period and it also may not be possible to keep wages always at higher level compared to industry.
- iii. **Graduated Time rate:** Under this method, payment consists of two portions – one based on regular time base payments and the other is linked to cost of living (e.g. dearness allowance) and merit awards. As the cost of living is taken care of, the system has an advantage. It's further enhanced by the fact that the method rewards individual merits. However, merit rating is highly subjective and thus the method is difficult to implement. It is difficult to calculate the cost of the cost unit.

It is generally observed that trade unions prefer time based payments as they do not have to guarantee output. The variations in the time based payments do not really bring in any additional benefits and they are difficult to sustain in the longer run.

Indirect non-monetary schemes: These schemes aim at improving working conditions in plant and other facilities. These benefits are normally of permanent nature as facilities once provided are rarely withdrawn. The non-monetary benefits generally include:

- a) Flexible working hours
- b) Subsidised canteen facilities
- c) Educational facilities for children of employees
- d) Housing colonies
- e) Medical and hospitalization insurance
- f) Club memberships
- g) Guest house facilities at hill stations
- h) Recreation, annual events, sports and other competitions
- i) Cultural events

1.5.5 Incentives for Indirect workers and employees

Doing well and getting rewards for good performance cannot be restricted to direct worker only. The other employees working with service departments also contribute in furtherance of overall business objective. These employees render valuable support to direct workers by maintaining the facilities, providing administrative services such as accounts, human resources, industrial relation, utilities etc. They ensure smooth flow of activities in the business routines. As such it makes



Study Note-1 : Payroll Accounting

a case of indirect workers to get incentives. The incentive schemes for such workers cannot be based on same logic of schemes for direct workers as there is no direct linkage with the final output. The incentives could be paid considering the type of activity performed by different indirect departments and their activity measurement logic could be decided separately.

If the work is routine and standard, the standards could be set and actual output measured in comparison with the standards. Many times, group incentives will suit these workers more than the individual schemes. It is also possible to extend the logic applied for direct workers and pay a certain proportion of their incentives to the indirect workers. When the output of such employees is not measurable, the incentives based on cost savings or proportion of savings to value added could be designed. Here are certain examples of incentives for indirect workers.

The maintenance workers are normally responsible for routine inspection, preventive maintenance and breakdown maintenance and repair work. For routine inspection & preventive work, standards can be established as a basis for incentive schemes. For repair work, special awards scheme may be introduced.

For employees engaged in material handling and internal transportation, standards can be set for such activities based on time and distance.

Quality control or inspection staff may be paid on the basis of quality inspections done and this work can be standardised. There are routine checks carried while checking the conformation to the quality norms. Standards could be set for such activities. The inspectors will cover those who inspect incoming material, in process material and finished goods.

For office staff, generally group schemes are more suitable. This could cover even the executives and managers. Many companies follow the spot award schemes and other recognitions like executive of the month, the most customer oriented person, the most quality conscious person etc.

1.5.6 Overtime

Working getting extended beyond normal working hours is a usual phenomenon in today's industrial world. The work pressures and need to deliver results fast, working long hours is considered as inevitable in many organisations. It could also be caused by understaffing and high attrition rates in the industry.

However, not all this is paid for. Employees normally do not get paid extra for such long hours worked.

For unionized workers, however, as per the agreement overtimes may be paid for. Such payments are made usually at a higher rate (normally at double rate). It certainly adds to the cost of manufacturing. Hence the payment made for the overtime hours worked comprises of

- Payment made at normal rates



- Premium paid for the overtime hours

Overtime is normally permitted on by the supervisors or departmental heads. There is a form called 'request for overtime' wherein the details of job and reason for extra hours beyond normal working hours are mentioned. If though fit, such working may be permitted. The reasons for overtime may be:

- Illness of some workers may force other to work extra and complete the work
- It may be at the request of customers to complete an order in quick time
- There could be receipt of more orders than planned and it may not be possible to immediately employ additional workers
- Receipt of rush orders

Control of Overtime work

- 1) It should be allowed only with prior permission.
- 2) It should be collected under an overtime ticket and assigned to the particular department
- 3) If it is becoming a regular feature, putting in more manpower may be considered.
- 4) Periodical reporting of overtime with the reason for extra hours worked may be circulated for action by the different levels of management.
- 5) The effort should be to reduce overtime as it could lead to health problems, more fatigue, quality deterioration, increase in the cost of power & electricity, other facilities, more wear and tear of machinery etc.

1.5.7 Direct Expenses

The expenses represent that part of the production cost which is other than material and labour. It is basically cost of facilities or services which are used as aids to production.

The expenses again could be classified as direct and indirect. In this section we will talk about Direct Expenses.

Direct expenses are those expenses (other than material & labour) which can be directly associated with a job or a process or a cost unit. They are a part of prime cost. They are also referred to as Chargeable expenses. They do not physically form part of the final product like material cost, but facilitate the output directly.

Examples of direct expenses are:

- Royalties and patent fees paid for using technology
- Hire charges for special machines, facilities, tools etc. that are used in relation to a specific job or process

Study Note - 2 : Store Accounting

- Sub-contractors charges for getting some operations done by outsourcing
- Consultancy charges paid exclusively for a job
- Cost of special design, layout
- Architect's fees
- Traveling for a specific job

The proportion of direct expenses in the total cost is usually small. In a factory, expenses that can be directly linked to production departments also can be clubbed as direct expenses. Examples are power & electricity charges paid based on the meter reading in the production departments. These are absorbed into the prime cost.

In service industry, the direct expenses are related to the generation of service. For example, a transporting company provides transportation service. The expenses on the vehicle maintenance, petrol & fuel etc. can be directly linked to a vehicle and can thus be treated as direct expense. For an educational institute, the charges paid for educational consultants in developing the curriculum may be taken as direct expense for that particular course.

Certain expenses may be direct expenses for certain costs centres but they are indirect for the production departments. These do not form part of prime cost, but absorbed as overheads.

Miscellaneous examples

Q 1

A firm's basic rate is Rs 3 per hour and overtime rates are one and half times for evenings and double rate for weekends. Following details have been given on the three jobs:

Hours recorded	Job X	Job Y	Job Z
Normal time	480	220	150
Evening time	102	60	80
Weekend	10	30	16

Calculate labour cost chargeable to the jobs under following circumstances:

- Where overtime is worked occasionally to meet production requirements
- Where overtime is worked at the customer's request to expedite the supply.

Answer 1

- If overtime is occasionally worked for production requirements, then the normal rates should be charged to the Jobs and the premium portion should be treated as production overheads. This will be:



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	Job X	Job Y	Job Z
Total Hours Worked	592	310	246
Charged to Jobs @3 per Hour	Rs.1776	Rs.930	Rs.738

- a) If OT is worked at the request of customers, then the entire cost of additional time worked (including the premium) must be charged to the jobs. This will be as follows:

	Job X	Job Y	Job Z
Normal time	480	220	150
Evening time	102	60	80
Weekend	10	30	16
Charged to Jobs			
Normal time @Rs.3 Per Hour	Rs.1440	Rs.660	Rs.450
Evening time@Rs.4.5 Per Hour	Rs.459	Rs.270	Rs.360
Weekend time@Rs.6 Per Hour	Rs.60	Rs.180	Rs.96
Total	Rs.1959	Rs.1110	Rs.906

Evening time is paid@1.5 times of Rs.3 i.e. at Rs.4.50 per hour and weekend@2

Q 2

The standard hours for a job are 100 hours. The job has been completed by Shanker in 60 hours, Ehasaan in 70 hours and Loay in 95 hours. The factory had a bonus system applicable to job based on the percentage of time saved as compared to standard hours. The rate of pay is Rs 1 per hour. Calculate the total earnings of the three based on the following table of the incentive scheme and also the rate of earnings per hour for them.

Percentage of time saved

Saving up to 10%

From 11% to 20%

From 21% to 40%

From 41% to 100%

Answer 2 :

	Shanker	Ehasaan	Loay
Standard Hours	100	100	100
Actual Hours	60	70	95
Hours saved	40	30	5
% of time saved to standard	40%	30%	5%



Study Note - 2 : Store Accounting

Bonus percentage	20%	20%	10%
Bonus Hours	8	6	0.5
Total Hours	68	76	95.5
Total Earning @Rs 1 Per Hour	68	76	95.5
Rate of earning per hour	1.133	1.086	1.005



STUDY NOTE – 2

STORE ACCOUNTING

This Study Note includes:

- Introduction to Store Accounting
- Pricing of purchase of Materials
- Issue of Material from Stores
- Pricing of returned materials
- Issue of material to formations
- Issue of material for disposals

2.1 INTRODUCTION TO STORE ACCOUNTING

Stores and material are used interchangeably. However, both the terms differ. A store has a wider meaning than materials. Store is a place in which the materials are stored. Different types of materials are kept in the stores.

It includes raw material, tools, equipments, repair, and maintenance of parts factory supplies, components, Fixtures, Jigs etc. Sometimes, it also includes finished goods, and semi finished goods within the scope of this term. Thus items kept in the store are called stores.

Inventories are goods that are meant for eventual conversion into cash in the normal course of business. Inventories are

- (a) **finished goods** – held for sale in the ordinary course of business
- (b) **semi-finished goods** – in the process of production for such sale
- (c) **stores, consumable items and packing materials** – in the form of materials or supplies to be consumed in the production process or in the rendering of services.

Receipt of Stores

All materials received should be examined, counted, measured or weighed, as the case may be, when delivery is taken, and they should be taken in charge by a responsible officer who should see that the quantities are correct, their quality good, and they are according to approved specification where prescribed and record a certificate to that effect. The officer receiving the stores should also be required to give a certificate that he has actually received the material and recorded them in the appropriate stock register.

Issue of Stores

When materials are issued from stock for departmental use, manufacture, sale, etc., the officer-



in-charge of the stores should see that an indent in the prescribed form has been made by a duly authorised (indenting) officer, examine it carefully with reference to the orders or instructions for the issue of stores and order the issue of stores.

The types of stores transactions are as detailed below:

(a) Receipts:

- (i) By purchases from suppliers
- (ii) By diversion from other stores
- (iii) By devolution from works

(b) Issues:

- (i) By issue of material of works.
- (ii) By issue of material to contractors, consumers, works, sale etc.,
- (iii) By diversion to other stores.

The substance from which the product is made is termed as material. It may be in a raw or a manufactured state. Raw materials are goods that are yet to be introduced into the production process. It forms an integral part of finished product. Materials are used for manufacturing goods. In most cases material is an important constituent of total cost. Hence, material cost is the main component of the cost of production. Materials may be direct or indirect:

Direct materials

Direct material means cost of raw material used or consumed in production. It is not necessary that all materials purchased in a particular period is used in production (in that period itself).

Indirect materials

Indirect Material is that material which cannot be easily identified and related with a particular product, job, and process.

Classification and codification

The storekeeper keeps the material in the store. The duties of storekeeper include accepting, identifying, classifying, and placing of materials.

Checking of material

He should verify the materials received with consignment note, inspection report and materials received report. Therefore, he should send the copy of materials received report received by him, after due verification to the Accounts Department for payment purposes.



Study Note - 2 : Store Accounting

Stocks levels

To avoid over and under investment in materials, the management decides the minimum/maximum quantity of materials to be kept in the store. The limits of minimum/maximum quantity set by the management should be strictly observed by the storekeeper.

Maximum stock Level

The maximum level is the largest quantity of a certain material which should be kept in the store at any point of time. Maximum stock level is computed as follows:

Maximum stock level = Reorder level + Reorder quantity – [Minimum consumption x minimum reorder period]

Or

Maximum stock level = Economic order quantity + Minimum stock

Minimum stock Level

The minimum stock level is the lowest quantitative balance of material which must be kept at all times so that the assembly line may not be stopped on account of non-availability of materials. It is decided by taking into account the followings:

Minimum stock level is computed as follows:

Minimum stock level = Re-order level – [Normal consumption x average Reorder period]

Re-order level

It is the point at which if material in store is reached, the order of further supply of material must be placed. This point is fixed between maximum level and minimum level. This point automatically initiates the process of placing a fresh order. Re-order level depends on the following factors:

- (i) Maximum usage
- (ii) Time interval i.e. the anticipated time lag between the date of issuing orders and the receipt of materials.

Re-order level = Maximum re-order period × Maximum usage

Average stock level

This level indicates the average stock held by the firm. It is calculated with the help of following:

Average stock level = $1/2$ [Maximum stock level + Minimum stock level]

Or

Average stock level = Minimum stock level + $1/2$ Re-order Quantity

Economic order quantity



The economic order quantity (EOQ) is the size of the purchase order which gives maximum economy in purchasing material. It is also termed as standard order quantity. It is fixed after taking into consideration the following points:

(i) Ordering cost

Cost of placing a order refers to the cost incurred for acquiring materials. It depends upon number of orders placed and the number of items ordered. If the order size is larger in quantity, orders placing cost per unit is lower and if order size is smaller in quantity, order placing cost per unit is higher: It includes cost of preparing and placing an order, cost of transportation, cost of receiving and inspecting the materials.

(ii) Carrying cost

It is the cost that is incurred in maintaining a given level of stock. It includes cost of handling materials, insurance premium, cost of storage space, obsolescence losses etc., larger size of stock, higher the stock carrying cost per unit per annum and vice versa.

EOQ is calculated as follows:

$$EOQ = \frac{2AB}{C}$$

Where, A = Annual consumption

B = Buying cost per order

C = Carrying cost per unit per annum

2.2 PRICING OF PURCHASE OF MATERIALS

The accounts of the stores are based on the fundamental principle that all materials purchased shall be charged to the suspense account 'stock' in the first instance though the materials purchased may be for a particular work and are chargeable ultimately to works for which the materials are issued.

The requirement of materials for works is estimated with reference to approved budgets and purchase orders are placed by the competent authority. The supplies against these orders will arrive into the stores. The value of these supplies will be debited to 'Stock' suspense account crediting supplier's account (Sundry Creditors).

All materials received should be examined, counted, weighed or measured as the case may be, by the custodian with assistance of work charged staff provided for the purpose.

After taking delivery of materials and after verification and check-measurement, the receipt of the material is recorded in the Stores Received Book. This is an initial record and serves the purpose of measurement book in so far as stores are concerned. The pages of the Stores Received Book are in triplicate and they are machine numbered.

General Procedures and Rules for Purchases : All the purchases should be made in a transparent,



Study Note - 2 : Store Accounting

competitive and fair manner to secure best value. This will enable the bidders to formulate and send their competitive bids with confidence.

All purchases shall be initiated with the approval of Stores Manager. An indent for the item will be raised specifying detailed specifications of the items required and the estimated value for the approval of Stores Manager. Stores Manager may redelegate powers at appropriate level of officers wherever necessary.

2.2.1 Purchase of Goods without Quotations

All small value purchases can be made directly by purchaser from the market including telephonic enquiry (after confirming that the price is reasonable) or through the Stores and Purchase section. Such purchase shall be done by following procedure:-

- a. Directly by the purchaser through an advance drawn for the purpose. This advance shall be subsequently adjusted by using the contingent advance adjustment form supported by Cash Memo/ Bill/ Receipt and proof of entry in the appropriate stock register. Intimation must be sent to Stores and Purchase section in case of NCS and LTAS items for entry in Asset register.
- b. The purchaser making purchase directly from the seller and payment being made by the Accounting unit for project purchase/ non project purchase against the proper invoice/bill, proof of delivery, acceptance of the item by the purchaser and entry in the appropriate stock register and asset register wherever relevant.
- c. Through the Stores and Purchase Section for which the quotations duly signed together with the purchase proposal approved by the Director shall be sent to Stores and Purchase Section for placing the order and further process.

2.2.2 Purchase of Goods with quotations

Purchase upto a value prescribed by the company can be made by inviting quotations from minimum of 3 firms by a Local Purchase Committee. The notice inviting quotations will be displayed on Company Notice Board. Quotations will be invited as per the procedure. Committee will prepare the comparative statement and forward its recommendations to Stores and Purchase Section for selected party with the approval of competent authority for placing purchase order.

2.2.3 Purchase of goods by Purchase Committee

In case of urgency purchase shall be done through a Local Purchase Committee consisting of at least 3 members. If required, a standing committee can be approved for a period of one year to make such purchases. The Committee will survey the market to ascertain the reasonableness of rates, quality and specifications and identify the appropriate suppliers. Based on the recommendations of the Local Purchase Committee, the purchase order will be released by Stores & Purchase Section.



The purchase shall be made only from those reputed sellers with valid Sales Tax Registration / CST Registration, VAT Registration, Shop Act Registration, PAN (Income Tax) and wherever relevant Excise Registration. The seller must be manufacturer of the item or authorized dealer of the manufacturer of the item.

For goods of high value prescribed by the company, the procurement will be by open tender by advertisement. The advertised tender enquiry should be on the website of the company as well as notice inviting tender displayed on the notice board. The company should also post the bidding documents in its website and permit prospective bidders to make use of the document download from the website. If such downloaded bidding document is priced, there should be clear instructions for the bidder to pay the amount by demand draft etc. along with bid.

The cost of purchase consist of the invoice price including duties and taxes, freight in and other expenditure directly attributable to the purchase.

2.2.4 Purchase through Petty Advances

Petty Advance is to be used for the reimbursement or purchase of items of an insignificant nature and for minor expenditure. A cash sale receipt or other form of supporting document must be obtained by the person claiming petty cash, as evidence of the expenditure. In exceptional circumstances, if reimbursement is requested but no receipt or other evidence is available, the claimant must complete a Statutory Declaration form, which must be duly authorised by a Manager, to validate the amount and nature of the expenditure being claimed.

Prior to reimbursing individuals for expenses incurred, the Custodian should examine the petty cash docket to ensure the following details have been completed:

- the date;
- the purpose/details of the expenditure;
- the amount paid;
- the account number including the use code; and
- the signature of the Claimant.

If a staff member requires an advance for the purchase of an item for which the exact cost is not known, they should sign an appropriate record for the advance in the first instance. The record of the advance should be held in the cash tin and should detail:

- the name of the person for whom the advance is given;
- the purpose of the advance;
- the amount of the advance; and
- the signature of the person to whom the advance is given.



Study Note - 2 : Store Accounting

On completion of the purchase, the staff member is to return the change and a completed petty cash docket, as detailed above, for the exact amount of the purchase.

Journal Entries for Inventory Transactions

There are a number of inventory journal entries that can be used to document inventory transactions.

	Debit	Credit
Inventory Purchase		
Raw materials inventory	XXX	
Merchandise inventory	XXX	
To Accounts payable		XXX
Record Indirect Production Costs in Overhead		
Overhead cost pool	XXX	
To Accounts payable		XXX
Record Production Labour in Overhead		
Overhead cost pool	XXX	
To Wages expense		XXX
Move Raw Materials to Work in Process		
Work-in-process inventory	XXX	
To Raw materials inventory		XXX
Record Inventory Scrap and Spoilage		
Overhead cost pool	XXX	
To Work-in-process inventory		XXX
Record Finished Goods		
Finished Goods inventory	XXX	
To Work-in-process inventory		XXX
Allocate Overhead		
Work-in-process inventory	XXX	
Finished goods inventory	XXX	
Cost of goods sold	XXX	
To Overhead cost pool		XXX
Sale Transaction Entry		
Cost of goods sold expenses	XXX	
To Finished goods inventory		XXX
Obsolete Inventory Entry		
Cost of goods sold expenses	XXX	



2.3 ISSUE OF MATERIALS FROM STORES

2.3.1. Procedure of issue:

Materials received and stored are issued on the basis of stores requisition, bills of materials, stock in balance, proper authorization and pricing material issues etc. It is clear that ascertainment of accurate material cost, fixing of material issue and effective cost control are the primary objective in order to fulfil the needs of management.

Material costing is very important in terms of the valuation of the cost of materials consumed by the production department as well as in terms of the estimation of the value of materials in stock. For costing purposes, the material cost is worked out by the actual cost incurred by taking price quoted by supplier as the basis subtracting the discounts and adding any other expenses not covered.

Issues of materials are based on production programme. Based on this and the bill of materials work orders are printed, listing for each material quantity to be issued against each component requiring that material. The storekeeper is very much concerned with the material control, as he is responsible for the issue of materials based on the proper authorization of material requisition and bills of materials.

Materials Requisition: Purchase or Material Requisition is also known as Intent for Materials. This is a document prepared by the production department for requisition of materials is known as Materials Requisition. The storekeeper is authorized to issue the materials based on the proper authority to avoid the misappropriation of material. The store keeper is responsible to maintained a record of serial number on requisition, issues and stock balances are up to date are must be posted in stores ledger.

Bill of Materials: Bill of materials is a document which shows a complete listing for each material, quantity to be issued against each component requiring that materials for a particular job order or process. Bill of Materials is prepared by the production department before the quantity of the components to be manufactured. This is helpful for the purpose of initiate material requisition and estimation of cost materials to collect quotations.

2.3.2 Method of Pricing of issue of materials

In the relation to the estimation of the cost of the product for pricing decisions, material issues assures a key role. Material price usually refers to the price quoted and accepted in the purchase orders.

There are different methods used for pricing the materials issues may be summarized in the following categories :

- (1) First In First Out (FIFO).
- (2) Last In First Out (LIFO).



Study Note - 2 : Store Accounting

- (3) Specific Price Method.
- (4) Base Stock Method.
- (5) Highest In First Out (HIFO).
- (6) Simple Average Method.
- (7) Weighted Average Method.
- (8) Periodic Simple Average Method.
- (9) Periodic Weighted Average Method.
- (10) Standard Price Method.
- (11) Inflated Price Method.
- (12) Market Price Method (or) Replacement Price Method.

2.3.2.1 First In First Out (FIFO):

Under this method, the pricing of issue is based on an assumption made that the oldest stock is issued first. Therefore at the time of issue, the rate pertaining to that will be applied until the whole lots is exhausted. It is based on the assumption that the materials purchased and received first are issued first to the job. After the first lot of material is used for production, the next lot is taken for the supply. This assumption is made for the purpose of assigning cost of material to a job/process/product. The price of first purchase for all the issues is same until the material of first purchase is entirely issued to various jobs, cost of materials issued represents the cost of earlier purchases. Cost of closing stock shows the cost of latest purchases. It is not necessary that the physical movement of the stock be in the order of first in and first out.

2.3.2.2 Last In First Out (LIFO):

This method is just opposite to First In First Out method. The basic assumption here is that the most recent receipts are issued first. The price of the materials to be issued would be the cost price of the last lots of materials purchased. It is based on the assumption that the material purchased and received last are issued first to the job. The cost of last lot of materials received is used to price the materials issued until the stock of that lot is exhausted. Thereafter the next lot for pricing is used, and so on through successive lots. The stock is priced at the oldest cost.

2.3.2.3 Specific Price Method:

In this method adopted where the materials are purchased for particular job or operation and the issue is charged with the actual cost price. This method is suitable only in the case of special purpose materials are purchased for a particular job. This method has been widely used in job order industries which carry out individual jobs or contract against specific orders.

2.3.2.4 Base Stock Method:



Under this method pricing is determined on the basis of assumption made here is that a certain minimum quantity of materials maintained in stock. This minimum quantity is known as Base Stock or Safety Stock. This quantity cannot be used unless an emergency arises. The minimum stock is in the nature of fixed assets because it is created out of the first lot of the material purchased.

Therefore it always valued at the actual cost price of the first lot and is carried forward as fixed assets. This method is usually applied with FIFO or LIFO.

2.3.2.5 Highest In First Out (HIFO):

This method is based on the assumption that the stock of materials should always be valued at the lowest possible price. Accordingly materials purchased at the highest price should be used for making the issue. This method is useful because issues are based on actual cost. It aims at recovering the highest cost of materials when the market is constantly fluctuating. But at the same time this method involves too many complicated calculations. And also this method has not been adopted widely.

2.3.2.6 Simple Average Method:

Under this method, price of issue materials is determined by dividing the total of the prices of the materials in stock, i.e., adding of different prices by the number of different prices. Then, this average price is applied to the issues to production. This method is simple and easy to operate. The value of closing stock becomes unrealistic. The following formula is applied for calculation of material issue price under simple average method :

$$\text{Issue Price} = \frac{\text{Total of Unit Prices of Materials in Stock}}{\text{Number of Units}}$$

2.3.2.7 Weighted Average Method :

Under this method, the price of materials issue is determined by dividing the total cost of materials in stock by the total quantity of material in stock. Here weighted average rate is calculated based on both quantity and price of the materials in stock. As more issues are made, a new average rate is computed and this average rate is applied to the subsequent issues. The material issue price is calculated by the formula given below:

$$\text{Weighted Average Price} = \frac{\text{Value of Materials in Stock}}{\text{Quantity in Stock}}$$

2.3.2.8 Periodic Simple Average Method:

Under this method, the simple average rate is calculated for a particular period ignoring the rate of opening stock. The issue price is calculated by totaling the unit price of all materials purchased during a particular period by the total number of prices during that period. Thus



Study Note - 2 : Store Accounting

this rate is applied to the issue to production for a particular period say a month and not at the occasion of each issue of materials.

2.3.2.9 Periodic Weighted Average Method:

This method is similar to the periodic simple average method. In this method issue rate is calculated by total cost of materials purchased during a period by the total quantity of materials purchased during that period. Here both quantity and prices of materials in stock during a particular period are taken into account for calculation of periodic weighted average rate. Under this method the issue rate is determined for a particular period ignoring the rate and quantity of opening stock. A new average rate is computed at the end of each period say a month and this average rate is applied to subsequent issues.

2.3.2.10 Standard Price Method:

Under this method, standard price of material issues are calculated on the basis of detailed analysis of market prices and trends. The standard price also referred to as predetermined price is fixed for a definite period of six months or more. Accordingly the material issue is done on the basis of standard price irrespective of actual rate. The difference between actual price and standard price is treated as material variance. At the end of the period, new standard price is fixed for a further period.

2.3.2.11 Inflated Price Method:

This method is used to cover material losses on account of obsolescence, deterioration, and materials handling expenses. Under this method cost of materials issue, such losses and expenses are directly charged to material cost. Therefore, when the issue of materials is made, the price is to inflated to cover all the losses and expenses.

2.3.2.12 Market Price Method:

This method is also known as Replacement Rate Method. Under this method issue materials that are valued at the market rate prevailing at the time issue. It therefore follows that when prices increase the stock on hand is continuously under estimated because receipts are cost at actual and issued at higher rates.

2.4 PRICING OF RETURNED MATERIALS

2.4.1 Unused Materials

When materials returned to stores from various departments, such returns are entered either in the receipts column at the price at which they have originally issued or included as fresh purchases at the original issue price.

2.4.2 Defective / Damaged Materials

Lower of Cost or Market Method: When damage, deterioration, obsolescence, this method is



used by recognizing the loss by writing down the stores to market. Stores should be valued at the lower of cost or net reliable value. Cost is computed using one of the four methods of issue. The market value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the costs necessary to make the sale.

2.5 ISSUE OF MATERIALS TO OTHER FORMATIONS

2.5.1 Diversion to other stores:-

Materials are issued to other stores within the system by receipt of requisitions signed by the officer of the indenting stores while charging the materials to works. These are classified as inter Divisional Stores drawals. It is of great importance that these transactions, are responded in the same month to avoid administrative and accounting difficulties. These issues are charged to intermediary suspense. When materials drawn for works and found surplus are returned to stock, they should be accompanied by a stores devolution note. (or stores return note). In order to enable the Accounts Office to correctly value the stores and credit the account number concerned reference to the original requisition and the work order for which the materials were originally drawn from the stores should be given in the devolutions. In the case of dismantled materials devoluted to stock, if the number and date of the original requisitions could not be given by the field, such particulars will enable the stores to trace the original requisition correctly should be given in the devolution. Alternatively, the depreciated value of materials may be arrived at and furnished.

Each devolution should be accompanied by a detailed report containing the following information:

(except for retrieved materials)

Quantity estimated.

Quantity drawn.

Quantity issued as actually measured or counted

Surplus

Explanation for excess drawl.

2.5.2 Issue to Contractors for departmental works:

Materials, to be issued to contractors according to terms and conditions of agreement for execution of works, should be drawn by the concerned field officer operating the work order on valid requisition duly supported by written demand from the Contractor for every drawal only by charging the amount to the concerned work orders. Such issues to contractors should however be regulated after drawal on requisitions, through unstamped Receipts or Transport Notes. Valuation of these unstamped Receipts or Transport notes will be regulated as per rates provided in the agreement. At the time of preparation of the contractor's Bill, these issues will



Study Note - 2 : Store Accounting

be valued at the agreement rates and shown as deductions. The requisitions issued by the field officer quoting work order numbers will however be valued as per book rates and taken to Accounts. The difference between the Book rate and the rate provided in the contract will get debited or credited as the case may be to work concerned.

2.5.3 Sale to private parties, officers and staff and others:

Sales outside the agreement should be based on out-right Cash Payment at book-rates or market-rates whichever is higher, plus Sales Tax and usual centages, etc. On receipt of payment by means of Demand Draft the custodian of the stores will issue the material, prepare the requisition, obtain the acknowledgement on the requisition itself from the purchaser, make out a Stores Issued Book and after posting the same in the Numerical ledger, send the Requisition/ Stores issued Book to accounts Office. The Demand Draft should be entered in the Petty Cash Book with full particulars by the Stores custodian and sent to accounts Office separately for being accounted for in Cash Book. In the pricing section the book value will be adopted for the purpose of pricing and the difference between the book value and the sale price will be adjusted in the requisition itself crediting the same to Miscellaneous Revenue.

2.6 ISSUE OF MATERIALS FOR DISPOSALS

2.6.1 Sales & Disposal of Stores & write off of Stores

All profits and losses due to revaluation, stock-taking or other causes should be duly recorded and adjusted where necessary. Formal sanction of the competent authority should be obtained in respect of losses even though no formal correction or adjustment in the accounts is involved.

The prior sanction of the competent authority should be obtained to the writing off of all losses, deficiencies or depreciation in the value of stores.

All stores reported to be obsolete, surplus or unserviceable should be declared as such and disposed of promptly by the competent authority or declared to the Directorate General of Supplies and Disposals where so required.

Sales to private persons of stores other than those which have become obsolete or unserviceable shall be regulated by special departmental rules/orders.

2.6.2 Write off, Condemnation and Disposal

An item may be declared surplus or obsolete or unserviceable, if the same is of no use to the Company or when the item is beyond economical repair. An item may be rendered surplus, obsolete or unserviceable in the process of upgrading or replacing company property or when company property or equipment no longer serves a functional use due to programme, procedure or other changes. Under such circumstances the property and equipment be disposed of in the best interest of the Company as per the following guidelines with prior approval of the Stores Manager.



2.6.3 General Procedure for writing off the unserviceable Materials / Items

The items to be declared the obsolete/ surplus / unserviceable should be examined by a committee at appropriate level to be appointed by the Stores Manager to declare an item of stores as obsolete, surplus or unserviceable and order their disposal. The committee should take into account the prescribed or stipulated life period of the stores. In case, such period is not prescribed / stipulated or it is not over, the committee should examine the conditions of stores and record suitable reasons. If an item has become obsolete/ surplus/ unserviceable on account of negligence, fraud or mischief on the part of employee, the same should be brought out clearly. Where the "life period" has been prescribed on any item and the same is already over, it should normally be taken as enough ground for declaring the item obsolete and unserviceable. However, the condition of the item should still be thoroughly examined to see whether the item could be put to further use. In other cases, where the life period is not over or no life period has been prescribed or stipulated, the reason for declaring the item unserviceable should be clearly recorded such as, may be normal wear and tear, excessive use in public interest, accidental fire, flood and other natural causes, damage due to insect, rats etc. An item may be declared obsolete / surplus if it is no longer required by the Departments. Reasons for the same should be recorded.

In case of loss due to negligence fraud or mischief on the part of any employee responsibility should be fixed and losses made good.

Authority competent to purchase a stores shall be competent to declare the store as obsolete/ surplus/unserviceable. The condemnation Committee shall submit its recommendations in the prescribed form obtainable from the Store Purchase Section. After approval of the Stores Manager on the recommendation of condemnation Committee, Head of the Department/ Section shall forward a copy of the Stores Manager's approval to the convener of the Auction Committee with copy of Store Purchase Section.

Actual physical disposal of items which have been written-off will be done only after the Stores Manager has approved the recommendations of the write-off /condemnation committee.

Obsolete, surplus materials etc., when sold by public auction, the highest bidder will deposit the amount agreed to in the auction. This amount will be taken to cash book by credit to sales Account (material). In the stores, a separate requisition/Stores Issued Book will be prepared charging the material auctioned to sales account. In the pricing section the book value will be adopted for the purpose of pricing and the difference between book value and the amount collected from the highest bidder will be adjusted as below in the requisition itself. If the book value is less than the bid value, the difference will be credited to "Loss of Gain on Stock Account" by means of passing minus entry for the excess value in the same requisition Spoiled units have imperfections that cannot be economically corrected. The loss can be treated as part of the job or charged to factory overhead.



Study Note - 2 : Store Accounting

Defective work has imperfections that are correctable. The extra costs are either charged to the job or factory overhead.

Summary and Glossary of Important Terms

- Learning Exercises
- Practice Problems – 5

Purchaser: Individual who raise an indent for the purchase shall be referred to as a Purchaser.

Seller/Vender: The seller / vender refers to the company/ dealer/agent/individual firm from whom the company may buy goods or services.

Classification of Stores: All stores to be procured shall be classified into 3 categories viz. Non Consumable Stores (NCS), Limited Time Asset Stores (LTAS), Consumable Stores (CS)

Non Consumable Stores (NCS): Non Consumable Stores are the stores which are intended to be used over the prolonged period before becoming unusable or obsolete and the store having a significant disposal value.

Limited Time Asset Stores (LTAS): The stores which have significant value when purchased but rapidly loss theirvalue/ relevance with the lapse of time and have very little or negligible disposal value.



STUDY NOTE – 3

SALES ACCOUNTING

This Study Note includes:

- Recognize revenue items at the proper time on the income statement
- Account for cash and credit sales
- Compute and interpret sales returns and allowances, sales discounts and bank credit card Sales
- Manage cash and its importance to the company
- Estimate and interpret uncollectible accounts receivable balances
- Assess the level of account receivable
- Develop and explain internal control procedures

3.1 RECOGNISING REVENUE ON THE INCOME STATEMENT

What do you mean by “Revenue”?

The term revenue means “income”. It is amount of income earned from business through its core and allied activities. It represents the gross inflow of cash, receivables and other transactions during the course of the business. It may be from sale of goods, from rendering service or from the use of the enterprise resources.

It connotes different meaning to different form of entities. For a merchandise business, it denotes the total amount of sales; for Government it denotes the amount collected through different form of taxes; for Service industries, it denotes the amount of professional income.

Example:

Revenue from Sale of Goods

- (a) Sri. Sharma has sold merchandise worth Rs.45,670 during the month of May 2020. The total value of sales represents the revenue.

Revenue from Rendering Service:

- (b) Bank of India, Raipur Branch has earned the following incomes during the month of Aug 2020.

Interest on Loans and Advances	Rs.3.45 lacs
Commission & Exchange	Rs.0.72 lacs



Income from locker facility	Rs.0.22 lacs
Total Income/ Revenue	Rs.4.38 lacs

Revenue from use of enterprise resources:

- (c) L&M Ltd., a construction company has leased out its building construction equipment to another infrastructure company at monthly rental of Rs.2 Crores. This income has been received by letting out on hire the enterprise's asset (resource).

Revenue can be accounted only when it is realised. Realisation does not mean the actual receipt of "money consideration". It denotes the "earning". It is not necessary that there should be an immediate settlement in cash for the transaction. For Accounting of revenue in the books the companies are following Accounting Standard-9 Revenue Recognition

The concept of revenue recognition should be traced to the basic accounting concepts – "Realisation Concept" and "Accrual Concept".

Realisation Concept:

According to this concept, revenue is considered to be earned on the date, whether it is realised or realisable. It can be understood with the help of an example.

Example:

When goods are sold to the customer on credit, the sales have to be accounted as soon as the transfer of property passes on from the seller to buyer (customer). The sale proceeds may be received at a later stage. Sale has to be accounted at the "time of Sale" and not at the "time of receipt of sale proceeds."

When an advance is received from a customer, the same cannot be accounted as revenue, unless the transaction of sale has occurred.

Moreover, revenue earned in an accounting year should be recognised in the same accounting period.

Accrual Concept:

The term accrual denotes, "something that becomes due", especially, an amount of money yet to be paid or recovered at the end of an accounting period. It is noteworthy that the revenues should be recognised in the books of accounts as earned, as soon as the required transaction has taken place. The revenue may have been received or not but it has to be "accounted for", as when it has occurred in the business. The financial statements will not reveal a true and fair view of the affairs of the business unless all the transactions pertaining to that year have been accounted for. According to system, the books of accounts have to be maintained on accrual (mercantile) basis.



Study Note - 3 : Sales Accounting

3.2 ACCOUNTING FOR CASH SALES AND CREDIT SALES

After Reading this unit you will be able to

- Differentiate between cash sales and Credit Sales
- Accounting for Cash sales and Credit Sales
- Familiarity with terms Cash Memo, Invoice

Business may sell goods for cash or "on credit" basis. When the goods are sold for cash, the proceeds are immediately received and accounted for. In case, the goods are sold on credit, the proceeds are received at a later stage, as per credit days allowed and the terms of sale. So business records sales either as cash sales or credit sales.

How to account for Cash Sales?

Whenever a cash sale is made, Cash Memo is prepared and delivered to the customer along with the goods. The format of a cash memo is given below:

Business Name

Business Address Line-1

Business Address Line-2

Business Phone No. & Business Fax No.

CASH MEMO

S. No.

Dated :

Quantity	Rates	Description	Amount
		Grand Total	

Amount in words Signature

.....



Features of Cash Memo:

- It is issued in case of cash sales transaction.
- It serves as evidence that cash is being paid by the buyer to the seller.
- It has to be serially numbered.
- It can be also termed as "Cash Bill".
- When the cash is received against the bill for sales, the words "Cash Received" is affixed on the face of the Cash Memo.
- Normally, Cash Memo is prepared in triplicate.

From the Cash memo, the transaction has to be recorded in the books of accounts. The Cash Memo/Bill forms the basis for the journal entry.

From the cash Memo, the transaction is recorded in journal as

Books of _____ Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Cash A/c	Dr.		XXX	
	To Sales A/c			XXX	
	(Being goods sold for Cash				
	as per Bill No. dt.....)				

Cash A/c - Real Account - Debit what comes in

Sales A/c - Real Account - Credit what goes out

It is not necessary to record the customer's name, since the sale proceeds have been realised immediately and transaction is complete in all respects.

Ledger Posting of Cash Sales :

The goods sold for cash (Cash Sales) are posted to the credit side of the Sales account as given below :

Dr.			Sales Account			Cr.	
Date	Particulars	Rs.	Date	Particulars	Rs.		
				By Cash A/c (Bill No.:)			

Alternatively, when subsidiary books are maintained, the cash sales have to be recorded in the cash book as :



Date	Receipts	Rs.	Date	Payment	Rs.
	To Sales A/c (Bill no.)				

2020 Feb	1.	Goods sold to Mr. Rajesh for Cash	Rs.4,590
	2.	Ramesh brought goods from us	Rs.7,896
	3.	Raviraj brought goods from us (credit)	Rs.10,115
	7.	Sold an old telephone and modem for cash	Rs.2,200
	9.	Cash sales to Helen	Rs.32,450
	10.	Priya paid cash and brought goods from us	Rs.3,210
	14.	Cash received from Raviraj	Rs.3,780

Date 2020	Receipts	Rs.	Date	Payment	Rs.
Feb 1	To Sales A/c	4,590			
7	To Office Equipment A/c	2,200			
9	To Sales A/c	32,450			
10	To Sales A/c	3,210			
14	To Raviraj A/c	3,780			

(2) For cash received from Raviraj, the entry to be passed would be



Cash A/c

Dr.

To Raviraj A/c

(3) Credit Sales will not appear in the cash book.

How to account for Credit Sales?

The goods are sold to the customer on credit basis. When the goods are sold on credit to the customers, the customer's names have to be recorded in the books of accounts. This would enable the business to identify and track the "receivables".

When the goods are sold on credit, Invoice is prepared and goods are delivered to the customer. The features of an invoice are as below:

- It is prepared at the time of credit sales in triplicate.
- It serves as Invoice cum Delivery Challan.
- It is prepared in triplicate.
 - Once copy is forwarded to the customer.
 - Second copy is acknowledged by the customer for the receipt of goods.
 - Third copy is maintained by the Seller for accounting purpose.
- It is also to be termed as "Tax Invoice" when tax is charged on sales.
 - (Example, When Excise Duty is charged it is to be termed as "Tax Invoice".)
 - It discloses the details regarding the despatch of goods, credit terms etc.,

INVOICE

Your Company Name

(Yoru Company Slogan)

[Street Address] Invoice

#[100]

[city, ST ZIP Code]

Date : October 9, 2019

Phone [509.555.0190] Fax [509.555.0191]

To:

[Name]

[Company Name]

[City, ST ZIP Code]

[Phone]

Ship To :

[Name]

[Company Name]

[City, ST ZIP Code]

[Phone]

Comments or Special Instructions :



Study Note - 3 : Sales Accounting

Sales Person	P.O. Number	Requisitioner	Shipped Via	F.O.B. Point	Terms
Quantity	Description			Unit Price	Total
				Sub Total	
				Sales Tax	
				Shipping & Handling	
				Total Due	
Make all checks payable to [Your Company Name] Payment is due within 30 days. If you have any questions concerning this invoice, contact [Name, phone number, e-mail] Thank you for your business!					

From the invoice, the necessary entries are to be made in the books. Thus, it is to be noted that Invoice forms the basis for credit sales accounting.

Books of _____ Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	When Goods are sold on Credit				
	Customer's A/c	Dr.		XXX	
	To Sales A/c (Being goods sold on credit to as per Invoice No..... dt....)				XXX
	At the time of receipt of sale proceeds:				
	Cash/Bank A/c	Dr.		XXX	



	To Customer A/c (Being Cash/Cheque received from customer towards Invoice No dt.....)				XXX
--	---	--	--	--	-----

Ledger Posting :

The goods sold on credit are posted to the credit side of the Sales account as shown below :

Dr. Sales Account Cr.

Date	Receipts	Rs.	Date	Payment	Rs.
				By Cash A/c (Bill No. :)	

The credit sales and receipt o sale proceeds shall be posted as shown below :

Books of _____ Journal

Date	Receipts	Rs.	Date	Payment	Rs.
	To Sales A/c (Bill no.)			By Cash/Bank A/c	

When the business has a numerable number of credit sales, it would become difficult or recording the transactiosn in journal. To overcome this limitation, "Sales Book" is prepared for recording credit sales of merchandise, instead of recording the transaction in journal.

The features of a Sale Book are :

When the business has a numerable number of credit sales, it would become difficult or recording the transactiosn in journal. To overcome this limitation, "Sales Book" is prepared for recording credit sales of merchandise, instead of recording the transaction in journal.

The features of a Sale Book are :

- It records only "goods sold on credit"
- It is also known as "Sales Day Book"
- Outward Invoice forms the basis for recording the credit sale.
- It is limited only to record credit sales. Cash Sales and Sale of Assets are excluded from sales book
- The Sales book discloses the quantity details, trade discount and net amount for every sale transaction.

The format of a sales book is given below :



Study Note - 3 : Sales Accounting

Sales Book

Date	Particulars	L.F.	Invoice	Amount (Rs.)	Amount (Rs.)
	Total				XXX

The total of sales book is posted to credit of sales account at the end of every month.

Dr. **Sales Account** **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
				By Credit Sales For the month of as per Sales book	XXX

The customer account is debited with the amount of sale for every transaction.

Illustration 2 :

Under which subsidiary book, will you record the following transactions?

a)	Sold goods to Kamal for Cash	Rs.14,550
b)	Ramesh & Co. Brought goods from us	Rs.1,56,799
c)	Sold old furniture at auction sale	Rs.1,560
d)	Cash Sales made to customers	Rs.49,785
e)	Sold goods to Ravi Pvt. Ltd.	Rs.10,785

- Ans. a) Cash Book (Cash Sales) b) Sales Book (Credit Sales)
 c) General Journal (Sale of Asset) d) Cash Book (Cash Sales)
 e) Sales Book (Credit Sales)

Illustration 3 :

Enter the following transactions in the sales day book of JFA Bazar

- 2020 1 Sold goods to Mehta Bros. (Invoice No. 1)
 10 Formal Shirts @ Rs.399 each.
 20 Hand Towels @ Rs.76 each
- 2 Sold to Andley on credit (Invoice No. 2)
 20 Trousers @Rs.499 each
 5 Neck-ties @Rs.152 each
- 3 Sold to Nest Pvt. Ltd. on credit (Invoice No.3)



50 Neck T-Shirt @Rs.99 each
100 meters of cloth @Rs.275 each
20 formal shirts @Rs.275 each
Trade discount - 10%

**JFA Bazar
Sales Book**

Date	Particulars	L.F.	Invoice No.	Amount (Rs.)	Amount (Rs.)
2020	Mehta Bros.		1		
Jan 1	10 Formal Shirts @ Rs.399 each				3,990
2	Andley		2		
	20 Trousers @Rs.499 each			9,980	
	5 Neck ties @Rs.152 each			760	10,740
3	Nest Private Limited				
	50 neck T Shirts @Rs.99 each			4,950	
	100 meters of cloth@Rs.78/mtr			7,800	
	Less : Trade Discount @10%			1,275	11,475
	Total				XXX

3.3 COMPUTATION AND INTERPRETATION OF SALES RETURNS AND ALLOWANCES, SALES DISCOUNTS, AND BANK CREDIT CARD SALES.

After Reading this unit you will be able to

- Differentiate between cash discount and trade discount
- Account for Cash discount and trade discount
- Understand the meaning of sales discount and sales allowances.
- Account for Sales discount and sales allowances
- Explain the operation and accounting of bank credit card sales.

In the earlier unit, we have studied the procedure for accounting for cash sales and credit sales. In this unit, we shall proceed with some of the transactions, that are incidental to sales.

Concepts of Trade Discount and Cash Discount:

Trade Discount:

Goods are sold by the wholesalers to the retailers in the market at the price listed in the product. In order to help the retailers, to earn a better profit on the products, the manufacturers offer them a "Trade Discount". The trade discount is mentioned in the invoice as a deduction from the Gross price in order to arrive at the "Price Payable" or "Net Price". The trade discount is not recorded in the books. Only the net price is recorded in the books.



Study Note - 3 : Sales Accounting

Example:

Sl. No.	Description	Price	Unit	Rs.
1.	Goods - A	400	30	12,000
	Goods - B	200	10	2,000
	Goods - C	150	20	3,000
	Gross Price			17,000
	Less : Trade Discount @ 10%			1,700
	Net Price			15,300

When the sale entry is recorded, the amount to be recorded would be Rs.15,300 only.

Illustration 4 :

Journalise the following :

Sold goods to Varun for Rs.20,000 and allowed him a trade discount @3%

Journal Entry

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Varun A/c	Dr.		19,400	
	To Sales A/c (Being goods sold to Varun for Rs.20,000 after a trade discount of 3%) (Rs.20,000-Rs.600)				XXX

Cash Discount:

Cash discount is allowed when a retailer/customer makes prompt payment on or before the due date. It is allowed to encourage prompt payment. It can be allowed only when the payment is made promptly before the due date. It is recorded as "Discount Allowed" in the books of the party allowing such discount. It is also termed as "Sales Discount". If a company is selling goods on Credit for 30 days and the customer is ready to give the payment within 7 days from the date of purchase, The Company can allow the customer an appropriate percentage of cash discount for prompt payment. Cash discount is also helpful in reducing the operating cycle time period and increase cash flow in the organisation.

Illustration 5:

Journalise the following transactions:

2020 Feb 3 Sold goods to Raman for Rs.18,000 @ Trade Discount of 2%

Feb 7 Cash Received from Raman – Rs.17,440 in full settlement*

* represents Cash discount



Journal Entry

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
2020	Raman A/c	Dr.		17,600	
Feb 3	To Sales A/c (Being goods sold to Raman for Rs.18,000 after a trade discount of 2%) (Rs.18,000-Rs.360)				17,640
Feb 7	Cash A/c	Dr.			17,440
	Discount Allowed A/c	Dr.		200	
	To Raman A/c (Being cash received from				17,640

Accounting for Sales Returns and Allowances:

The term "Sales Returns" denotes the goods returned by the customer due to defectives, damages or poor quality of the product supplied. The Goods is returned along with a Purchase return memo/invoice by the customer and the "Credit Note" is prepared to record the Sales Returns in books of accounts.

Journal Entry:

The journal Entry to be passed for Sales Returns would be :

Books of _____
Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	When Goods are returned by the customer				
	Sales Returns A/c	Dr.		XXX	
	To Customer A/c (Being goods sold on credit to as per Invoice No. dt...)				XXX

Illustration 6 :

Smt. Suraksha purchased goods from Doveton Ltd. for Rs.65,000. 2 days later she returned goods worth R.18,750 due to poor quality. Pass journal entries in the books of Doveton Ltd.

Books of _____
Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Suraksha A/c	Dr.		65,000	
	To Sales A/c				65,000



Study Note - 3 : Sales Accounting

	(Being goods sold to Suraksha)				
	Sales Returns A/c	Dr.		18,750	
	To Suraksha A/c (Being goods returned by suraksha due to poor quality)				18,750

Note: The "Sales Returns" account is a contra account to "Sales Account". In the income statement, the value of sales returns is deducted from Sales to arrive at "Net Sales".

Trading and Profit & Loss Account of for the year ended...

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By Sales	XXX	
			Less : Sales Returns	XXX	XXX

Recording In Sales Returns Book:

Instead of recording in journal, the Sales returns could be recorded in "Sales Returns book" or "Return Inwards book".

- 1) The sales returns book records the goods returned by the customers.
- 2) The Sales returns book records only the return of "Credit Sales" made. It does not record the returns of 'Cash Sales' made
- 3) The "Credit note" forms the basis for recording the goods the sales returns.

The format of a Sales returns book is given below:

Sales Returns Book

Date	Particulars	L.F.	Credit Note No.	Amount (Rs.)	Amount (Rs.)
	Total				XXX

Posting from Sales Returns book to the ledger accounts would be done below :

Dr. **Sales Account** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Posting as per sales returns book				

Dr. **Customer's Account** Cr.



Date	Particulars	Rs.	Date	Particulars	Rs.
				By Sales Returns A/c	

Sales Allowances:

- Sales allowance is a distinct type of transaction, whereby the customers agree to keep the undesirable products (instead of returning back), for a reduction in the selling price.
- The value of reduction in the selling price is debited to the "Sales Allowance" account as it is a loss for the business.
- Sales allowance arises after the initial billing to the customer but before the payment is received from the customer.
- Technically, two separate accounts – Sales Returns and Sales Allowances are opened to record and analyse the quantum of returns and allowances.

Books of _____ Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Sales Allowances A/c	Dr.			
	To Customer A/c (Being Sales Allowance made by to the customer as per credit note no.....)			XXX	

Note: Sales allowances would be also be reduced from net sales in income statement to arrive at the net sales. The treatment of Sales allowances is shown as below :

Trading and Profit and Loss Account of _____ for the year ended

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
			By Sales	XXX	
			Less: Sales Allowances	XXX	XXX

Illustration 7 :

A company sold goods worth Rs.37,500 to Sri. Aakash. Of those goods, Rs.8,000 worth goods were found to be out of specification. The company after careful consultation, allowed a sales allowance of Rs.5,500 for the undersirable sales. Pass journal Entries in the books of the company. Also, Calculate the amount receivable from Aakash.

Books of _____



Study Note - 3 : Sales Accounting

Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Aakash A/c	Dr.			37,500
	To Sales A/c (Being goods sold to Aakash as per invoice ... No....)				37,500
	Sales Allowance A/c	Dr.		5,500	
	To Aakash A/c (Being sales allowance made to Aakash)				5,500

Amount receivable from Aakash = Rs.37,500-Rs.5,500=Rs.32,000

Debtor's Ledger :

The format of debtors is shown below :

Particulars	Rs.	Particulars	Rs.
To balance b/d (Opening)	XXX	By Cash (Cash Received)	XXX
To Sales (Credit)	XXX	By Bank (Cheque Received)	XXX
		By Sales Returns	XXX
		By Sales Allowance	XXX
		By Bad Debts	XXX
		By Discount (Cash Discount)	XXX
		By Balance c/d (Closing)	XXX
	XXX		XXX

Illustration 8 :

From the following prepare Total Debtors Account

Debtors (Opening)	-	Rs.25,500	Debtors (Closing)	-	Rs.34,500
Cash Received	-	Rs.76,000	Return Inwards	-	Rs.6,750
Bad Debts	-	Rs.3,000	Cash Sales	-	Rs.71,000

Also, Compute Gross Sales

Debtors Account

Particulars	Rs.	Particulars	Rs.
To balance b/d	25,500	By Cash Received	76,000



To Sales (Credit)	94,750	By Return Inwards	6,750
(Bal. Fig)		By Bad Debts	3,000
		By Balance c/d	34,500
	1,20,250		1,20,250

Total/Gross Sales = Cash Sales + Credit Sales = Rs.71,000+Rs94,750=Rs.1,65,750

Bank Credit Sales:

We have discussed about the traditional methods of sales such as cash sales and credit sales. In the modern technological era, the business houses have introduced various methods of payments for the sales made to them. Cash on Delivery (COD), Acceptance of Bank cards (Credit/Debit Card) are the new types of payments made to them. Let us discuss about the bank credit sales in this section:

How it Operate?

Bank issues Debit cards and credit cards to its customers. Using these cards, the customers can carry on a lot of transactions such as cash withdrawal, online payments, purchase using the cards at shops, malls, etc., the banks issue branded credit cards such as VISA Cards, MASTER Cards, MAESTRO Cards in association with the international card associations. These cards are valid universally and it helps for compatible payments.

The business houses enter into tie-ups with the banks to enable the customers to operate the card transactions with them. Such transactions are known as "Point of Sales" (POS) transactions.

Parties to the transactions:

- 1) **Card-holder** : The holder of the card – customer
- 2) **Card –issuing bank**: The cardholder's bank - The bank issues card to the customer in association with the international agencies such as VISA, MASTER, etc.,
- 3) **Merchant /Business House**: The party accepting the card payment for the goods sold or services rendered.
- 4) **Acquiring bank**: The bank accepting the payment on behalf of the merchant. The merchant normally have an account with the acquiring bank for the credit of the proceeds. The acquiring bank charges service fees (normally 1% to 3%) from the merchant for the transactions.

The Operation of the credit card transaction can be represented diagrammatically.

Study Note - 3 : Sales Accounting

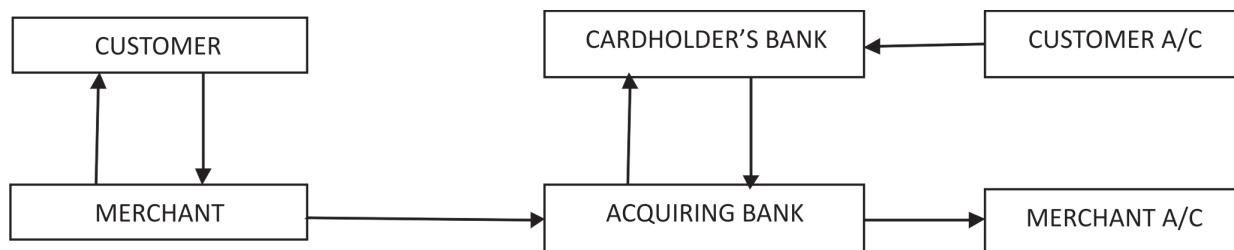


Figure : Bank Card payments operations

The transactions are:

- (1) Customer's purchases goods from the merchant
- (2) Customer issues the card to the merchant for the payment
- (3) The merchant SWIPES the card in the card machine and the customer authenticates the identity with the PIN
- (4) The card transaction reaches the acquiring bank and forwarded to the approval of the cardholder's bank.
- (5) When there is adequate funds/credit in the customer account, the cardholder bank approves the transaction.
- (6) The funds are transferred from the cardholder's bank to the acquiring bank.
- (7) The acquiring bank, after the deduction of service charges, credits the balance to the merchant account.

When there are no funds/ inadequate funds for the transaction, the message "Transaction Declined" is communicated to the merchant. All the above transactions, takes place within a minute.

Benefits of Card Payments:

- 1) It is more secure mode of payments to a merchant than a cheque or a draft. The amount realised through POS transactions are directly credited to the merchant's bank account.
- 2) The customer is relived from carrying huge amount of cash to the shops. He can just carry the card(s) and make the payment. It is a hassle –free transactions. Also, offers of cash-back, prize encourage the customers to use the card effectively.
- 3) It reduces the risk of cash thefts and misplacements and is time-effective.
- 4) It also serves an evidence for the transaction both for the merchant and the customer.

Accounting for bank card transactions:

A single entry is passed for recording the sales, service fees and the sale proceeds.



Books of _____
Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Bank A/c	Dr.		XXX	
	Bank Service Charges A/c	Dr.		XXX	
	To Sales (Card) A/c				XXX

Note: For the purpose of convenience and reconciliation, a separate ledger called "Sales (Card)" is to be opened in the books. In the Income Statement Cash Sales, Credit Sales and Card Sales would be aggregated to arrive at the Gross Sales.

Computation of Gross Sales and Net Sales

Cash Sales	XXX
Credit Sales	XXX
Card Sales	XXX
Gross Sales	XXX
Less : Sales Returns	XXX
Sales Allowances	XXX
Net Sales	XXX

Illustration 9 :

A company made a sale transaction through card for Rs.76,564. The bank charges 1.06% service fees. Journalise the transaction.

Journal

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Bank A/c	Dr.		75,742.53	
	Bank Service Charges A/c	Dr.		811.47	
	To Sales (Card) A/c				76,554

Bank charges = Rs.76,554 x 1.06% = Rs.811.47

Important Points:

- (1) In case of Card transactions, the bank does not round off the figures, as the funds are transferred to the merchant account. There is no cash transfer. Hence, students are also expected not to round off the service fee.



Study Note - 3 : Sales Accounting

3.4 MANAGING CASH AND ITS IMPORTANCE TO THE COMPANY.

After Reading this unit you will be able to

- Define Cash and Cash equivalents
- Importance of Cash in day to day operations.
- Estimation of cash requirement
- Cash break-even point.

For any organisation, cash is important and it is the lifeblood of the business. Without cash, no business can survive and it is most important component for working capital. Working capital is the amount which is invested in the business for day to day transactions, Net working capital is the difference between Current Assets and Current Liabilities. Cash is required for making day-to-day expenses, payment to and other liabilities. Cash Management is an important function of a finance executive. It involves the forecast of the cash receivable and cash to be paid. A efficient and an effective cash budget would help the business to run smoothly without any financial crunch. Cash Management is important for any business as it is one of the important component of working capital management. It is the beginning and end of the working capital cycle. Cash represents cash and its near equivalents.

What do you mean by Cash?

Cash includes money in hand (including petty cash), balance available in bank, unutilised bank overdraft, marketable securities.

$$\text{Cash} = \text{Cash in Hand} + \text{Cash Equivalents}$$

Cash Equivalents are Marketable securities, bank balance etc.,

Importance of Cash Management:

Cash management is a broader term used in dealing with collection, handling, payment and investment of surplus cash to earn adequate returns. Cash management aims at positive cash flow. Cash management aims at

- 1) Proper Collection of Receivables
- 2) Prioritize over payments and make payment promptly.
- 3) Investment Surplus Cash to earn interest.

The components of cash management are:

- Collection of Cash
- Concentration and handling of cash
- Disbursement of cash



- Investment of Surplus Cash

Goal of Cash Management:

- Maximize the availability of cash for working capital and long term investments.
- Minimize the risk of insolvency.
- Maintain a level of company's liquidity and ensure adequate profitability.
- To Reduce the period of operating cycle by better cash management.

Importance of Cash Management:

Managing cash flow is important function of business managers. Cash flow represents the movement of cash into and out of a business. There may be situation of positive cash flow and negative cash flow.

Positive Cash Flow: It is the situation of cash inflows exceeding the cash outflows. There would be surplus cash available with the company and it is a positive sign of financial health.

CASH INFLOWS > CASH OUTFLOWS

Negative Cash Flow: It is the situation of cash outflows exceeding the cash inflows. The company would be in a state of shortage of funds and they would not be in a position to meet the working capital requirements. Negative Cash Flow would lead the company to borrow funds and thereby increasing its liability.

CASH OUTFLOWS > CASH INFLOWS

Cash is the king of all business activities. With cash there is no business. To have a better command over the cash flow, the business manager should know When, where and how the cash needs will occur the best source for meeting the cash requirements.

Accurate cash balance in hand and at banks.

The business manager should be prepared to meet the challenges by maintaining cordial relationship with the customers, suppliers and other stakeholders.

Steps in Cash Management:

Creation of Realistic Cash Budget for short term funds (working capital) and long term funds.

Offers discounts to customers for prompt and early payments.

Monitoring and prioritizing all cash disbursements.

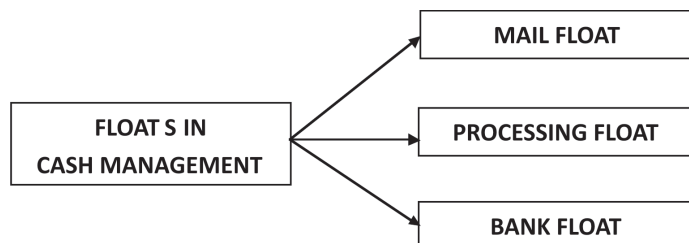
Avail the facility of discount from the vendors by making prompt payments. (On date)

Liquidate the obsolete and abnormal stock of inventories.

“Floats” in Cash Management:

Study Note - 3 : Sales Accounting

Cash management aims at reducing the time taken to collect the receivables and matching them properly for the payments/outflow. There is always a time lag in collection of receivables and disbursement of payables. The delays can be termed as “Floats”



Examples :

Mail Float

The payment (Cheque) couriered by the customer does not reach the office immediately. It takes a couple of days to reach the office and it would be in transit.

Processing Float

The company on receipt of the cheque, would send the same for processing to the Finance department and there may be slack in depositing the cheque to the bank, immediately on the receipt of the cheque.

Bank Float

Finally, when the cheque is deposited into the bank, the banker would take 1-2 days for clearance and then finally clears the funds to the account.

While planning for the cash outflows based on the cash inflow, the above floats should be considered. The company can reduce the processing float as it is within its control.

Online Transfers:

In this era, online transfers RTGS/NEFT modes of transfers are more popular than Cheque payments. The Suppliers are giving their bank details to the customers like Bank account number, IFSC Code and Branch address. The customers are directly transferring funds to the suppliers account through online banking. With this mode of payment the floats in the cash management can be reduced. Following are the benefits of online fund transfers:

Advantages of Online Transfer:

1. To reduce the operating cycle time in cash management
2. To increase the working capital for the business.
3. To reduce the floats in the cash management.



4. To reduce the risk in the transaction through cheque.
5. To increase the liquidity in the organisation.

Requirement of cash is to be estimated on daily basis. The following important points are note worthy:

- 1) The finance executive should be aware of the quantum of account receivable/amount to be received from the debtors on that day.
- 2) The priority of payments to be made on that day.
- 3) The amount of cash available in hand and the bank balance.

Daily Cash Report:

Small business firms, prepare cash report at the end of every day to know about the cash position. Also, they plan for the nest day's payments:

Sl.No.	Particulars	Cash	Bank
1.	Opening Balance	XXX	XXX
	Add : Cash Sales	XXX	---
	Card Sales	----	XXX
	Collection from Debtors/Accts. Receivable	XXX	XXX
	Any other receipts (Mention individually)		
	Total	XXX	XXX
	Add/Less : Movement of Cash		
	(Deposit/Withdrawal)	XXX	XXX
	Total Cash Available for Disbursements	XXX	XXX
	Less : Disbursements Made		
	1.	XXX	XXX
	2.	XXX	XXX
	3.		
	4.		
	5.		
	Balance available at the end of the day	XXX	XXX

What is good Cash Management?

Good cash management is simple. It means

- 1) Knowing when, where, and how cash needs occur
- 2) Knowing the best and optimum sources of cash and how the sources occur.



Study Note - 3 : Sales Accounting

(By maintaining a good relationship with the bankers and the customers, one can know the sources better)

- 3) Know credit period of the supplier and make payment to supplier on credit period.

Cash Break –even point

The cash breakeven point indicates the minimum amount of sales required to contribute to a positive cash flow.

$$\text{Cash Break Even Point (in units)} = \frac{(\text{Fixed costs} - \text{Non Cash Flow Expenses})}{\text{Contribution per unit}}$$

Illustration 10

Total Fixed Expenses – Rs.76,50,000

Depreciation – Rs.54,800

Preliminary Expenses Written Off – Rs.1,50,200

Sales (Per unit) - Rs.199 Variable Cost – Rs.42

Calculate Cash break even point.

$$\text{Cash Break Even Point (in units)} = \frac{(\text{Fixed costs} - \text{Non Cash Flow Expenses})}{\text{Contribution per unit}}$$

(Contribution per unit – Sales – Variable Cost = Rs.199 – Rs.42 = Rs.157

$$\begin{aligned} &= \frac{(\text{Rs.76,50,000} - \text{Rs.54,800} - \text{Rs.1,50,200})}{\text{Rs.157}} \end{aligned}$$

= 47,420 units (approx)

3.5 ACCOUNTS RECEIVABLE ESTIMATION, ASSESSMENT AND INTERPRETATION OF UNCOLLECTIBLE ACCOUNTS RECEIVABLE.

After Reading this unit you will be able to

- Understand the meaning of Accounts Receivable
- Estimate and Assess Accounts receivable
- Understand “Uncollectible Receivable” and interpret the same.

What are accounts receivable?

Money owed by customers to the business are termed as Accounts Receivable (AR). Accounts receivable arises due to credit sales or credit transaction of service rendered.

It is shown on the balance sheet as a current asset.

**Estimation of Accounts Receivable:**

The sales department usually maintains a sales ledger and it normally records the transactions customer wise. In short, Debtors' ledgers is maintained individually by the sales/Accounts receivable department. It records the following in the customer's ledger:

- a) The transaction of sales, Sales returns and sales allowances
- b) The transactions pertaining to amount received from customer

The balance in the customer's ledger would represent the amount due from/to customers.

The sales/Accounts receivable department would allow credit to the customers for goods sold on credit. Example, Net 30 days may be credit terms allowed – it means that the customer has to pay within 30 days from the date of the invoice.

Payment Terms:

The commonly used payment terms (Credit terms) is listed below:

Sl. No.	Payment Terms	Description
1.	Immediate	The Payment is to made immediately. No Credit days are allowed
2.	Net----- (n) days.	The payment is to be made within "n" days from the date of invoice (Eg Net 30 days
3.	----- (n) days after sight	The payment is to be made within....(n) days from the date of receipt of invoice

3.6 ASSESSMENT OF ACCOUNTS RECEIVABLE

The Accounts Receivable department makes an assessment of receivables from every customer. Normally, they prepare an ageing analysis and they "follow up" on the receivables. Ageing analysis is a statement prepared categorising the debtors outstanding for a period of 30 days, 60 days, 90 days, more than 90 days.

The general format of an ageing analysis is given below :

S. No.	Customer Account	<30 days	>30 days but<60 days	>60 days
1.				
2.				
3.				
4.				
	Total			

Uncollectible Accounts Receivable:



Study Note - 3 : Sales Accounting

The account balance of a customer which has no chance of being realised is termed as uncollectible receivable. Normally, they remain overdue for a reasonable period of time. The business undertakes all legal and possible methods to collect the money. In spite of all measures, the account remains overdue and becomes of doubtful of realisation. After a specified period (assume 180 days), the doubtful account becomes uncollectible accounts receivable. There are various reasons for an account to become uncollectible. Reasons for a business to assume an account is uncollectible include the other party refuses to pay or the buyer has undergone financial difficulties making it impossible for him to pay.

The policy for classification of accounts receivable differs from business to business. Once the account is classified as uncollectible, then it should be written off to the income statement. It is also termed as "Bad Debts".

There are two methods of Evaluating and interpreting accounts receivable. They are:

- 1) Direct Write off method
- 2) Allowance method

Direct Write off Methods :

The company decide that the accounts receivable has no reason to be realised and they are "Bad debts". All the recovery measures attempted by the company to realise the amount has failed and the company is confident about the default committed. The company completely writes off the account receivable. Tax benefits are available under this method.

The entry would be

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Bad Debts A/c	Dr.		75,742.53	
	To Customer A/c	Dr.			XXX

Allowance Method :

Under Allowance method, the company estimates the doubtful debts based on previous track records. Under this method, provision for bad debts is created at the end of every financial year and it is revised from year to year. The Provision for bad and doubtful debts is appropriated from the profit and Loss Account and it is shown as a deduction from the Debtors in the balance sheet.

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
	Profit and Loss A/c	Dr.		75,742.53	
	To Provision for bad Debts	Dr.			XXX



Illustration 11 :

- (a) Write off Rs.2,250 owed by Mr. Joe as bad debts.
- (b) The company has estimated 5% of its debtors to be doubtful. Create a provision on debtors. Debtors amounted to Rs.12,56,770

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
(a)	Bad Debts A/c	Dr.		2,250	
	To Joe's A/c				2,250
(b)	Profit and Loss A/c	Dr.		62,838.50	
	To Provision for bad Debts A/c				62,838.50

3.7 DEVELOP AND EXPLAIN INTERNAL CONTROL PROCEDURES

After Reading this unit you will be able to

- have a basic knowledge on Internal control procedures for Sales and AR

Internal controls are the procedures, guidelines or company policies business owners use to safeguard their business information and operations. Business owners often use internal controls to specifically protect financial information. Internal control procedures help in the process of avoiding errors, preventing frauds in the business. Some of the internal control procedures that could be implemented with reference to sales and handling of accounts receivable are:

- 1) **Proper Billing system:** There should be a proper billing system to monitor the quantum of sales. Proper billing system would help in preventing unauthorised sales or unbilled sales. This would also control the credit terms that are offered to the customers.
- 2) **Segregation of Duties:** There should be a segregation of duties with respect to handling invoices, credit memo, and receiving customer payments. When a same person is handling all the activities together, it would result in fraud.

For Example: Single person is handling customer cash receipts and he is authorised to raise credit memo's. It will result in embezzlement and misappropriation of cash, as the employee would receive the cash, but raise a credit memo to close the customer's account.

- 3) **Online Transfers:** There should be reduction of receipts through cheque from customers. Online transfer should come from customer to the company's account. With online transfer of funds the risk of fraud can be reduced and the amount directly credit in to the company's current account.
- 4) **Audit Trails of Softwares:** There should be an audit trail of billing software and collection



Study Note - 3 : Sales Accounting

software. It would help in tracking down the transactions. The access to the software's should be completely restricted in order to have accurate data.

- 5) **Approval of Credit Terms and Contract Terms:** Whenever goods are sold on credit, the credit terms should be approved by the higher executive at the finance department and the contract terms should be approved by the finance and legal department before being executed.
- 6) **Pre-numbering of Invoices:** The invoices issued should be continuously numbered.
- 7) **Control over Bad Debts:** The bad debts written off should be done after careful consideration and necessary steps should have been attempted to recover the outstanding accounts receivable. Bad debts to be written off should be done only with approval from the sales department / finance department.



STUDY NOTE – 4

ASSET ACCOUNTING

This Study Note includes:

- Introduction & Meaning of Assets Accounting
- Current Assets Accounting
- Fixed Assets Accounting
- Project Accounting

4.1 INTRODUCTION TO ASSET ACCOUNTING

After Reading this unit you will be able to

- Understand the term Asset
- understand the types of assets
- Accounting of Assets

4.1.1 Meaning:

Asset Accounting is the process of accounting of acquisition, use and disposal of assets over their entire life. It aims at the recording and reporting of financial information related to business's financial statement. The balance sheet reports all assets of a business. Accountants must properly report this information because assets represent a portion of the total wealth or economic improvements made by the business.

The accounting equation is:

Assets = Liabilities + Owner's equity.

4.1.2 Types of Assets

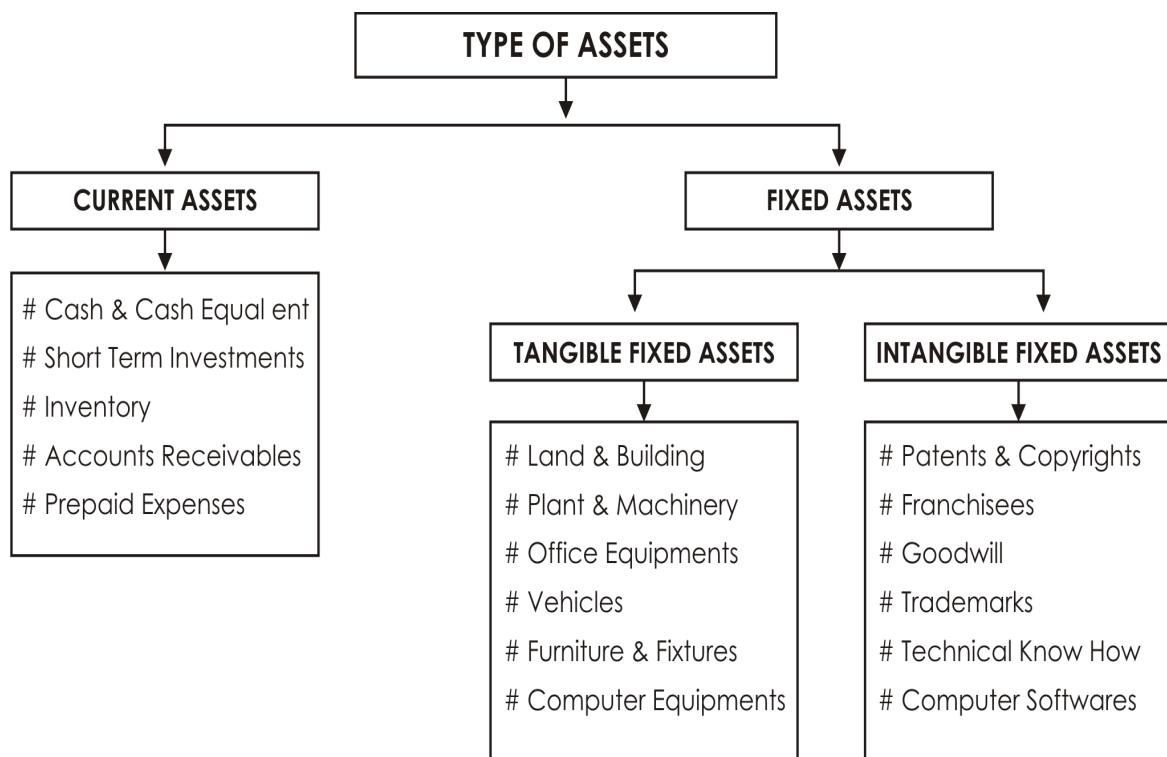
The balance sheet assets are grouped under two types viz., Fixed Assets & Current Assets.

Current assets are those that form part of the circulating capital of a business. They are replaced frequently or converted into cash during the course of trading. The most common current assets are stocks, accounts receivables, and cash. These assets are cash and other assets expected to be converted to cash or consumed either in a year or in the operating cycle (whichever is less), without disturbing normal operation of a business. Following are the major assets considered as Current Assets.



- (a) **Cash & Cash Equivalent** is the most liquid asset, which includes currency cash, Bank Deposit, Negotiable Instruments etc. (Cash or Bank Balance denotes the same meaning)
- (b) **Short Term Investment** includes Securities bought and held for sale in the near future to generate income on short term.
- (c) **Accounts Receivables** are the non-collectable balance of debtors, which are not due at the time of closing of books and shown outstanding in the books of accounts.
- (d) **Inventory** is major part of current assets. It includes Raw Material, Work in Progress and Finished Goods Inventory. The inventory value is reported on the balance sheet date is usually on the historical cost or fair market value, whichever is less as per the AS-2. This is known as the "Lower of cost or market" rule.
- (e) **Prepaid Expenses** are the expenses paid in cash and recorded as assets before they are used or consumed.

Fixed assets are assets of a business intended for continuing use, rather than a short-term, temporary asset. Fixed assets must be classified in a company's balance sheet as tangible, intangible, or investments. Tangible Assets are Assets having a physical existence, such as land and buildings, plant and machinery, fixtures and fittings, motor vehicles and IT equipment. Examples of intangible assets include goodwill, patents, and trademarks.





Study Note - 4 : Asset Accounting

4.2 CURRENT ASSET ACCOUNTING

After Reading this unit you will be able to

- Understand the features of current asset
- understand the accounting of current asset

4.2.1 Features of current asset

Current asset – It is rightly observed that “Current assets have a short life span. These type of assets are engaged in current operation of a business and normally used for short– term operations of the firm during an accounting period i.e. within twelve months. The two important characteristics of such assets are, (i) short life span, and (ii) swift transformation into other form of assets. Cash balance may be held idle for a week or two, account receivable may have a life span of 30 to 60 days, and inventories may be held for 30 to 100 days.”

Current assets are the first items reported on the balance sheet under asset accounting. These items include cash and cash equivalents, inventory, accounts receivables and short-term marketable securities. Current assets are cash and other assets that will be converted to cash or used up during a relatively short period of time, usually a year or less. Current assets are normally listed in the order of liquidity (how readily they can be converted to cash).

Current asset accounting values these items at current market value since this information is readily available and the items can be quickly bought or sold in the open market. Current assets may also represent the items used by a company to generate sales from normal business operations.

Current assets consist of cash and other assets, such as debtors and inventories, which are expected to be converted into cash or to be used in the operations of the enterprise within one year.

4.2.2 Accounting of current assets

4.2.2.1 Cash

This is the most liquid of all assets because it is already in liquid form. If a company has a large pile of cash, then it has a nice safety cushion for hard times. The cash amount on the Balance Sheet is the amount of cash owned by the entity on the Balance Sheet date.

Cash management is necessary to ensure that at any point in time, a company has neither too little nor too much cash on hand. It is important that a company does not maintain cash on hand and on deposit in checking accounts beyond a minimal amount that is necessary to support ongoing operations, since cash is essentially a nonbearing asset.



To help manage its cash, a company should regularly reconcile its bank statements, including preparing a reconciliation report and making adjustments if there are discrepancies between the company's records and the bank's records.

Cash and bank balance is shown in the Assets side of the balance sheet under Current Assets heading. At the time of closing of books of accounts there should letter of confirmation required on bank's letterhead for the bank balance shown in balance sheet, also one letter of confirmation from the management of company is required for cash balance shown in balance sheet at the end of the accounting period. It is the requirement as per The Companies (Auditor's Report) Order 2003 (CARO) guidelines.

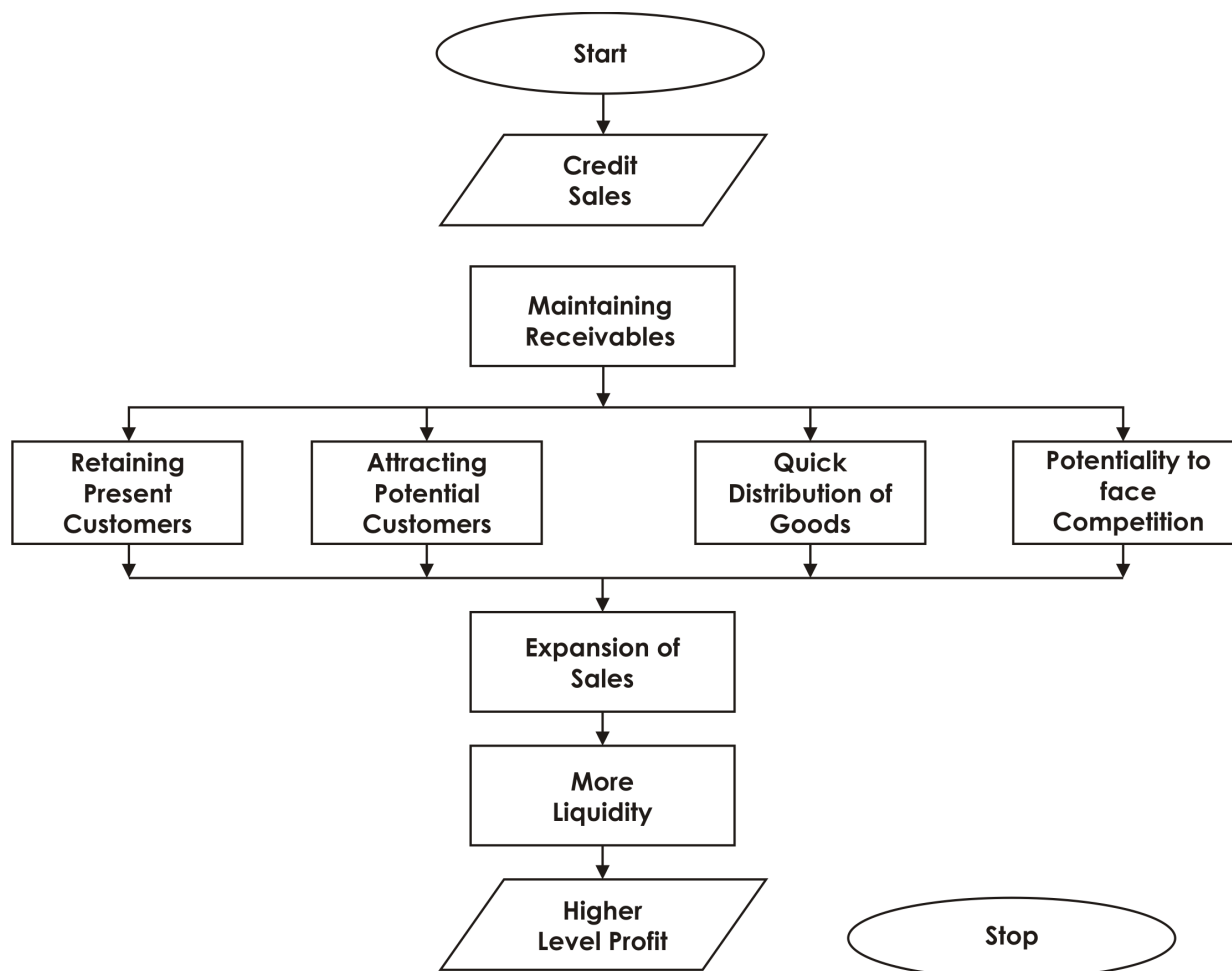
4.2.2.2 Accounts Receivable

When goods and services are sold under an agreement permitting the customer to pay for them at a later date, the amount due from the customer is recorded as accounts receivables; so, receivables are assets accounts representing amounts owed to the firm as a result of the credit sale of goods and services in the ordinary course of business. The value of these claims is carried on to the assets side of the balance sheet under titles such as accounts receivable, trade receivables or customer receivables. This term can be defined as "debt owed to the firm by customers arising from sale of goods or services in ordinary course of business." According to Robert N. Anthony, "Accounts receivables are amounts owed to the business enterprise, usually by its customers. Sometimes it is broken down into trade accounts receivables and non-trade accounts receivables; the former refers to amounts owed by customers, and the latter refers to amounts owed by employees and others".

Generally, when a concern does not receive cash payment in respect of ordinary sale of its products or services immediately in order to allow them a reasonable period of time to pay for the goods they have received, the firm is said to have granted trade credit. Trade credit thus, gives rise to certain receivables or book debts expected to be collected by the firm in the near future. In other words, sale of goods on credit converts finished goods of a selling firm into receivables or book debts, on their maturity these receivables are realized and cash is generated. According to Prasanna Chandra, "The balance in the receivables accounts would be; average daily credit sales X average collection period

Accounts receivables are reported on the Balance Sheet at their "Net Realizable Value." This amount is the amount of cash expected to be collected from the accounts receivable. Usually the balances shown in the debtor's ledger are supported by sales documents.

When sales are made on account, a very high probability exists that some accounts receivable will not be collected. The amount of accounts receivable not expected to be collected is recorded and reported in the account "Allowance for Bad Debts" which is a "contra asset" account on the Balance Sheet.



4.2.2.3 Inventories

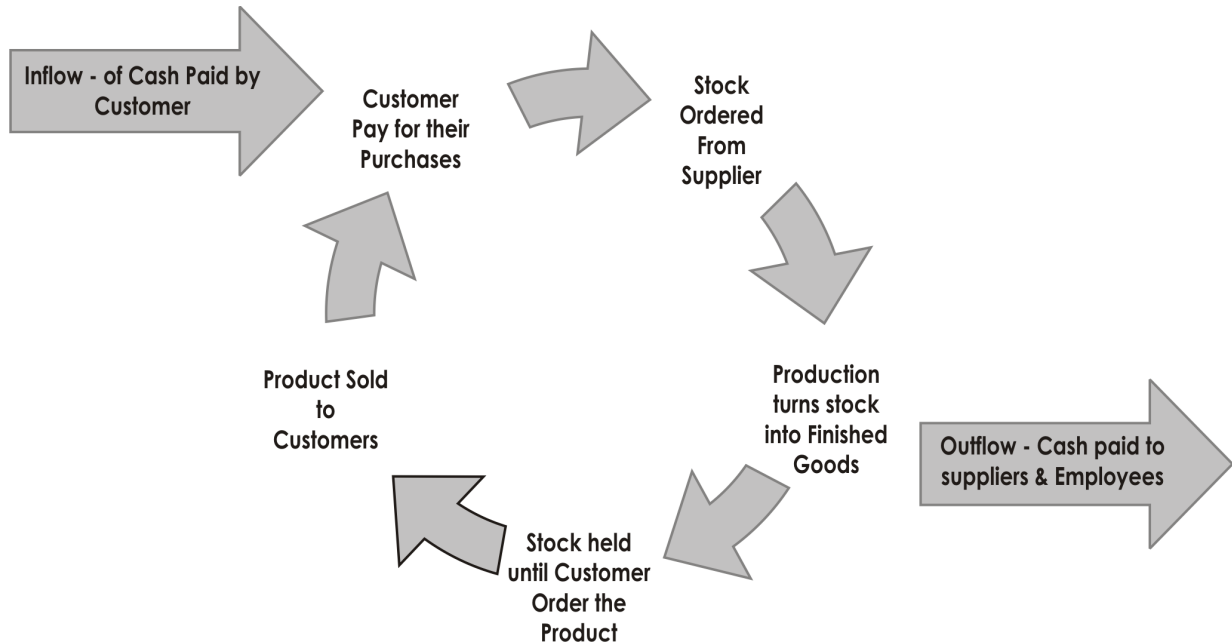
Inventories are the major part of current assets, It includes Raw Material, Work in Progress, Finished Goods and Store & Spares Items. Ideally in an organization the inventory maintenance is for 30 to 100 days depending upon the requirements. Inventory are those items which are required to make production smoothly and it will be converted in cash by sale of Finished Goods.

For the smooth functioning of an organization, Inventory management is important, with the proper inventory management an origination can earn more profits than its competitors. Excess inventory may cause serious loss to the company. So, in an organization inventory level will be observed by the expert group of persons.

When an item is purchased, it is shown in the assets side of the balance sheet under current assets heading under the Inventory. When an item of inventory is sold, its cost is transferred from the inventory asset account, a Balance Sheet account, to the cost of goods sold account, an Income Statement account.



4.2.2.3.1 Operating Cycle of Inventory



Particulars		Debit (Rs.)	Credit (Rs.)
At the time of Purchase of Inventory Items			
Raw Material Inventory A/c	Debit	xxx	
To Party A/c (Being Raw Material Purchased from M/s. _____ against Bill No.)			xxx
At the time of Issue of Material to the Machines on Shop floor			
Work in Progress Inventory A/c	Debit	xxx	
To Raw Material Inventory A/c (Being Material issued to production against Store Issue Note No.)			xxx
At the Time of conversion of WIP Inventory in to Finished Goods Inventory			
Finished Goods Inventory A/c	Debit	xxx	
To Work In Progress Inventory A/c Credit (Being Material Transfer to Finished Goods)			xxx
At the Time of Sale of Finished Goods Inventory			
Party (Customer) A/c	Debit	xxx	



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To Sales A/c (Being Sale of ____ to M/s ____ Against Bill No.)			xxx
At the time of booking Material Consumption against Sales			
Material Consumed (Trading A/c) A/c	Debit	xxx	
To Finished Goods A/c (Being Material Consumed for the Month of April 2013)			xxx

4.2.2.4 Prepaid Expenses

A prepaid expense is an asset awaiting assignment to expense. Some expenditure made during one period are not properly recognizable as expenses until a subsequent period. Prepaid expenses result from the application of accrual accounting. Prepaid expenses are accounted in the assets side of the balance sheet. Prepaid expenses are the expenses which are not related to the accounting period in which it is accounted in the books. So, these expenses are not charged in the Profit and Loss account. It is shown in the Assets side of the balance sheet as prepaid expenses. For Instance, if a company has paid insurance expense of Rs. 12000/- for the period 01-Jan-2013 to 31-Dec-2013 and the accounting period of company is from 01-April to 31-March. In that case the prepaid expenses will be from 01-April-2013 to 31-Dec-2013 for Rs. 9000/- which is paid in advance in the financial year 2012-13 and to be shown on the assets side of the balance sheet as prepaid expenses. Rs. 3000/- pertaining to the period 01 Jan 2013 to 31 March 2013 will be taken in to the Profit and Loss Account and Rs. 9000/- will be shown as prepaid expenses in the Balance Sheet for the period ending 31-03-2013. The following entries will be passed for this insurance expenses

Particulars		Debit (Rs.)	Credit (Rs.)
At the time of Payment of Insurance Policy			
Insurance Expenses (Profit & Loss A/c)	Debit	3,000.00	
Prepaid Expenses (Balance Sheet A/c)	Debit	9,000.00	
To Bank/Cash A/c (Being Insurance Expenses paid for period 01-Jan-2014 to 31-Dec-2013)	Credit		12,000.00
In the Financial year 2013-14 the following entry to be passed			
Insurance Expenses (Profit & Loss A/c)	Credit	9,000.00	
To Prepaid Expense (Being Insurance Expensed paid in the Financial Year 2012-13 pertaining to the Financial Year 2013-14. Now transferred to Profit & Loss Account)	Credit		9,000.00



4.3 Fixed Assets Accounting

After Reading this unit you will be able to

- Understand the features of fixed asset
- Understand the term Tangible and Intangible Assets
- understand the accounting of fixed asset
- familiar with various methods of calculating depreciation

4.3.1 Features of Fixed Assets:

Fixed assets are items held for long-term use by the company. Companies may have several fixed assets depending on the size and type of operations of the business. Fixed Asset accounting usually records these items at historical cost and depreciates this value over a set amount of time.

Fixed assets are items of property that

- are tangible in nature;
- have an economic useful life longer than 1 year;
- maintain their identities throughout their useful lives, either as separate entities or as identifiable components of larger conglomerations of property;
- are not repair parts or supply items; and
- Have significant value.

Acquisition Cost means the total cost of obtaining a fixed asset and putting it in place and in condition for use. This cost will be recorded in the books of accounts, representing the value of the asset when it was acquired. The acquisition cost is generally the historical or original cost but may be based on a different valuation for certain types of transactions.

4.3.2 Tangible & Intangible Assets

Tangible Assets: Tangible assets are those assets which are having physical substance. It includes the traditional items or land, building, machinery, vehicles, fixtures and computer equipments. Assets accounting usually records these items at historical cost and depreciates this value over a set amount of time. GAAP (Generally Accepted Accounting Principles) usually allows companies to choose depreciation method consistent with the type of asset reported amount several business industries or sectors. When reporting theses fixed assets for tax purposes, accountants must use the Modified Accelerated Cost Recovery System (MACRS) to report the depreciation on annual tax fillings. Assets accounting must keep two separate depreciation schedules when depreciating fixed assets.

Intangible Assets: An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Intangible assets includes, Patents, Copyright, Franchises, Goodwill,



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Trademarks, and Softwares etc. As per the revised Schedule VI of Companies Act the intangible assets are separately shown under the head of Non-Current Assets. Separate note to be prepared for Intangible Assets.

4.3.3 Depreciation

The cost of the fixed asset will contribute to the organization's ability to earn revenue for a number of accounting periods. It would be unfair if the whole cost were treated as an expense in the income statement in the year of acquisition. Instead, the cost is spread over all of the accounting periods in which the asset is expected to be making a contribution to earnings (this is known as the asset's useful life). The process by which this is achieved is called depreciation. As per Companies Act 2013 the minimum depreciation rates are charged as mentioned in Schedule-2. Under Companies Act 2013, the depreciation is calculated on the basis of life of Assets as per Schedule-2, and not on the basis of the rate of depreciation. But, as per Income Tax Act 1961 for assessing the tax liability of the company, the company has to use WDV method for calculation of Depreciation. Whatever difference is coming in the depreciation as per the calculation under Companies Act and under Income Tax Act, that difference will be defined as Deferred Tax Assets or Liabilities as the case may be, and shown in the balance sheet of the company.

4.3.3.1 Definition of Depreciation

Depreciation is defined as the permanent loss in the value of assets through wear and tear or the passage of time.

Depreciation is the measurement of the decrease in the value of the fixed asset or consumption of the value of an asset or value of usage through wear and tear.

Depreciation is the allocation of the value of an asset through its estimated life. It is a proportion of the amount in each accounting year by a fair means during the expected life of an asset.

Accounting to IASC (International Accounting Standards Committee) "Depreciation is the allocation of the depreciable amount of an asset its estimated useful life. Depreciation for the accounting period is charged to income either directly or indirectly."

To follow the provisions of Companies Act 2013: The Companies Act makes it compulsory to write off depreciation on fixed assets before declaring dividend. So in the case of companies, dividend cannot be declared unless depreciation is provided.

4.3.3.2 Causes of Depreciation

Causes of depreciation are :

1. **Usage:** The primary cause for depreciation of assets is its usage. Assets physically deteriorate due to wear and tear in use. When assets are used constantly, they wear out. More the usage of assets, the more will be their wear and tear. This wear and tear reduce the useful life of an asset.



2. **Passage of time:** The useful life of some assets, even if they are not put to use, will be reduced, since they are exposed to nature, rains, wind etc. On the other hand, Intangible assets like patents, copy-right, and lease hold property etc. that are acquired for a particular period after expiry of the period, become useless. These intangible assets will have to be depreciated within their legal life.
3. **Non – usage:** Assets depreciate when it is used; it also depreciates more when it is not used. Machines depreciate move with the passage of time when kept idle. When machines are not used and exposed to weather they compared to when they are in use.
4. **Accidents:** Accidents also reduce the value of an asset. Loss due to accidents or natural disasters is permanent.
5. **Exhaustion:** Mines, oil-wells, quarries etc. have natural deposits as resources. When they are extracted used year after year, the value of natural deposit reduces such that these assets are wasting assets. An oil well, a coal mine or quarry gets physically depleted by removal of its deposits three by depreciatis its value
6. **Obsolescence:** Due to new inventions, change in fashions, change in government policies, change in technology, change in market conditions, an asset may go out of use. New and improved machines result in discarding old machines. It is not depreciation in the real sense. But if a new machine performs better than the existing machine in all aspects, such existing machines may become outdated or outmoded or obsolete and removed from use.
7. **Improper maintenance:** Assets acquired have to be properly maintained in order to derive the estimated useful life of the asset. But it also happens that plant, machinery, building etc. not maintained properly will reduce the useful life of the asset and hence will result in more depreciation.

4.3.3.3 Need for Providing Depreciation

To know the true result: Assets are used as an important tool in earning revenue. Large amounts are contributed for acquisition of assets. These assets are worn out in the process of earning revenues. When the assets 'value decreases, the loss must be accounted for; otherwise the real working' result cannot be known. Therefore depreciation is taken as an operating expenses and charged to the profit and loss account to arrive at the true profit of a business.

To reflect the real value of an asset: Balance sheet has to reflect true financial position. To have the true value of a business, depreciation has to be charged on the original cost of the asset year after year.

To replace the asset: The value of assets decreases year after year and when an asset becomes obsolete it needs to be replaced. By making depreciation annually over the life of an asset, it becomes easy to replace it with a new one by making provision for the replacement of that



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asset. If depreciation is not charged against profit every year, a business may find it difficult to build reserve to replace the asset.

To follow the provisions of Companies Act 1956: The Companies Act makes it compulsory to write off depreciation on fixed assets before declaring dividend. So in the case of companies, dividend cannot be declared unless depreciation is provided.

4.3.3.4 Calculating depreciation

While calculating the amount of depreciation, the following factors are normally taken into account;

1. Original cost of the asset which includes the actual cost price, installation charges, additions and improvements to the asset.
2. Estimated life of the asset expressed in number of years or product units based on the effective service of the asset to the barriers.
3. Residual value or estimated scrap value of an asset is the estimated realisable (Sale) value of the asset at the end of its estimated working life.

4.3.3.5 Methods of Depreciation

Depreciation is provided and charged in the books of Accounts by various methods. Fixed assets differ in their nature, so providing depreciation cannot be on a single methods. The following are some of the important methods of depreciation:

1. Fixed installment method
2. Diminishing balance method
3. Annuity method
4. Insurance policy method
5. Sinking fund method
6. Revaluation method
7. Machine hour-rate method
8. Kilometer method
9. Depletion method
10. Sum of year digital method

Some of the important methods are explained below:

*Depreciation has been covered in detail under Paper No. I, Fundamentals of Financial Accounting, Study Note 3, and students may refer this chapter for detailed understanding.



1. Fixed Installment Method or straight-line method

Under this method a fixed or equal of depreciation is charged at the end of each year, during the economic life of the asset till the value of the asset become zero or attains its scrap value. Under this method, the amount of depreciation remains the same.

Features

- Calculation is very simple.
- It is suitable for those assets whose usage remain uniform each year.
- It is also suitable for such assets whose economic life is easily determined.
- The value of assets under this method can be reduced to zero or to their estimated scrap value.
- It is a method which is recognized by the Companies Act.
- The assets value keeps on decreasing but the depreciation amount remains the same every year.
- It is difficult to compute the depreciation amount upon any additions to the asset during any year.
- This method does not provide any provision for the interest on capital which is invested in the fixed assets.
- The quantum of depreciation may be worked out as follows:
 - (a) When the asset has no residual value:
$$\text{Depreciation} = \frac{\text{Original cost of asset}}{\text{Estimated life of asset in years}}$$
 - (b) When the asset has residual value :
$$\text{Depreciation} = \frac{\text{Original cost of asset} - \text{Estimated scrap value}}{\text{Estimated life of asset in years}}$$
 - (c) To Calculate rate of Depreciation:
$$\text{Rate of Depreciation} = \frac{\text{Amount of Depreciation}}{\text{Original value of asset}}$$

Example 1

A machinery costing Rs.50,000 was purchased on 1st January 2018, the useful life of the machinery is 4 years and residual value is Rs.10,000 after 4 years. Compute the rate and amount of depreciation.

Solution :

$$\text{Depreciation} = \frac{\text{Original cost of asset} - \text{Estimated scrap value}}{\text{Estimated life of asset in years}}$$

Study Note - 4 : Asset Accounting

$$= 50,000 - 10,000 / 4 \text{ years}$$

$$= \text{Rs. } 10,000$$

$$\text{Rate of depreciation} = \text{Depreciation} / \text{Cost of Machine} \times 100$$

$$= \text{Rs. } 10,000 / \text{Rs. } 50,000 \times 100$$

$$= 20\%$$

Example 2

A machine was purchased on 1st October 2018 for Rs.50,000 and Rs.3,000 was spent on installation. Depreciation is at the rate of 10%. The books are closed on 31st March every year. Show the machine accounts for 3 years.

Solution:

Dr. Machinery Account			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
2018 Oct 1	To Bank A/c Cost	50,000	2019 Mar 31	By Depreciation (53,000 x 10% x 6/12)	2,650
"	To Bank A/c (Installation)	3,000	"	By Balance c/d	50,350
		53,000			53,000
2019 Apr 1	To Balance b/d	50,350	2019 Mar 31		
				By Depreciation (53,000 x 10%)	5,300
				By Balance c/d	45,050
		50,350			50,350
2020 Apr 1	To Balance b/d	45,050	2020 Mar 31		
				By Depreciation	5,300
				By Balance c/d	39,750
		45,050			45,050
2021 Jan 1	To Balance b/d	39,750			
		39,750			

2. Written Down Value Method or Diminishing Balance Method

This method is also called as "Declining Charge Method" or "Reducing Installment Method" or "Fixed percentage on Declining Base method." Under this method depreciation is computed



as a fixed percentage on the written down value (WDV) of an asset each year. Depreciation is calculated on the book value of the asset every year. The amount of depreciation of the asset will not be same each year. It goes on reducing every year but the percentage is fixed. Depreciation is provided till the WDV of the asset becomes negligible.

Features

- This method is suitable for those assets whose repairs/maintenance increase as they become old.
- This method eliminates a major part of the cost in the early years and so it minimizes the impact of obsolescence.
- This method is recognized by the Income Tax Act and also by the Companies Act.
- No fresh calculation of depreciation is required when additions are made.
- The calculation of depreciation under this method is slightly complex compared to Straight Line Method.
- The amount of depreciation provided under this method will not be sufficient to replace the asset at the end of its useful life.
- This method emphasizes on the historical cost of the asset.

The rate of depreciation may be found out by the following formula:

Rate of depreciation = $1 - \frac{\text{Residual or Scrap Value}}{\text{Cost of Acquisition}}$

n = expected useful life in years

3. The machine-hour method/units of production method

Some fixed assets depreciate according to their usage. If the asset has a measurable 'life' in terms of the number of hours it is likely to be used, or the number of units of output it is likely to produce, it can be depreciated according to that rate.

For example, a computer printer might have an expected total output of 40,000 sheets. If it produces 10,000 sheets in a year, it can be said to have used up one-fourth of its cost in that year.

4. The revaluation method

This method of calculating depreciation differs from the straight-line and reducing balance methods, by not being a calculation based on the original cost of an individual asset. Instead, the method relies on an estimated cost being made in respect of a group of similar small-value assets when preparing the financial statements.

4.3.4 Accounting for the disposal of a fixed asset

At the end of the asset's life it will be either abandoned or sold. This is known as a 'disposal' for the



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purpose if Accounting. At this time a comparison is made of the difference between the carrying amount of the asset at the date of its disposal and the proceeds received (if any). The difference is referred to as the profit or loss arising on the disposal of the asset. It effectively represents the extent to which the depreciation charged during the life of the asset was Correct or Incorrect.

If the proceeds received on disposal are less than the carrying amount at that date the difference is a loss on disposal, which is treated as an expense when calculating the company's profitability.

4.3.5 Model Accounting Entries for Assets

Acquisition:

Particulars		Debit (Rs.)	Credit (Rs.)
Fixed Asset	Dr	XXX	
To Cash/Bank			XXX

Depreciation:

Particulars		Debit (Rs.)	Credit (Rs.)
Depreciation Expense	Dr	XXX	
To Accumulated Depreciation		XXX	

Disposal (Loss):

Particulars		Debit (Rs.)	Credit (Rs.)
Cash/Bank A/c	Dr	XXX	
Accumulated Depreciation	Dr	XXX	
Loss on Disposal of Asset	Dr	XXX	
To Asset			XXX

Disposal (Loss):

Particulars		Debit (Rs.)	Credit (Rs.)
Cash/Bank A/c	Dr	XXX	
Accumulated Depreciation	Dr	XXX	
Loss on Disposal of Asset	Dr	XXX	
To Asset			XXX

**Disposal (Gain):**

Particulars		Debit (Rs.)	Credit (Rs.)
Cash/Bank A/c	Dr	XXX	
Accumulated Depreciation	Dr	XXX	
To Asset			XXX
To Gain on Disposal of Asset			XXX

Disposal (Discarded Asset-No Resale Value):

Particulars		Debit (Rs.)	Credit (Rs.)
Accumulated Depreciation	Dr	XXX	
Loss on Disposal of Asset	Dr	XXX	
To Asset			XXX

Asset exchanged for new assets (Loss):

Particulars		Debit (Rs.)	Credit (Rs.)
Asset (New)	Dr	XXX	
Accumulated Depreciation Asset (Old)	Dr	XXX	
Loss on Disposal of Asset	Dr	XXX	
To Cash			XXX
To Asset (Old)			XXX
Asset (New)	Dr	XXX	
Accumulated Depreciation Asset (Old)	Dr	XXX	
To Cash			XXX
To Asset (Old)			XXX

Since the assets are similar, we do not recognize the gain, instead, we deduct it from the cost of the new asset.

4.4 PROJECT ACCOUNTING

After Reading this unit you will be able to

- Understand the term Project
- understand the difference between project accounting and financial accounting
- Recognize the project expenditure.

4.4.1 Meaning of Project accounting:

Project accounting differs from standard accounting in that it is designed to monitor the financial progress of a project rather than the overall progress of organizational elements. With Project



Study Note - 4 : Asset Accounting

Accounting, financial reports are specifically created to track the project process. Utilizing Project Accounting provides Project Managers with the ability to accurately assess and monitor project budgets and ensure that the project is proceeding on budget. Project managers can quickly address any cost overruns and revise budgets if necessary.

Project accounting also differs from standard accounting in the time period that it is reported. Standard accounting reports financial progress for fixed periods of time, for example, quarterly or annually. Projects can last from a few days to a number of years. During this time, there may be numerous budget revisions. The project may also be part of a larger overall project. For example, if an organization were constructing a new building that would be the larger project, however telecommunications could be handled as its own project, and as such with a separate project budget.

Costs and revenues that are allocated to projects may be further subdivided into a work breakdown structure (WBS). In utilizing project accounting, you have the flexibility to report at any such level and can also compare historical as well as current budgets.

Project accounting allows companies to accurately assess the ROI of individual projects and enables true performance measurement. Project managers are able to calculate funding advances and actual versus budgeted cost variances using project accounting. As revenue, costs, activities and labors are accurately tracked and measured, project accounting provides future benefits to the organization. Future quotes and estimates can be fine-tuned based on past project performance. Project accounting can also have an impact on the investment decisions that companies make. As companies seek to invest in new projects with low upfront costs, less risk, and longer-term benefits, the costs and benefit information from a project accounting system provides crucial feedback that improves the quality of such important decisions.

A project accounting is the practice of creating financial reports specifically designed to track the financial progress of the projects.

The projects typically exhibit the following characteristics:

- a finite project life
- a nominated project manager
- a specified source of funding
- an approved project plan and budget
- specified deliverables

A project manager shall be appointed for each project. The project manager is responsible for both the operational and administrative components of the project.

The Project Managers are primarily responsible for the recording and accounting of the project expenditure on a daily basis



4.4.2 Basis of accounting

Expenditure on projects shall be accounted for on a cash or as committed basis.

4.4.3 Recognition of project expenditure

The expenditure of a project must include all direct costs of undertaking the project. The following items are to be included in project expenditures:

- the cost of establishment, that is, salaries and allowances of permanent and temporary staff, including that of the project manager.
- direct purchases of materials and items of plant and equipment acquired exclusively for the project
- direct services purchased exclusively for the project such as training, casual labour and other contract work
- any direct costs incurred and passed on from other departments that relate to the project
- any other costs set out in the project budget,

Project expenditures should not include any indirect costs, such as interest, depreciation, or administrative overheads unless specifically provided for in the project budget.

4.4.4 Accounting Entry:

For a project total contract is Rs. 1 Crore. Our company invoiced 90 lakhs in 2018, but 10% will be invoiced after completion of project in 2019. What is the journal entry if the 10% is invoiced only in next year.

In the profit and loss account, it be shown as a separate income (Sales income - retention)

Materials already consumed in year 2018.

For 2018

2018

Particulars		Debit (Rs.)	Credit (Rs.)
Retention Account	Dr.	90,00,000	
To Sales - Retention Account	Cr.		90,00,000

2019

Particulars		Debit (Rs.)	Credit (Rs.)
Customer Account	Dr.	10,00,000	
To Retention Account			10,00,000



STUDY NOTE – 5

ACCOUNTING FOR SPECIAL TRANSACTIONS

This Study Note includes:

- Bills of Exchange
- Consignment Accounting
- Joint Venture Accounts
- Sales of Goods on Approval or Return Basis

5.1 BILLS OF EXCHANGE

5.1.1 Introduction

Business activity involves exchange of goods or services for money. A business transaction gets 'closed' if the exchange is settled immediately. When goods are purchased from supermarket and paid for in cash the settlement is instant. Same is the case when we go to a restaurant, have food and pay either by cash or credit card. Most of the settlements are not on cash basis, where payment for goods or services is deferred at the behest of both parties to the transaction. Such deferred payments are done through instruments like cheques, pay order, letter of credit, promissory note, bills of exchange, hundies etc. These instruments facilitate credit transactions and hence sometimes they are referred to as credit instruments or negotiable instruments. Even in ancient times some credit instrument like hundies were extremely popular.

In case of credit transaction, the supplier normally gets a promise from the customer that he will settle the payment at a future date as agreed. It could either be a promissory note or bill of exchange. The promissory note is written by the customer as an undertaking to pay the money, whereas the bill of exchange is a note drawn by the seller and accepted by the buyer. In India, the Negotiable Instruments Act 1981 governs the provisions for bills of exchange. As per this act, the bill of exchange is defined as " an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain some of money only to the order of the certain person or to the bearer of the instrument"

Based on this definition the following features of a bill of exchange are noticed:

- (a) It's an instrument in writing.
- (b) It contains an unconditional order



- (c) It's signed by the maker.
- (d) It's drawn on a specific person
- (e) There is an order to pay a specific sum of money
- (f) It must be dated.
- (g) It specifies to whom the payment is to be made e.g. to the maker or to person mentioned by him or to the bearer.

Whereas, a bill of exchange is drawn by seller and accepted by buyer; a promissory note, on the other hand, is created by the buyer as an undertaking to pay to the seller.

Specimen of a bill of exchange:

Stamp	Address of Drawer Date
Three months after date pay to a sum of Rs. 50,000 (Fifty Thousands only) for the value received.	
To B accepted	
(B's signature & stamp)	A (Drawer)

5.1.2 Parties to Bill of Exchange

The parties involved in transaction that uses bill of exchange as a mode of settlement are:

- (a) Drawer: He is a person who draws the bill. Typically, he is the seller or a creditor.
- (b) Drawee: He is the person on whom the bill is drawn. Normally, he is the buyer or debtor. He has to pay the amount of the bill to the drawer on the due date.
- (c) Payee: He is the person to whom the amount of bill is payable. He may be the drawer himself or the creditor of the drawer.
- (d) Endorsee: He is the person in whose favour the bill is endorsed by the drawer. He is usually the creditor of the drawer.

Suppose, 'A' sells goods to 'B' for Rs. 1,00,000. 'A' draws a bill on 'B' who accepts the same to pay this amount after 90 days. Here, 'A' is the drawer and 'B' is the drawee. If 'A' specifies that the amount will be paid to 'C', then 'C' will be the payee.

It is necessary that the bill is accepted by the drawee. Only then it becomes a valid negotiable instrument. Such accepted and signed bill of exchange is usually 'noted' with 'notary public'. Such noting is usually done when the bill is dishonoured.



Study Note - 5 : Accounting for Special Transactions

5.1.3 Holder and Holder in Due Course Holder

According to Sec 8 of the Negotiable Instruments Act a Holder is "Any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereon". It indicates the person who is legally entitled to receive the money due on the instrument is called the 'Holder'.

Holder in Due Course

According to Sec 9 of the Negotiable Instruments Act, the holder in due course is a particular kind of holder. The person of a negotiable instrument is called holder if he/she satisfies the following conditions:

- (a) He/she has obtained the instrument for valuable consideration.
- (b) He/she became the holder of the instrument before the maturity of the instrument.
- (c) He/she must acquire the instrument bonafide and having no cause to believe that, any defect existed in the title of the person from whom he derived his title.

5.1.4. Dishonour of Bill

Dishonour of a Bill means that the acceptor refuses to honour his commitment on due date and for this, payment of the bill on presentation does not take place. At the time of dishonor of a bill, original relationship between the parties is restored, that is, the drawee again becomes the debtor of the drawer in his books and drawer is treated then as a creditor in the books of drawee. Moreover, the drawer becomes liable here to compensate the bank (or for that matter endorsee) if the bill is not retained by the drawer till date of the maturity.

To provide a legal evidence of dishonour, the fact of dishonour is to be noted on the bill by 'Notary Public'. The fact of dishonour which he is recording is called 'noting' and the amount charged by him for his services are called 'noting charges'. These charges are to be paid by the holder of the bill on the date of default. Actually the acceptor of the bill is liable for the dishonour, the noting charges paid by the holder are to be reimbursed by the acceptor.

The Journal Entries for dishonor of a bill are as follows:

- (a) When bill is retained till due date:

Books of Drawer		Books of Acceptor	
Acceptor A/c	Dr.	Bills Payable A/c	Dr.
To Bills Receivable A/c		Noting Charges A/c	Dr.
To Cash A/c (Acceptor account is debited with the amount of the bill and the amount of noting charges paid in cash)		To Drawer A/c (Drawer account is credited with the amount of the bill and the amount of the noting charges to be reimbursed through the drawer)	



Acceptor A/c	Dr.	Bills Payable A/c	Dr.
To Bank A/c (Amount of the bill plus the noting charges paid by the bank are debited to Acceptor A/c credited to Bank A/c)		Noting Charges A/c To Drawer A/c (Drawer account is credited with the amount of the bill and the amount of the noting charges paid by the bank to be reimbursed through the drawer)	Dr.

5.1.5 Discounting of Bills

If the holder of a bill receivable cannot wait till the date of maturity of the bill and needs cash before the date due, then he can get the bill discounted from the bank. At the time of discounting it, the bank pays cash after deducting the discount from the value of the bill. The discount which is to be deducted depends upon the rate of interest and the remaining period of the bill and is calculated as follows.

Discount = Amount of the bill × Remaining period to maturity × Rate of interest

For example, if a bill of Rs.10,000 due for payment on 15.03.2020 is discounted on 15.01.2020 at 24% p.a., the amount of discount is calculated as under:

Amount of Bill = Rs.10,000

Rate of interest = 24%

Remaining period of the bill = 2 months

Discount = Rs.10,000 $\frac{2}{12} \times \frac{24}{100} \times 100$ = Rs.400

Cash received on Discounting = Rs. (10,000-400) = Rs.9,600

Discount is an expenses for the holder receiving the payment and gain to the bank.

Journal Entries in the books of drawer and drawee at the time of discounting and payment on due date are as under:

Books of Drawer		Books of Drawee	
At the time of cash received from Bank on discounting of bills:		Discounting of bill: No entry is passed in the books of Drawee for discounting of the bill.	
Bank(or Cash) A/c	Dr.		
Discount A/c	Dr.		
To Bills Receivable A/c (For bills, discounted from bank)			



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Payment of bill by drawee to Bank on due date: No entry is passed in the books of the drawer because the bill is duly honoured by the drawee.		Payment of the bill on due date : Bills Payable A/c. To, Cash (or Bank) A/c. (For payment of the bill to bank)	Dr.
Transfer of discount to Profit and Loss Account: Profit & Loss A/c	Dr.	No entry	
To Discount A/c			

5.1.6 Tenure, Days of Grace and Date of Maturity or Due Date of Bills

The bill is payable at sight, on demand after sight, after date etc. The period between the date of drawing of the bill and the period it becomes due is called Tenure of the Bill.

Days of Grace

In case the bill is payable on demand, it becomes due immediately on presentation for payment. In the same way if the bill is not payable on demand becomes due on the third day from the date of maturity. These three days are called Days of Grace. For example, if a bill is drawn on 1.4.2020 for 4 months, the due date or date of maturity will be 4.8.2020. The same can be computed as under:

Date of Drawing	1.4.2020
Add: Period/Tenure	4 months
	<u>1.8.2020</u>
Add: Days of Grace	3
Due Date / Date of Maturity	<u>4.8.2020</u>

Date of Maturity

Date of Maturity is also known as Due Date. The date on which the amount of the bill becomes payable is called 'Due Date' or 'Date of Maturity'. To compute due date, three days (called Grace Period) are included to the date of maturity of the period of the bill.

The date of maturity of the period of bills depends on whether (a) the bill is payable on date or bill is payable on sight. If the bill is payable on date, the date of maturity is computed by including tenure of bill to the making of the bill.

Date of maturity can be understood with the help of the following example:

Date of Drawing	12.12.2020
Tenure	+3 Months
	<u>12.03.2021</u>



However, If the bill becomes due at sight, the date of maturity is counted by including tenure of the bill to the date of acceptance of the bill. In that case, the due date of the bill is calculated as follows:

Date of Acceptance	16.12.2020
Tenure	+3 months
	<u>16.3.2021</u>

The due date of the bill after including grace period of 3 days is 15.3.2021 if the bill is payable at date and 19.3.2021 if the bill is payable at sight.

For computing the date of maturity, following points should be noted:

1. Days of grace are allowed on bills payable on maturity of a fixed period. In case of bills payable on demand, amount is required to be paid on presentation and no grace period is allowed.
2. If period of the bill matures on a date which is not there in the month in question, then the due date is taken as the last date of the month. For example, if a bill is drawn on 31.1.2020 and the period of the bill is 3 months, the period bill becomes payable on 30.4.2020 and after including grace days, due date is 3.5.2020.
3. In case the expiry date of a bill falls on a holiday, the bill becomes payable on the preceding day. But when the maturity date is a bank holiday or a Sunday and the second day of grace is also a holiday, the bill is payable on the next working day.
4. The tenure of the bill can be explained in months or in days. The due date of bill should be computed considering this fact in mind. Hence, if S draws bill on A on 31.1.2020 of one month, the maturity date of the bill is computed as follows :

Date of Drawing	31.1.2020	
Tenure	+1 month	(2020 is a leap year)
	<u>29.2.2020</u>	
Days of Grace	+3 days	
	<u>03.03.2020</u>	

However, if tenure of the bill is 30 days , the expiry date of the bill is computed as follows :

Date of Drawing	31.1.2020
Tenure	+30 days
	<u>01.03.2020</u>



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Days of Grace	+3 days
	<u>4.3.2020</u>

Hence, tenure of one month and 30 days are different.

5.1.7 Types of Bills of Exchange

- a) Trade bill: This bill is drawn to settle a trade transaction.
- b) Accommodation bill: This bill is used without a trade transaction and is for mutual benefit. If Mr. X is in need of money, he draws a bill on his friend Mr. Y who accepts it. This bill is then discounted with bank (bank will pay money before due date) and the money is shared between X and Y. On the due date, Y will pay to the bank and X will pay Y his share. Law generally does not recognise such bills.

5.1.8 Operating Cycle of the Trade Bill of Exchange

We will see the cycle in case of a trade bill of exchange. There is a trade transaction to begin with. The seller will then draw a bill on the buyer who will accept it and return it back to the seller. The seller has four options:

- (a) Retain the bill with him till maturity and then present the bill to the buyer to claim the money on that date.
- (b) Discount the bill with the bank if urgent money is needed. The bank will deduct discounting charges and pay the drawer. The bank will collect the bill from the drawee on due date.
- (c) Endorse the bill to his creditor to settle his liability towards the creditor. Here, on the due date the creditor of the drawer will receive money from the drawee.
- (d) Send the bill to the bank for collection. Here, the bank will keep the bill with them till maturity, collect the payment on the due date and credit it to the A/c of the drawer. Bank charges commission for such activity.

The bill of exchange, being a credit instrument, means a right to claim for the drawer and an obligation to pay for the drawee. For the drawer, the bill is Bill Receivable (often referred to as B/R) since he has to get the money on due date. This is a monetary asset shown under current assets in books of the drawer.

For the drawee, the bill is Bill Payable (often referred to as B/P) since he has to make the payment on the due date. This is shown under current liability in the books of the drawee.

For endorsee, it represents a monetary asset (B/R).

If on the due date the payment of the bill is not done, it is said to have dishonoured. When bill is dishonoured, the old claims of trade transaction is reopened.



5.1.9 Promissory Note

A person, by whom any amount is payable himself prepares and signs a written undertaking to pay. Here the credit document is called a 'Promissory Note'. It's a written document and contains an undertaking or promise to pay. As per Indian Negotiable Instrument Act, a 'Promissory Note' is "an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money to, or to the order of, a certain person." The person to whom the amount is payable is called Promisee or Payee.

A specimen of Promissory Note which is prepared by Mr. A.Chakraborty in favour of Mr.R.K.Nandy is as follows:

Rs.15,000	12-03-2020 J-49, B.N. Marg, New Delhi
I, promise to pay Mr. R. K. Nandy after 3 months on order, the sum of Rs.15,000 (Rupees Fiteen Thousands only) for value Received.	
Place: Date : 16/03/2020	Sd/- A.Chakraborty 16-03-2020

5.1.10 Essential features of Promissory Note

Essential Features of Promissory Note are as follows:

- (i) It is a written document and adequately signed by the maker or promisor.
- (ii) It must contain an undertaking or promise to pay a definite amount given in both figures and words.
- (iii) The amount is payable either on demand or on the maturity of a fixed period.
- (iv) The amount is payable either to a prescribed person or to his/her order. The person to whom the amount should be payable is known promisee or payee.

5.1.11 Difference between Bills of Exchange and Promissory Note

The differences between these two items are as under:

Bills of Exchange		Promissory Note	
1.	It is drawn by the seller.	1.	It is drawn by the purchaser.

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2.	It involves an order to make payment.	2.	It involves a promise to make payment
3.	It consist of three parties, viz. the drawer, the acceptor and the payee.	3.	It consist of two parties, namely, the promisor (or maker) and promisor (or payee)
4.	To be effective, it must be accepted.	4.	It does not need acceptance.
5.	Drawer and the payee can be the same person.	5.	Maker and payee cannot be the same person.
6.	Acceptor is required to make payment on due date. In case of any default, drawer is liable to pay the amount to payee.	6.	Drawer or maker is required to make payment on due date.

5.1.12 Methods of Accounting

Let us see what accounting entries are passed in the books of the drawer, drawee and the endorsee. These entries may be thoroughly understood. Here entries only regarding bill transactions are listed. The trade transaction that precedes the bill of exchange will be accounted for in the usual manner, hence the entries are not given here.

a) When the drawer retains the bill till maturity

Situations	Drawer's books		Drawee's books		Endorsee's books
Drawing of a bill	B/R A/c	Dr.	Drawer A/c	Dr.	Not applicable
	To, Drawee A/c	Dr.	To, B/P A/c		
Payment on due date	Bank A/c	Dr.	B/P A/c	Dr.	Not applicable
	To, B/R A/c		To, Bank A/c		
Dishonoured on due date	Drawee A/c	Dr.	B/P A/c	Dr.	Not applicable
	To, B/R A/c		Noting Charges A/c	Dr.	No applicable
	To, Bank A/c (for noting charges)	Dr.	To, Drawer A/c	Dr.	

b) When the drawer discounts the bill with bank before maturity

Situations	Drawer's books		Drawee's books		Endorsee's books
Drawing of a bill	B/R A/c	Dr.	Drawer A/c	Dr.	Not applicable
	To, Drawee A/c		To, B/P A/c		
Discounting with bank	Bank A/c	Dr.			Not applicable
	Discount A/c	Dr.	No Entry		



Payment due date	No Entry		B/P A/c	Dr.	Not applicable
			To, Bank A/c		
Dishonoured on due date	Drawee A/c	Dr.	B/P A/c	Dr.	Not applicable
	To, Bank A/c (bill+noting charges)		Noting Charges A/c	Dr.	
			To, Drawer A/c		

Proportionate Discount Charges

If the date of maturity of a bill falls on a date of a month within the accounting year, discounting of bill can be done without any problem. But when the date of maturity falls on a month of the next year i.e. the due date falls on two accounting periods, problem will arise. In such a situation, proportionate amount of discount will be charged to Profit and Loss Account. This can be understood with the help of the following example:

A bill was drawn on 1st November, 2020 for Rs.20,000 for 3 months. The bill was discounted by the bank on same day @12% p.a. Therefore, the total amount of discount will be Rs.600

(i.e. $20000 \times \frac{12}{100} \times \frac{3}{12}$. So 2/3rd of Rs.600, i.e. Rs.400 will be transferred to Profit and Loss

Account for the year ended 31st December, 2020.

Treatment of Discount in the Books of the Bank

The following entries are recorded in the books of the bank:

a. When the bill is discounted:

Bill Discounted A/c Dr.
 To, Customer's Current A/c
 To, Discounting on Bill A/c

b. When amount is received from the drawee:

Cash A/c Dr.
 To, Bills Discounted A/c

Transactions		Entries in the books of Drawer		Entries in the books of Drawee	
1	If the bill is drawn	Bills Receivable A/c	Dr.	Drawer A/c	Dr.
		To, Drawee A/c		To, Bills Payable A/c	



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2	If the bill is discounted	Cash/Bank A/c	Dr.		
	by the bank	Discount A/c	Dr.		
		To, Bills Receivable A/c			
3	If the bill is honoured	–		Bills Payable A/c	Dr.
	at the due date			To, Cash / Bank A/c	

c) When the drawer endorses the bill to a person before maturity

Situations	Drawer's books		Drawee's books		Endorsee's books	
Drawing of a bill	B/R A/c	Dr.	Drawer A/c	Dr.	Not applicable	
	To, Drawee A/c		To, B/P A/c			
Endorsement	Endorsee A/c	Dr.	No Entry		B/R A/c	Dr.
	To, B/R A/c				To, Drawer A/c	
Payment on due date	No Entry		B/P A/c	Dr.	Bank A/c	Dr.
			To, Bank A/c		To, B/R A/c	
Dishonoured on due	Drawee A/c	Dr.	B/P A/c	Dr.	Drawer A/c	Dr.
	To, Endorsee A/c (bill+noting charges)		Noting Charges A/c	Dr.	To, B/R A/c	
			To, Drawer A/c		To, Bank A/c (noting charges)	

d) When the drawer sends the bill to bank for collection before maturity

Situations	Drawer's books		Drawee's books		Endorsee's books	
Drawing of a bill	B/R A/c	Dr.	Drawer A/c	Dr.	No Entry	
	To, Drawee A/c		To, B/P A/c			
Sending for	Bill for Collection	Dr.	No Entry		No Entry	
	To, B/R A/c					



Payment on due date	Bank A/c	Dr.	B/P A/c	Dr.	No Entry	
	To, Bill for Collection A/c	Dr.	To, Bank A/c			
Dishonoured on due	Drawee A/c	Dr.	B/P A/c	Dr.		
	To, Bill for Collection A/c		Noting Charges A/c	Dr.	No Entry	
	To Bank A/c (bill & noting charges)		To Drawer A/c			

Illustration 1.

Mohan sold goods to Sohan for Rs. 50,000. On 1st Jan 2020, Mohan drew a bill for three months on Sohan who accepted the same. Pass necessary journal entries in the books of Mohan and Sohan in following situations:

- The bill is retained by Mohan till 31st March and Sohan paid it on that day upon presentation.
- Bill is discounted with the bank and the bank pays Rs. 49,000 to Mohan. Sohan paid the bill on due date.
- Mohan endorsed the bill to Rohan (his creditor) in settlement of his claim for Rs. 51,000. The bill is settled on the due date.
- Mohan sent the bill to the bank for collection on due date. The bank collected bill amount and after deducting collection charges of Rs. 100 paid the balance to Mohan.

Solution:

Entries in the books of Mohan

(a) Bill is retained by Mohan:

Particulars			L.F.	Dr. (Rs.)	Cr. (Rs.)
On getting Sohan's acceptance	B/R A/c	Dr.		50,000	
	To, Sohan's A/c (Being the bill accepted by Sohan)				50,000
On payment on 31-03-20	Bank A/c	Dr.		50,000	
	To, B/R A/c (Being the payment received against the B/R)				50,000

(b) Bill is discounted by Mohan:



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Particulars			L.F.	Dr. (Rs.)	Cr. (Rs.)
On getting Sohan's acceptance	B/R A/c	Dr.		50,000	
	To, Sohan's A/c (Being the bill accepted by Sohan)				50,000
On discounting	Bank A/c	Dr.		49,000	
	Discount A/c	Dr.		1,000	
	To, B/R A/c (Being Sohan's acceptance discounted)				50,000

On the date of maturity, as the bill is settled by Sohan to bank, there will be no entry in Mohan's books.

(c) Bill is endorsed to Rohan by Mohan:

Particulars			L.F.	Dr. (Rs.)	Cr. (Rs.)
On getting Sohan's acceptance	B/R A/c	Dr.		50,000	
	To, Sohan's A/c (Being the bill accepted by Sohan)				50,000
On endorsement	Rohan's A/c	Dr.		51,000	
	To, B/R A/c				50,000
	To, Discount A/c (Being B/R endorsed to Rohan and discount availed)				1,000

(d) Bill is sent for collection to bank by Mohan:

Particulars			L.F.	Dr. (Rs.)	Cr. (Rs.)
On getting Sohan's acceptance	B/R A/c	Dr.		50,000	
	To, Sohan's A/c (Being the bill accepted by Sohan)				50,000
On sending bill for collection	Bill for Collection A/c	Dr.		50,000	
	To, B/R A/c (being bill sent to bank for collection)				50,000



On payment on due date	Bank A/c	Dr.	49,900	
	Collection Charges A/c		100	
	To, Bills for Collection A/c (being payment received on bill collected)			50,000

Entries in the books of Sohan

In all four situations, since the bill was honoured, the entries will be same as below.

Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
On acceptance of bill drawn	Mohan's A/c	Dr.	50,000	
	To, B/P A/c (Being the bill of Mohan accepted)			50,000
On payment on due date	B/P A/c	Dr.	50,000	
	To, Bank A/c (Being payment of bill)			50,000

5.1.13 Insolvency of Drawee (Acceptor)

Insolvency of acceptor means that he cannot pay the amount owed by him. Therefore, on insolvency of the acceptor, bill will be treated as dishonoured and entries for dishonor of bill will be passed in the books of respective parties. Later on, when some amount is realized from the property or estate of the insolvent acceptor, entry for cash received is passed and the balance of amount due from the insolvent acceptor is treated as bad debts. In the books of acceptor the amount not paid is transferred to deficiency account (or profit and loss account). Normally, the amount paid by the insolvent person is expressed as percentage of the amount due and is called the 'Rate of Dividend'. For example, if Rs.25,000 is payable by Mr. A to Mr. B and Mr. A is declared insolvent and a dividend of 20% is declared, journal entries for the final settlement are passed as under:

In the books of Mr. A

Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
Mr. B A/c	Dr.		25,000	
To, Cash A/c				5,000
To, Deficiency A/c				20,000

In the books of Mr. B



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Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
Cash A/c	Dr.		5,000	
Bad Debts A/c	Dr.		20,000	
To, Mr. A A/c				25,000

In case of insolvency, it is better to prepare acceptor's account to work out the amount finally owed by him. Then, calculate cash received on account of dividend declared and the amount of bad debts.

Illustration 2.

A owes B Rs. 21,000. On 1.1.2020 he accepts a Bill for 3 months for Rs. 20,000 in full settlement. On the same date B discounts the Bill from his Banker at 6% p.a.

Before the due date, A becomes bankrupt and B receives first and final dividend of 20 paise in the rupee.

Write up the necessary accounts to record the above transactions in the books of B.

Solution :

In the books of B A Account

Dr.

Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2020			2020		
Jan.1	To, Balance b/d	21,000	Jan.1	By, Bills Receivable A/c	20,000
April 4	To, Bank	20,000	April 4	By, Discount A/c	1,000
	To, Discount A/c	1,000		By, Cash A/c	4,200
				By, Bad Debts A/c	16,800
		42,000			42,000

Bills Receivable Account

Dr.

Cr.

Date	Particulars	Amount	Date	Particulars	Amount
2020			2020		
Jan.1	To, A A/c	20,000	Jan. 1	By, Bank A/c	19,700
				By, Discount A/c	300
		20,000			20,000

Illustration 3.



Paper III: Financial Accounting-2

Sagar purchased goods worth Rs. 1,000 from Ravi for which the latter drew a bill on the former, payable after one month. Sagar accepted it and returned it to Ravi. Ravi endorsed it to Kamal, and Kamal to Amal. Amal discounted the bill with State Bank of India at 6% p.a. On maturity, the bill was dishonoured, noting charge being Rs. 10.

Show the entries in the books of all the parties including the books of State Bank of India.

Solution:

In the books of Ravi Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Sagar A/c	Dr.		1,000	
	To, Sales A/c (Goods sold to Sagar)				1,000
?	Bills Receivable A/c	Dr.		1,000	
	To, Sagar A/c (Bills drawn and accepted by Sagar for 1 month)				1,000
?	Kamal A/c	Dr.		1,000	
	To, Bills Receivable A/c (Bill endorsed to Kamal)				1,000
?	Sagar A/c	Dr.		1,010	
	To, Kamal A/c (Bill endorsed to Kamal dishonoured by Sagar including noting charge of Rs. 10)				1,010

In the books of Sagar Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Purchase A/c	Dr.		1,000	
	To, Ravi A/c (Goods purchased from Ravi)				1,000
?	Ravi A/c	Dr.		1,000	
	To, Bills Payable A/c (Bill accepted for 1 month)				1,000

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?	Bill Payable A/c	Dr.		1,000	
	Noting Charge A/c	Dr.		10	
	To, Ravi A/c (Bill dishonoured at maturity, noting charge being Rs. 10)				1,010

In the books of Kamal Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Bills Receivable A/c	Dr.		1,000	
	To, Ravi A/c (Bill received from Ravi)				1,000
?	Amal A/c	Dr.		1,000	
	To, Bills Receivable A/c (Bill received from Ravi endorsed to Amal)				1,000
?	Ravi A/c	Dr.		1,010	
	To, Amal A/c (Bill endorsed to Amal dishonoured on maturity, noting charge being Rs. 10.)				1,010

In the books of Amal Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Bills Receivable A/c	Dr.		1,000	
	To, Kamal A/c (Bill received from Kamal.)				1,000
?	Bank A/c	Dr.		995	
	Discount A/c	Dr.		5	
	To, Bills Receivable A/c (Bill received from Kamal discounted by the Bank at 6% p.a.)				1,000
?	Kamal A/c	Dr.		1,010	
	To, Bank A/c (Bill received from Kamal dishonoured, noting charge being Rs. 10.)				1,010

In the books of State Bank of India Journal Entries



Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Bill Discounted A/c	Dr.		1,000	
	To, Amal's Current A/c				995
	To, Discount A/c (Amal's bill discounted which is due after 1 month.)				5
?	Amal's Current A/c	Dr.		1,010	
	To, Bills Discounted A/c				1,000
	To, Cash A/c (Bill received from Amal dishonoured at maturity, noting charge being Rs. 10.)				10

5.1.14 Renewal of Bills

Sometimes the drawee of a bill is not able to meet the bill on due date. He may request the drawer to draw a new Bill for the amount due. Sometimes he pays a certain amount out and accepts a first bill for the balance for which he has to pay a certain amount of interest which is either paid in cash or is included with the fresh bill. This bill is known as Renewal of Bills. That, the amount of the new bill will be face value of the original bill minus cash payment, if any, plus interest for the renewed period.

Entries in the books of Drawer and Drawee are shown below:

Transactions		Entries in the books of Drawer		Entries in the books of Drawee	
(a)	For dishonour of Bills	Usual entry		Bills Payable A/c	Dr.
				To, Drawer A/c.	
(b)	For interest on renewed period	Drawee A/c	Dr.	Interest A/c.	Dr.
		To, Interest A/c		To, Drawer A/c.	
(c)	If interest is paid in Cash	Cash A/c	Dr.	Interest A/c.	Dr.
		To, Interest A/c		To, Cash A/c	
(d)	For fresh Bill	Bills Receivable A/c		Drawer A/c	Dr.
		To, Drawee A/c.		To, Bills Payable A/c.	

Illustration 4.

Sunil owed Anil Rs. 80,000. Anil draws a bill on Sunil for that amount for 3 months on 1st April 2020. Sunil accepts it and returns it to Anil. On 15th April 2020, Anil discounts it with Citi Bank at a discount of 12% p.a. On the due date the bill was dishonoured, the bank paid noting charges of Rs. 100. Anil settles the bank's claim along with noting charges in cash. Sunil accepted another bill for 3 months for the amount due plus interest of Rs. 3,000 on 1st July 2020. Before the new bill

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became due, Sunil retires the bill with a rebate of Rs. 500. Show journal entries in books of Anil.

Solution:

Journal entries in the books of Anil

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2020 April, 1	Bills Receivables A/c	Dr		80,000	
	To, Sunil's A/c (Being acceptance by Sunil)				80,000
2020 April, 15	Bank A/c	Dr		78,000	
	Discount A/c	Dr		2,000	
	To, Bills Receivables A/c (Being discounting of the bill @12% p.a. & discounting charges for 2.5 months)				80,000
2020 June, 30	Sunil's A/c	Dr.		80,100	
	To, Bank A/c (Being dishonour of the bill & noting charges paid by bank)				80,100
2020 June, 30	Bank A/c	Dr.		80,100	
	To, Cash (Being cash paid to bank)				80,100
2020 July, 1	Sunil's A/c	Dr.		3,000	
	To, Interest (Being interest due from Sunil)				3,000
2020 July, 1	Bills Receivables A/c	Dr.		83,100	
	To, Sunil's A/c (Being new acceptance by Sunil for Rs. 80,100 & interest of Rs. 3,000)				83,100
2020 July, 1	Bank A/c	Dr.		82,600	
	Rebate A/c	Dr.		500	
	To, Bills Receivables A/c (Being the amount received on retirement of the bill)				83,100

Illustration 5.

On 1st April 2020 Mr. Bala draws a bill of Rs. 1,20,000 on Mr. Lala for the amount due for 4 months. On getting acceptance, on 5th April 2020, Bala endorses it to Mr. Kala in full settlement of his claim of Rs.1,40,000 by paying the difference in cash. Lala approached Bala on 25th July saying that he needed to renew the bill for a further period of 4 months at an interest of 12% p.a. which



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Bala accepted. A fresh bill including interest was accepted by Lala on 1st August 2020. Bala settled his liability to Kala by cheque. This was duly settled on the due date. Pass journal entries in the books of Bala and Lala. Also show Bills Receivables A/c and bills Payable A/c.

Solution:

Journal entries in the Books of Bala

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2020 April 1	Bills Receivables A/c	Dr.		1,20,000	
	To, Lala's A/c (Being acceptance by Lala)				1,20,000
2020 April 5	Kala's A/c	Dr.		1,40,000	
	To, Cash A/c				20,000
	To, Bills Receivables A/c (Being bill endorsed to Kala & cash payment made to him)				1,20,000
2020 July 25	Lala's A/c	Dr.		1,20,000	
	To, Kala's A/c (Being cancellation of bill for renewal)				1,20,000
2020 July 25	Lala's A/c	Dr.		4,800	
	To, Interest A/c (Being interest due from Lala)				4,800
2020 July 25	Kala's A/c	Dr.		1,20,000	
	To, Bank A/c (Being claim of Mr. Kala settled)				1,20,000
2020 Aug., 1	Bills Receivables A/c	Dr.		1,24,800	
	To Lala's A/c (Being acceptance by Lala with interest)				1,24,800
2020 Nov. 30,	Bank A/c	Dr.		1,24,800	
	To Bills Receivables A/c (Being payment received on due date)				1,24,800

Dr.

Bills Receivable Account

Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
1 Apr-20	To Lala A/c	1,20,000	5 Apr-20	By Kala A/c	1,20,000
1 Aug-20	To Lala A/c	1,24,800	30 Nov-20	By Bank A/c	1,24,800



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		2,44,800			2,44,800
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Journal entries in the Books of Lala

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2020 April, 1	Bala's A/c	Dr.		1,20,000	
	To Bills Payable A/c (Being acceptance of Bala's bill)				1,20,000
2020 July, 25	Bills Payable A/c	Dr.		1,20,000	
	To Bala's A/c (Being cancellation of the bill for renewal)				1,20,000
2020 Aug., 1	Interest A/c	Dr.		4,800	
	To Bala's A/c (being interest due to Bala)				4,800
2020 Aug., 1	Bala's A/c	Dr.		1,24,800	
	To Bills Payable A/c (Being Bala's bill accepted with interest)				1,24,800
2020 Nov. 30	Bills Payable A/c	Dr.		1,24,800	
	To Bank A/c (Being settlement of the bill due)				1,24,800

Dr.			Bills Payable Account			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount			
2020 July, 25	To Bala A/c	1,20,000	2020 April, 1	By Bala A/c	1,20,000			
2020 Nov. 30	To Bank A/c	1,24,800	2020 August, 1	By Bala A/c	1,24,800			
		2,44,800			2,44,800			

Illustration 6.

Short owes Slow Rs. 6,000 for which the former accepts a three months bill drawn by the latter. Slow immediately discounts the bill with his banker Strong Bank, at 12%. On the due date the bill is dishonoured and Strong Bank pays Rs. 20 as noting charge.

Short pays Rs. 1,180 including interest of Rs. 200 and gives another bill at three months for the balance. Slow endorses the bill to his creditor Slim in full settlement of his debts for Rs. 5,100. Slim discounts the bill with his banker Strong Bank who charges Rs. 40 as discount. Before maturity Short becomes bankrupt and a first and final dividend of 20 paise in a rupee is realized from his estate.



Show the journal entries in the books of Slim and Strong Bank and ledger account of Short in the book of Slow.

Solution:

**In the books of Slim
Journal Entries**

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Bills Receivable A/c	Dr.		5,040	
	Discount Allowed A/c	Dr.		60	
	To, Slow A/c (Endorsed bill received from Slow in full settlement.)				5,100
?	Bank A/c	Dr.		5,000	
	Discount A/c	Dr.		40	
	To, Bills Receivable A/c (Bill discounted by the bank.)				5,040
?	Slow A/c	Dr.		5,100	
	To, Bank A/c	Dr.			5,040
	To, Discount Allowed A/c (Bill dishonoured at maturity.)				60

**In the books of Strong Bank
Journal Entries**

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Bills Discounted A/c To,	Dr.		6,000	
	To Slow Current A/c To,				5,820
	To Discount A/c (Bill discounted which is due for 3 months.)				180
?	Noting Charges A/c	Dr.		20	
	To, Cash A/c (Noting charges incurred for dishonor of the bill.)				20
?	Slow Current Account A/c	Dr.		6,020	
	To, Bills discounted A/c				6,000
	To, Noting Charges A/c (Bill dishonoured, noting charge being Rs. 20.)				20



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?	Bills Discount A/c	Dr.		5,040	
	To, Slim Current A/c				5,000
	To, Discount A/c (Bill discounted which is due for 3 months.)				40
?	Slim Current A/c	Dr.		5,040	
	To, Bills Discounted A/c (Bill dishonored at maturity.)				5,040

In the books of Slow

Dr.			Short Account			Cr.		
Particulars		Amount (Rs.)	Amount (Rs.)	Particulars		Amount (Rs.)	Amount (Rs.)	
To ,Balance b/d			6,000	By, Bills Receivable A/c			6,000	
To, Strong Bank A/c			6,020	By, Cash A/c			1,180	
To, Interest A/c			200	By, Bills Receivable A/c			5,040	
To, Slim A/c			5,040	By, Cash A/c		1,008		
				By, Bad Debts A/c		4,032	5,040	
			17,260				17,260	

Illustration 7.

Pass journal entries in the books of Hema for the following transactions :

- Hema's acceptance to Nanda for Rs. 5,000 renewed for 3 month with interest at 10% p.a.
- Nalini's acceptance to Hema was for Rs. 10,000 was retired one month before due date at a discount of 12% p.a.
- Discounted Natasha's acceptance to Hema for Rs. 4,000 with the bank for Rs. 3,920
- Neela requests Hema to renew her acceptance for Rs. 3,500 for 3 months. Hema accepted on the condition that interest of Rs. 100 was paid in cash which Neela did.
- Received an acceptance from Geeta for Rs. 1,200 and it was endorsed to Seeta in full settlement of her claim.

Solution:



**In the books of Hema
Journal Entries**

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Bills Payable A/c	Dr.		5,000	
	To, Nanda's A/c (Being cancellation of Nanda's bill for renewal)				5,000
?	Interest A/c	Dr.		125	
	To, Nanda's A/c (Being interest due to Nanda)				125
?	Bills Payable A/c	Dr.		5,125	
	To, Nanda's A/c (Being acceptance given for new bill)				5,125
?	Bank A/c	Dr.		9,900	
	Discount A/c	Dr.		100	
	To, Bills Receivable A/c (Being Nalini's acceptance retired at discount)				10,000
?	Bank A/c	Dr.		3,920	
	Discount A/c	Dr.		80	
	To, Bills Receivable A/c (Being Natasha's acceptance discounted)				4,000
?	Neela's A/c	Dr.		3,500	
	To, Bills Receivables A/c (Being Neela's acceptance cancelled for renewal)				3,500
?	Cash A/c	Dr.		100	
	To, Interest A/c (Being interest received from Neela in cash)				100
?	Bills Receivable A/c	Dr.		3,500	
	To, Neela's A/c (Being Neela acceptance for new bill)				3,500

5.1.15 Operating Cycle of the Accommodation Bill of Exchange

The basis for accommodation bill is not a trade transaction. It is drawn to accommodate the financial requirements of drawer or even a drawee. This transaction presupposes trust and understanding between the parties to the transaction. The drawer normally discounts this bill with the bank. The amount received from bank is either retained by the drawer for himself or shared between the drawer and the drawee. On the date of maturity, the drawee settles the bill with



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bank by effecting payment. The drawer will pay the drawee either full amount of the bill or his share. Accounting entries for accommodation bill are:

Transactions		Entries in the books of Drawer		Entries in the books of Drawee	
(a)	Drawing of a bill	B/R A/c	Dr.	Drawer A/c	Dr.
		To, Drawee A/c		To, B/P A/c	
(b)	Discounting with bank	Bank A/c	Dr.		
		Discount A/c	Dr.	No Entry	
		To, B/R A/c			
(c)	Payment on due date	Drawee A/c	Dr.	B/P A/c	Dr.
		To, Bank A/c		To, Bank A/c	

5.1.16 Retirement of Bill

Sometimes the drawee pays the bill before the date of maturity. Under the circumstances, the drawer allows certain amount of rebate or discount which is calculated on certain percentage p.a. basis. The rebate is calculated from the date of payment to the date of maturity.

Entries in the books of drawer and drawee are given below :

Transactions		Entries in the books of Drawer		Entries in the books of Drawee	
(a)	When the bill is drawn	Bills Receivable A/c.	Dr.	Drawer A/c.	
		To, Drawer A/c.		To, Bills Payable A/c.	Dr.
(b)	When the bill is retired	Bank/Cash A/c.	Dr.	Bills Payable A/c.	Dr.
		Rebate Allowed A/c.	Dr.	To, Cash/Bank A/c.	
		To, Bills Receivable A/c.		To, Rebate Received A/c.	

Illustration 8

X bought goods from Y for Rs. 4,000. Y draws a bill on 1.1.2020 for 3 months which was accepted by X for this purpose. On 1.3.2020, X arranged to retire the bill at a rebate of 12% p.a. Show the entries in the books of X and Y.

Solution:

In the books of Y Journal

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2020 Jan 1	X A/c	Dr.		4,000	
	To, Sales A/c (Goods sold to X)				4,000



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Jan 1	Bills Receivable A/c	Dr.		4,000	
	To, X A/c (Bills drawn for 3 months)				4,000
March 1	Cash A/c.	Dr.		3,954	
	Rebate Allowed A/c.			46	
	To, Bills Receivable A/c. (Bills retired under a rebate of 12% p.a.)	Dr.			4,000

Rebate = Rs. 4,000 x 12/100 x 35/365 (1st March to 4th April) = Rs. 46.

In the books of X Journal

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2020 Jan 1	Purchase A/c	Dr.		4,000	
	To, Y A/c (Goods purchased from Y)				4,000
Jan 1	Y A/c	Dr.		4,000	
	To, Bills Payable A/c (Bills accepted for 3 months)				4,000
March 1	Bills Payable A/c.	Dr.		4,000	
	To, Cash A/c.				3,956
	To, Rebate Received A/c. (Bills retired under a rebate of 12% p.a.)				46

Illustration 10.

Following information is given to you by Govind from his books:

On 1st April 2019 he had with him bills of Rs. 1,50,000 accepted by his customers and Rs. 1,00,000 worth accommodation bills accepted by his friends. He had accepted bills worth Rs. 90,000 for his suppliers and Rs. 75,000 worth accommodation bills for his friends.

During the year the following transactions took place:

- He raised bills of Rs. 3,75,000 which were accepted by his customers.
- He accepted bills of Rs. 2,25,000 for his suppliers.
- He accepted accommodation bills of Rs. 60,000 for his friends.
- His friend accepted accommodation bills of Rs. 1,25,000 for him.
- He honoured on due dates trade bills of Rs. 1,75,000 and accommodation bills of Rs. 85,000.
- He received payments on due dates for trade bills of Rs. 4,00,000 and accommodation bills of Rs. 150,000.



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- (vii) He endorsed bills of Rs. 25,000 to his suppliers, which were honoured by the acceptors.
- (viii) His customers endorsed bills of Rs. 30,000 to him which he accepted in favour of his suppliers.
- (ix) Accommodation bills were settled on the due dates and money was paid and received duly. Prepare Bills Receivable A/c and Bills Payable A/c for both trade and accommodation bills.

Solution:

Dr.			Bills Receivable Account			Cr.	
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)		
2019 April, 1	To Balance b/d	1,50,000	2020 March 31	By Bank A/c	4,00,000		
2020 March 31	To Debtors A/c	3,75,000	2020 March 31	By Suppliers A/c	25,000		
			2020 March 31	By Balance c/d	1,00,000		
		5,25,000			5,25,000		

Dr.			Bills Payable Account			Cr.	
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)		
31 Mar-20	To, Bank A/c	1,75,000	1 Apr-19	By Balance b/d	90,000		
31 Mar-20	To, Debtors A/c	30,000	31 Mar-19	By Suppliers A/c	2,25,000		
31 Mar-20	To, Balance c/d	1,10,000					
		3,15,000			3,15,000		

Dr.			Accommodation Bills Receivable Account			Cr.	
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)		
1 April -19	To, Balance b/d	1,00,000	31 Mar-20	By, Bank A/c	1,50,000		
31 Mar-20	To, Friends A/c (acceptors)	1,25,000	31 Mar-20	By, Balance c/d	75,000		
		2,25,000			2,25,000		



Dr. Accommodation Bills Payable Account			Cr.		
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
31 Mar-20	To, Bank A/c	85,000	1 April-20	By, Balance b/d	75,000
31 Mar-20	To, Balance c/d	50,000	31 Mar-20	By, Friends A/c (drawers)	60,000
		1,35,000			1,35,000

Dr. Friends (acceptors of bills) Account			Cr.		
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
31 Mar-20	To, Bank A/c	1,50,000	1 April-19	By, Balance b/d	1,00,000
31 Mar-20	To, Balance c/d	75,000	31 Mar-20	By, Accommodation BR A/c	1,25,000
		2,25,000			2,25,000

Dr. Friends (drawers of bills) Account			Cr.		
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
1 April-19	To, Balance b/d	75,000	31 Mar-20	By, Bank A/c	85,000
31 Mar-20	To, Accommodation BP A/c	60,000	31 Mar-20	By, Balance c/d	50,000
		1,35,000			1,35,000

Illustration 11.

Vijay draws a bill for Rs. 60,000 and Anand accepts the same for mutual accommodation of both of them to the extent of Vijay 2/3rd and Anand 1/3rd. Vijay discounts it with bank for Rs. 56,400 and remits 1/3rd share to Anand. Before the due date, Anand draws another bill for Rs. 84,000 on Vijay in order to provide funds to meet the first bill on same sharing basis. The second bill is discounted at Rs. 81,600. With these proceeds, the first bill is settled and Rs. 14,400 were remitted to Vijay. Before the due date of the second bill, Vijay becomes insolvent and Anand receives a dividend of only 50 paise in a rupee in full satisfaction. Pass journal entries in the books of Vijay.

Solution:

In case of accommodation bills, the proceeds of discounting are shared by parties as agreed. The discounting charges are also shared in agreed proportion. Here, the ratio between Vijay and Anand is given as two-thirds and one-third. The first bill of Rs. 60,000 is discounted at Rs. 56,400 which means the discounting charges are Rs. 3,600. The share of each one is:



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	1st Bill		2nd Bill	
	Proceeds (Rs.)	Discount (Rs.)	Proceeds (Rs.)	Discount (Rs.)
Vijay (2/3rd)	37,600	2,400	59,400	1,600
Anand (1/3rd)	18,800	1,200	27,200	800
Total	56,400	3,600	81,600	2,400

Further, as Vijay has become insolvent, the amount due to Anand is settled at 50% of total. To calculate this amount, it's necessary to post all transactions to Anand's account and arrive at the balance.

In the Books of Vijay Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Bills Receivable A/c	Dr.		60,000	
	To, Anand's A/c (Being bill drawn on Anand)				60,000
?	Bank A/c	Dr.		56,400	
	Discount A/c	Dr.		3,600	
	To, Bills Receivables A/c (Being discounting of bill)				60,000
?	Anand's A/c	Dr.		20,000	
	To, Bank A/c				18,800
	To, Discount A/c (Being 1/3rd proceeds paid to Anand)				1,200
?	Anand's A/c	Dr.		84,000	
	To, Bills payable A/c (being acceptance of bill)				84,000
?	Bank A/c	Dr.		14,400	
	Discount A/c	Dr.		1,600	
	To, Anand's A/c (Being proceeds of discounting 2nd bill)				16,000
?	Bills Payable A/c	Dr.		84,000	
	To, Anand's A/c (Being dishonour of bill)				84,000
?	Anand's A/c	Dr.		56,000	
	To, Bank A/c				28,000
	To, Deficiency A/c (Being payment of 50% & balance proved to be bad)				28,000



Dr.		Anand's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Bank A/c	18,800	By B/R A/c	60,000		
To, Discount A/c	1,200	By Bank A/c	14,400		
To, B/P A/c	84,000	By Discount A/c	1,600		
		By B/P A/c	84,000		
To, Bank A/c	28,000				
To, Deficiency A/c	28,000				
	1,60,000				160,000

Illustration 12.

Rahim, for mutual accommodation, draws a bill for Rs. 3,000 on Ratan. Rahim discounted it for Rs. 2,925. He remits Rs. 975 to Ratan. On the due date, Rahim is unable to remit his dues to Ratan to enable him to meet the bill. He, however, accepts a bill for Rs. 3,750 which Ratan discounts for Rs. 3,625. Ratan sends Rs. 175 to Rahim after discounting the above bill. Rahim becomes insolvent and a dividend of 80 paise in the rupee is received from his estate.

Pass the necessary journal entries in the books of both the parties.

In the books of Rahim Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Bills Receivable A/c	Dr.		3,000	
	To, Ratan A/c (Bill drawn for mutual accommodation and accepted by Ratan.)				3,000
?	Bank A/c	Dr.		2,925	
	Discount A/c	Dr.		75	
	To, Bills Receivable A/c (Bill discounted by the bank.)				3,000
?	Ratan A/c	Dr.		1,000	
	To, Bank A/c				975
	To Discount A/c (Proceeds remitted to Ratan.)				25
?	Ratan A/c	Dr.		3,750	
	To, Bills Payable A/c (Bill accepted.)				3,750

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?	Bank A/c	Dr.		175	
	Discount A/c	Dr.		75	
	To, Ratan A/c (Proceeds received from Ratan including discount charges.)				250
?	Bills Payable A/c	Dr.		3,750	
	To, Ratan A/c (Bill dishonored since e became insolvent.)				3,750
?	Ratan A/c	Dr.		2,250*	
	To, Bank A/c				1,800
	To Deficiency A/c (Cash paid to Ratan @80 paise in the rupee and balance transferred to deficiency account.)				450

* This amount can be ascertained by preparing Ratan's Account in Rahim's book.

In the books of Ratan Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
?	Rahim A/c	Dr.		3,000	
	To, Bills Payable A/c (Bill accepted for mutual accommodation).				3,000
?	Bank A/c	Dr.		975	
	Discount A/c	Dr.		25	
	To, Rahim A/c (1/3 proceeds received from Rahim including discount.)				1,000
?	Bills Receivable A/c	Dr.		3,750	
	To, Rahim A/c (Bill drawn and accepted by Rahim.)				3,750
?	Bank A/c	Dr.		3,625	
	Discount A/c	Dr.		125	
	To, Bills Receivable A/c (Bill discounted.)				3,750



?	Rahim A/c	Dr.		250	
	To Bank A/c				175
	To Discount A/c (Proceeds remitted to Rahim including discount.)				75
?	Rahim A/c	Dr.		3,750	
	To Bank A/c (Bill honoured at maturity.)				3,750
?	Bills Payable A/c	Dr.		3,000	
	To, Bank A/c (Bill honoured at maturity.)				3,000
?	Bank A/c	Dr.		1,800	
	Bad Debt A/c	Dr.		450	
	To, Rahim A/c (Amount realised from the official liquidator of Rahim @ 80 paise in the rupee and the balance proved bad.)				2,250

Note: Sharing discount:

After discounting of the 1st bills, Rahim received Rs. 2,000
(including discount)

Add: Amount remitted by Ratan (after discounting of the 2nd bill). Rs. 175

Total benefit received by Rahim. Rs. 2,175

Now,

After discounting of the 2nd bill Ratan received Rs. 3,675 (Net)

Proportion of Rahim to Ratan = $\frac{\text{Rs. 2,175}}{\text{Rs. 3,625}} \times 125 = \text{Rs. 75}$

Rahim is to bear = Rs. 75 of discounting charges, and the balance by Ratan.

Illustration 13.

On 1.7.2020 Salil, for mutual accommodation of himself and Sunil, drew on the other a bill for Rs. 10,000 payable at 3 months date. The bill was discounted with Central Bank of India at 5% and half of the proceeds were remitted to Sunil on 2.7.2020.

On 2.7.2020, Sunil drew a bill on Salil for Rs. 4,000 payable at 3 months' date. He discounted the bill with Bank of India at 10% and remitted half the proceeds to Salil.

Sunil became bankrupt on 31.8.2020 and only 25% was received by Salil on 15.9.2020 as the first

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and final dividend from his estate. Write the journal entries in the books of Salil.

In the books of Salil Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2020 July 1.	Bills Receivable A/c	Dr.		10,000	
	To, Sunil A/c (Bill drawn for mutual accommodation for 3 months.)				10,000
“	Bank A/c	Dr.		9,875	
	Discount A/c	Dr.		125	
	To, Bills Receivable A/c (Bill discounted by the bank.)				10,000
“	Sunil A/c	Dr.		5,000	
	To, Bank A/c				4,937.5
	To, Discount A/c (Half the proceeds remitted to Sunil.)				62.5
“	Sunil A/c	Dr.		4,000	
	To, Bills Payable A/c (Bill accepted for 3 months.)				4,000
“	Bank A/c	Dr.		1,950	
	Discount A/c	Dr.		50	
	To, Sunil A/c (Proceeds received from Sunil.)				2,000
Aug. 31	Sunil A/c	Dr.		10,000	
	To, Bank A/c (Bill dishonoured as Sunil became insolvent.)				10,000
Sept. 15	Bank A/c	Dr.		1,750	
	Bad Debts A/c	Dr.		5,250	
	To, Sunil A/c (Amount realized from the official liquidator of Sunil @ 25% and the balance proved bad.)				7,000
Oct. 5.	Sunil A/c	Dr.		4,000	
	To, Bank A/c (Bill honoured at maturity.)				4,000

Illustration 14.

On 1.1.2020, Pandit, for mutual accommodation of himself and Thakur, drew upon the latter a 3 months' bill for Rs. 12,000 which was duly accepted. Pandit discounted the bill at 6% p.a. on



4.1.2020 and remitted half of the proceeds to Thakur.

On 1.2.2020, Thakur drew and Pandit accepted a bill at 3 months' for Rs. 4,800. On 4.2.2020, Thakur discounted the bill at 6% p.a. and remitted half of the proceeds to Pandit.

At maturity Pandit met his acceptance but Thakur failed to meet his and Pandit had to take it up. Pandit drew and Thakur accepted a new bill at 2 months on 4.5.2020 for the amount due to Pandit plus Rs. 100 as interest. On 1.7.2020, Thakur became insolvent and first and final dividend of 50 paise in the rupee was received from his estate on 30.09.2020.

Pass necessary journal Entries in the books of Pandit.

Solution:

In the books of Pandit Journal Entries

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
2020 Jan. 1	Bills Receivable A/c	Dr.		12,000	
	To, Thakur A/c (Bill Drawn on Thakur.)				12,000
Jan.4	Bank A/c	Dr.		11,820	
	Discount A/c	Dr.		180	
	To, Bills Receivable A/c (Bill discounted by bank.)				12,000
Jan.4	Thakur A/c	Dr.		6,000	
	To, Bank A/c				5,910
	To, Discount A/c (Half of the proceeds remitted to Thakur.)				90
Feb. 1	Thakur A/c	Dr.		4,800	
	To, Bills Payable A/c (Bill accepted.)				4,800
Feb. 1	Bank A/c	Dr.		2,364	
	Discount A/c	Dr.		36	
	To, Thakur A/c (Half of the proceeds received from Thakur.)				2,400
Apr. 4	Thakur A/c	Dr.		12,000	
	To, Bank A/c (Bill dishonoured at maturity.)				12,000

Study Note - 5 : Accounting for Special Transactions

May 4	Bills Payable A/c	Dr.		4,800	
	To, Bank A/c (Bills honoured at maturity.)				4,800
May 4	Thakur A/c	Dr.		100	
	To, Interest A/c (Interest becomes due)				100
May 4	Bills Receivable A/c	Dr.		8,500	
	To, Thakur A/c (Fresh bill drawn on Thakur.)				8,500
July 1	Thakur A/c	Dr.		8,500	
	To, Bills Receivable A/c (Bill dishonoured at maturity.)				8,500
Sept. 30	Bank A/c	Dr.		4,250	
	Bad Debts A/c	Dr.		4,250	
	To, Thakur A/c (Dividend received from Thakur's estate @50 in a rupee)				8,500

5.2 CONSIGNMENT ACCOUNTING

5.2.1 Introduction

The sales activity of any business can be organized in different ways. With the customers spread all over, the business entity cannot afford to have only minimum selling points nor can it have its own resources to have the outlets all over. The business volumes cannot be limited in any case. The core competence of a manufacturing company is to produce a good quality product. It creates a network of its own outlets, dealers, commission agents, institutions etc to distribute its products efficiently and effectively. Thus the selling may be handled directly through own salesmen or indirectly through agents.

In case of direct selling, the company usually has depots all over. The stocks are transferred to these depots and from there finally sold to ultimate customers. This involves huge expenses and problems of maintaining the same on a permanent basis. Hence, the firm could appoint agents to whom stocks will be given. These agents distribute the products to ultimate customers and receive commission from the manufacturer. One such way of indirect selling is selling through consignment agents. The relationship between consignor and consignee is that of Principal-Agent relationship.



5.2.2 Main Terms of Consignment Trade

Consignor - He is the person who sends goods to agents e.g. a manufacturer or wholesaler.

Consignee - He is the agent to whom goods are sent for selling.

Ordinary Commission - This is a fee payable by consignor to consignee for sale of goods when the consignee does not guarantee the collection of money from ultimate customer. The % of such commission is generally lower.

Del Credre Commission - This is additional commission payable to the consignee for taking over additional responsibility of collecting money from customers. In case, the customers do not pay of the consignee takes over the loss of bad debts in his books. Although it's paid for taking over risk of bad debts that arise out of credit sales only, this commission is calculated on total sales and not on credit sales.

Account Sales - This is a periodical statement prepared by consignee to be sent to the consignor giving details of all sales (cash and credit), expenses incurred and commission due for sales.

5.2.3 Operating Cycle of Consignment Arrangement

- (i) Goods are sent by consignor to the consignee
- (ii) Consignee may pay some advance or accept a bill of exchange
- (iii) Consignee will incur expenses for selling the goods
- (iv) Consignee maintains records of all cash and credit sale.
- (v) Consignee prepares a summary of results called as Account sales
- (vi) Consignor pays commission to the consignee

Sometimes, the consignor may send the goods at a price higher than cost so that the consignee gets no knowledge of the real cost of goods which is confidential for the consignor.

5.2.4 Accounting for Consignment Business

The consignor and consignee keep their own books of accounts. The consignor may send goods to many consignees. Also, a consignee may act as agent for many consignors. It is appropriate that both of them would want to know profit or loss made on each consignment. There are certain new accounts that are to be opened in addition to regular accounts as cash or bank. Let us see the entries in the books of consignor as well as consignee.

Study Note - 5 : Accounting for Special Transactions

Situations	Consignor's books		Consignee's books	
On sending goods	Consignment A/c	Dr	No Entry	
	To Goods Sent on Consignment			
On expenses for sending goods	Consignment A/c	Dr	No Entry	
	To Cash/ Bank A/c			
On consignee accepting bill of exchange	Bill Receivables A/c	Dr	Consignee's Personal A/c	Dr.
	To Consignor's Personal A/c		To Bills Payable A/c	
On expenses incurred by consignee	Consignment A/c	Dr.	Cash/ Bank A/c	Dr.
	To Consignor's Personal A/c		To Consignee's Personal A/c	
On consignee reporting sales	Consignee's Personal A/c	Dr	Cash/ Bank A/c	Dr.
	To Consignment A/c		To Consignor's Personal A/c	
For commission	Consignment A/c	Dr	Consignor's Personal A/c	Dr
	To Consignee's Personal A/c		To Commission A/c	
On closing stock	Stock on Consignment A/c	Dr	No Entry	
	To Consignment A/c			

The Consignment Account in the books of consignor will ultimately show the net profit or loss on account of consignment business. It must be noted that a separate consignment account must be opened for different agents. This will enable him to know profit or loss on each consignment.

Credit Sales Accounting in books of Consignor

In case consignee sales goods on cash and credit both, the responsibility of collection from customers may be either with consignee or consignor. The risk of non-collection is usually borne by the consignor. If consignor want this to be shouldered by the consignee, additional commission in the form of 'Del Credere' commission is payable. It may be noted that in case of credit sales, the personal accounts of debtors are to be maintained by the consignor and not the consignee. The entry for credit sales will be:

Consignment Debtors A/c	Dr
To Consignment A/c	

5.2.5 Del Credere Commission and Bad Debts

Sometimes the consignor allows an extra commission to the consignee in order to cover the risk of collection from customer. On account of credit sales which is known as Del Credere Commission. Naturally, if debt is found to be irrecoverable the same must be borne by the consignee. There will be no effect in the books of consignor. In short, credit sales will be treated as cash



sales to consignor. If no Del credere commission is given by the consignor to the consignee, the amount of Bad debts must be borne by the consignor.

Entries in the Books of Consignor

(a) When Del Credere Commission is given

(i)	For Credit Sales -		
	Consignee's Personal A/c	Dr.	
	To, Consignment A/c		
(ii)	For Bad Debts -		
	No Entry		
(iii)	For Del Credere Commission -		
	Consignment A/c	Dr.	
	To, Consignee's Personal A/c		

(b) When Del Credere Commission is not given

(i)	For Credit Sales -		
	Consignment Debtors A/c	Dr.	
	To, Consignment A/c		
(ii)	For Bad Debts -		
	Consignment A/c		
	To, Consignment Debtors A/c	Dr.	
(iii)	For realization of Cash -		
(a)	Cash A/c	Dr.	
	To, Consignment Debtors A/c		if collected by Consignor
(b)	Consignee's Personal A/c	Dr.	
	To, Consignment Debtors A/c		if collected by Consign-ee

Entries in the Books of Consignee

(a) When Del Credere Commission is given

(i)	For Credit Sales -		
	Consignment Debtors A/c	Dr.	
	To, Consignor A/c		

Study Note - 5 : Accounting for Special Transactions

(ii)	For Bad Debts -		
	Bad Debts A/c	Dr.	
	To, Consignment Debtors A/c		
(iii)	For realization of cash from cash from Debtors -		
	Cash/ Bank A/c	Dr.	
	To, Consignment Debtors A/c		
(iv)	For Closing Bad Debts A/c-		
	Commission Received A/c	Dr.	
	To, Bad Debts A/c		

(b) When Del Credere Commission is not given -

There will be no entry against a bad debts entry in the books of consignee.

5.2.6 Valuation of Stock

Unsold stock on consignment should properly valued; otherwise final accounts cannot be prepared. Usually, unsold stock on consignment is value at cost price plus proportionate expenses of the consignor plus proportionate non recurring expenses of consignee.

Alternatively, total cost of goods plus total expenses incurred by the consignor plus total non recurring expenses of the consignee are to be added and stock should valued on the basis of proportionate unsold goods.

But it must be remember while valuing stock on consignment, the usual principle for valuation of stock, that stock should be valued at cost price or market price whichever is less.

The entry will be:

Stock on Consignment A/c	Dr.
To, Consignment A/c	

Needless to say that unsold stock on consignment will appear in the asset side of Balance Sheet.

Illustration 15.

Sree Traders of Gujrat purchased 10,000 sarees @ Rs. 100 per saree. Out of these 6,000 sarees were sent on consignment to Nirmala Traders of Kolkata at the selling price of Rs. 120 per saree. The consignors paid Rs. 3,000 for packing and freight.

Nirmala Traders sold 5,000 sarees @ Rs. 125 per saree and incurred Rs. 1,000 for selling expenses and remitted Rs. 5,00,000 to Gujrat on account. They are entitled to a commission of 5% on total sales plus a further of 20% commission on any surplus price realized over Rs. 120 per saree.

3,000 sarees were sold at Gujrat @ Rs. 110 per saree.



Owing to fall in market price, the value of stock of saree in hand is to be reduced by 5%. You are required to prepare (i) Consignment Account, and (ii) Nirmala Traders Account.

(i) In the books of Sree Traders

Dr.		Consignment Account		Cr.			
Particulars		Amount (Rs.)		Particulars		Amount (Rs.)	
To, Goods Sent on Consignment A/c (6,000 x Rs. 100)		6,00,000		By Nirmala Traders A/c :			
To, Bank A/c (Packing and Freight)		3,000		By, Sale proceeds (5,000 x RS. 125)		6,25,000	
To, Nirmala Traders A/c: Selling Expenses		1,000		By, Stock on Consignment A/c (W.N.2)		9,025	
Commissions (W.N.1)		37,500		By, Profit and Loss A/c (Loss on Consignment transferred)		7,475	
		6,41,500				6,41,500	

Note:

3,000 sarees which were sold at Gujrat @ Rs. 110 per saree are not to be taken into consideration since it is not a consignment transaction and hence the same is extended from Consignment Account.

Although the consignor purchased 10,000 sarees, only 6,000 sarees are related to consignment transaction, balance is not to be taken into Consignment Account at all.

Dr.		(ii) Nirmala Traders Account		Cr.	
Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
To Consignment A/c : Sales Proceeds			By, Bank A/c (Advance)		5,00,000
		6,25,000	By, Consignment A/c (Exp. + Com.)		38,500
			By, Balance c/d		86,500
		6,25,000			6,25,000



Study Note - 5 : Accounting for Special Transactions

Workings:

1. Calculation of Commission payable to Nirmala Traders:

	(Rs.)
Total Sales @ Rs. 125 per saree	6,25,000
Less: Amount Rs. 120 per saree	6,00,000
Surplus Price Realised	25,000
Less: @ 5% on total Sales (Rs. 6,25,000 x 5%)	31,250
Add: 25% on Rs. 25,000	6,250
	37,500

2. Valuation of Unsold Stock:

Since market price has fallen by 10%, valuation of unsold stock on consignment will be calculated as under:

	(Rs.)
Total Cost (1,000 x Rs. 100) (without Considering expenses)	10,000
Less: 5%	500
	9,500
Less: Consignee's Com. @5%	475
Estimated Selling Price	9,025

5.2.7 Losses on Consignment

There are two types of losses which may arise in case of a consignment transaction, viz.

- (a) Normal Loss, and
 - (b) Abnormal Loss
- (a) **Normal Loss** - Normal Losses arise as a result of natural causes, e.g. evaporation, leakage, breakage etc., and they are inherent in nature. Since normal loss is a charge against gross profit no additional adjustment is required for this purpose. Moreover, as the same is a part of cost of goods, when valuation of unsold stock is made in case of consignment account the quantity of such loss (not the amount) should be deducted from the total quantity of the goods received by the consignee in good condition. Thus,

**Value of closing stock will be**

$$= \text{Total Value of goods sent} \times \frac{\text{Unsold quantity}}{\text{Good quantity received by consignees}}$$

Illustration 16.

From the following particulars ascertain the value of unsold stock on Consignment.

Goods sent (1,000 kgs.)	Rs. 20,000
Consignor's expenses	Rs. 4,000
Consignees non-recurring expenses	Rs. 3,000
Sold (800 kgs.)	Rs. 40,000
Loss due to natural wastage (100 kgs.)	

Solution:**Value of unsold stock**

	Rs.
Total cost of goods sent	20,000
Add : Consignor's expenses	4,000
Add : Non-recurring expenses	3,000
Cost of (1,000 kgs - 100 kgs) = 900 kgs.	27,000

Value of unsold stock (1,000 - 800 - 100)

$$= 100 \text{ kgs. will be} = \text{Rs. } 27,000 \times \frac{100 \text{ kgs}}{900 \text{ kgs}}$$

$$= \text{Rs. } 3,000$$

- (b) Abnormal Losses - Abnormal Losses arises as a result of negligence/ accident etc., e.g., theft, fire etc. Before ascertaining the result of the consignment, value of abnormal loss should be adjusted. The method of calculation is similar to the method of calculating unsold stock. Sometimes insurance company admits the claim in part or in full. The same should also be adjusted against such abnormal loss.

Treatment of Abnormal Loss

- (i) For abnormal Loss -
- | | |
|--------------------|----|
| Abnormal Loss A/c | Dr |
| To Consignment A/c | |
- (ii) If goods are insured and admitted or covered by Insurance Company.
- | | |
|------------------------|----|
| Insurance Co./Bank A/c | Dr |
| To Abnormal Loss A/c | |



Study Note - 5 : Accounting for Special Transactions

- (iii) If goods are not insured:
 Profit & Loss A/c Dr
 To Abnormal Loss A/c
- (iv) For the balance (i.e. which is not covered/ admitted by Insurance Co.):
 Profit & Loss A/c Dr
 To Abnormal Loss A/c

Illustration 17.

5,000 shirts were consigned by Raizada & Co. of Delhi to Zing of Tokyo at cost of Rs. 375 each. Raizada & Co. paid freight Rs. 50,000 and Insurance Rs. 7,500.

During the transit 500 shirts were totally damaged by fire. Zing took delivery of the remaining shirts and paid Rs. 72,000 on custom duty.

Zing had sent a bank draft to Raizada & Co. for Rs. 2,50,000 as advance payment. 4,000 shirts were sold by him at Rs. 500 each. Expenses incurred by Zing on godown rent and advertisement etc. amounted to Rs. 10,000. He is entitled to a commission of 5%

One of the customer to whom the goods were sold on credit could not pay the cost of 25 shirts. Prepare the Consignment Account and the Account of Zing in the books of Raizada & Co. Zing settled his account immediately. Nothing was recovered from the insurer for the damaged goods.

Dr.

(ii) Nirmala Traders Account

Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Goods Sent on Consignment A/c (5000xRs. 375)	18,75,000	By, Zing A/c :	
To, Bank A/c :		-Sale proceeds (3,975 x Rs. 500)	19,87,500
- Freight	50,000	By, Consignment Debtors A/c	
- Insurance	7,500	- Credit Sales (25 x Rs. 500)	12,500
	57,500	By, Abnormal Loss A/c (W.N. 1)	1,93,250
To, Zing A/c :		By, Stock on Consignment A/c : (W.N.2)	2,01,250
- Custom Duty	72,000		
- Godown Rent, Adv. etc	10,000		
- Commissions @5% on total Sales	1,00,000		
	1,82,000		
To, Consignment Debtors A/c:			



- Bad Debts		12,500		
To, Profit and Loss A/c :				
- Profit on Consignment		2,67,500		
transferred				
		23,94,500		23,94,500

Dr. Zing Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Consignment A/c :		By, Bank Draft A/c :	
Sale Proceeds	19,87,500	Advance	2,50,000
		By, Consignment A/c : Expenses & Com.	1,82,000
		By, Bank A/c : Final Settlement	15,55,500
	19,87,500		19,87,500

Dr. Abnormal Loss Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Consignment A/c	1,93,250	By, Profit and Loss A/c	1,93,250
	1,93,250		1,93,250

Workings:

1. Valuation of goods Lost-in-transit and unsold Stock:

	Amount (Rs.)
Total Cost	18,75,000
Add: Consignor's Expenses	57,500
C.P. of 5,000 Shirts	19,32,500
Less: Lost-in-transit $\left(\frac{19,32,500 \times 500}{5,000} \right)$	(1,93,250)
Add: Non-recurring Ex. of Consignee	72,000
C.P. of 4,500 Shirt	18,11,250

Study Note - 5 : Accounting for Special Transactions

2. Value of under Stock Note:

$$\left(\frac{18,11,250 \times 500}{4,500} \right) = 201250$$

Since Del Credere Commission is not given by the consignor to the consignee, amount of bad debt is to be charged against Consignment Account.

Simultaneous Normal Loss and Abnormal Loss

Illustration 18.

Lubrizols Ltd. of Mumbai consigned 1,000 barrels of lubricant oil costing Rs. 800 per barrel to Central Oil Co. of Kolkata on 1.1.2020. Lubrizols Ltd. paid Rs. 50,000 as freight and insurance. 25 barrels were destroyed on 7.1.2020 in transit. The insurance claim was settled at Rs. 15,000 and was paid directly to the consignor.

Central Oil took delivery of the consignment on 19.1.2020 and accepted a bill drawn upon them by Lubrizols Ltd., for Rs. 5,00,000 for 3 months. On 31.3.2020 Central Oil reported as follows:

- (i) 750 barrels were sold as Rs. 1,200 per barrel.
- (ii) The other expenses were:

	(Rs.)
Clearing charges	11,250
Godown Rent	10,000
Wages	30,000
Printing, Stationery, Advertisement	20,000

25 barrels of oil were lost due to leakage which is considered to be normal loss.

Central Oil Co. is entitled to a commission of 5% on all the sales affected by them. Central Oil Company paid the amount due in respect of the consignment on 31st March itself.

Show the Consignment Account, the Account of Central Oil Co., and the Lost -in-Transit Account as they will appear in the books of Lubrizols Ltd.

Solution:

In the books of Lubrizols Ltd.

Dr.

Consignment to Kolkata Account

Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2019 Jan.1	To Goods sent on Consignment A/c	8,00,000	2020 Jan.7	By, Abnormal Loss A/c	
				By, Central Oil Co. A/c	21,250



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Mar.31	To, Bank A/c - Expenses		50,000	Mar. 31	Sale proceeds (750x Rs. 1.200)	9,00,000
	To, Central Oil Co. A/c :				By, Stock on Consignment A/c	1,76,842
	Freight	11,250				
	Godown Rent	10,000				
	Wages	30,000				
	Printing etc.	20,000	71,250			
	To, Central Oil Co. A/c : Commissions @5%		45,000			
	To, Profit on Consignment A/c: Transferred to Profit & Loss A/c		1,31,842			
			10,98,092			10,98,092

Dr.

Central Oil Co. Ltd. Account

Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020 Mar.31	To, Consignment to Kolkata A/c		2020 Jan.7	By, Bills Receivable A/c By, Consignment to Kolkata A/c	5,00,000
	-Sale Proceeds	9,00,000	Mar.31	- Expenses	71,250
				- Commission	45,000
				By, Bank (amount due)	2,83,750
		9,00,000			9,00,000

Dr.

Abnormal Loss Account

Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020 Jan. 7	To, Consignment to Kolkata A/c	21,250	2020 Jan.7	By Bank-Insurance Claim A/c	15,000
				By, Profit and Loss A/c (bal. fig.)	6,250
		21,250			21,250

Study Note - 5 : Accounting for Special Transactions

Workings:

Total Cost (1,000 x Rs. 800)	= 8,00,000
Add: Consignor's Expenses	= 50,000
Value of 1,000 barrels	= 8,50,000

$$\text{Less: Lost-in-transit } 25 \times \frac{8,50,000}{1,000} = 21,250$$

$$\text{Add: Non-recurring expenses of Consignee} = \frac{11,250}{840,000}$$

Value of (1,000 - 25 - 25) = 950 Kg.

$$\text{Therefore, Value of Stock} = 200 \times \frac{8,40,000}{950} = 1,76,842 \text{ (App.)}$$

5.2.8 Invoice Price Method

Generally, the method is used where the consignor does not want to disclose the real price of the goods which are sent to the consignee for a number of reasons. For this purpose, he sends goods at invoice price. It means, certain amount of profit is added to the cost price of goods. Profit/ Loading is calculated after charging certain percentage either on Cost or Sale/ Invoice price.

Naturally, for finalization of accounts, such loading should be adjusted accordingly. Loading is usually calculated on:

(a) Goods Sent on Consignment; (b) Any Abnormal Cost; or (c) Unsold Stock.

Entries to be Recorded in the Books of Consignor

a. For Goods Sent on Consignment -

Consignment A/c	Dr.
To, Goods sent on Consignment A/c	At Invoice Price.

b. For Loading of Goods sent on Consignment -

Goods Sent on Consignment A/c	Dr.
To, Consignment A/c	With the Amount of Loading on Goods Sent.

c. For Loading on Abnormal Loss -

Consignment A/c	Dr.
To, Abnormal Loss A/c	With the Amount of Loading on Abnormal Loss .



d. For Loading on Unsold Stock-

Consignment A/c Dr.
 To, Stock Suspense A/c / Stock Reserve A/c

Note: Other entries are as usual.

Illustration 19.

Mr. X, the consignor, consigned goods to Mr. Y 100 Radio sets valued Rs. 50,000. This was made by adding 25% on cost. Mr. X paid Rs. 5,000 for freight and insurance. 20 sets are lost - in- transit for which Mr. X recorded Rs. 5,000 from the Insurance company.

Mr. Y received remaining goods in good condition. He incurred Rs. 4,000 for freight and miscellaneous expenses and Rs. 3,000 for godown rent. He sold 60 sets for Rs. 50,000. Show the necessary ledger account in the books of Mr. X assuming that Mr. Y was entitled to an ordinary Commission of 10% on sales and 5% Del Credere Commission on sales. He also reported that Rs.1,000 were provide bad.

Solution:

In the books of Mr.X			
Dr.		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Goods Sent on Consignment A/c	50,000	By, Goods Sent on Consignment A/c (Loading) (Rs. 50,000x100/125)	10,000
To, Bank A/c - Expenses	5,000	By, Y A/c - Sale Proceeds	50,000
		By, Abnormal Loss A/c	11,000
To, Y A/c			
- Freight and Misc. Expenses	4,000		
- Godown Rent	3,000		
To, Abnormal Loss A/c (Loading)	2,000	By, Stock on Consignment A/c	12,000
To, Stock surplus A/c	2,000		
To, Y A/c			
- Commission (ordinary) @10%	5,000		
- Del credere Commission @5%	2,500		
To, Profit and Loss A/c			
- Profit on Consignment A/c	9,500		
	83,000		83,000



Study Note - 5 : Accounting for Special Transactions

Dr.		Y Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Consignment A/c	50,000	By, Consignment A/c			
- Sale proceeds		- Expenses	7,000		
		- Commission	7,500		
		By, Balance C/d	35,500		
	50,000		50,000		

Dr.		Abnormal Loss Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Consignment A/c	11,000	By, Consignment A/c (Loading)	2,000		
		By, Bank A/c- Insurance Claim	5,000		
		By, Profit and Loss A/c	4,000		
		- Loss transferred			
	11,000		11,000		

Workings:

(1) Calculation of Loading:	I.P.	Load	C.P.
	125	25	100
	5,000	$\frac{100 \times 50,000}{125}$	= 40,000

Loading = Rs.(50,000 - 40,000) = Rs. 10,000

Loading Per Set = Rs. 10,000 ÷ 100 = Rs. 100

- (2) Valuation of Goods Lost - in - transit and Unsold stock

	Rs.
Total Invoice Price	50,000
Add: Consignor's Expenses	<u>5,000</u>
Invoice Price of 100 sets	55,000
Less: Lost In Transit -	<u>11,000</u>
$\frac{20 \times 55,000}{100}$	44,000
Add: Non recurring Expenses of Mr. Y	4,000
I. P. of 80 sets	48,000



For Unsold Stock of $(100 - 20 - 60) = 20$ sets

$$48,000 \times 20/80 = \text{Rs. } 12,000$$

(3) Loading on Abnormal Loss = $20 \times \text{Rs. } 100 = \text{Rs. } 2,000$

(4) Stock surplus = $20 \text{ sets} \times \text{Rs. } 100 = \text{Rs. } 2,000$

(5) Since Del Credere Commission is given that will not be any entry for bad debts.

Illustration 20.

From the following two statements, prepare Consignment A/c and Consignee's A/c in the books of Consignor, presuming that the goods were invoiced at 20% above cost.

M/s Vijay & Company To: M/s Jyoti Electric House

Mumbai Pune

No 2355 Proforma Invoice Date: 21st April 2020

Particulars of goods sent on consignment:	Amount (Rs.)	Amount (Rs.)
800 Fans @ Rs. 1680 per fan		13,44,000
Add: Expenses Paid:		
Freight	4000	
Insurance	6000	
Sundries	2000	12,000
Total		13,56,000
E & O E Mumbai		
sd/- For Vijay & Company		

M/s Jyoti Electric House To: M/s Vijay & Company

Pune Mumbai

(Account sales of 800 fans received from Vijay & Company, Mumbai)

Date: 21st September 2020

	Amount (Rs.)	Amount (Rs.)
Sale proceeds of 600 Fans @ Rs. 2000 per fan		12,00,000



Study Note - 5 : Accounting for Special Transactions

Less: Expenses Paid :		
Advertising	4,500	
Insurance	1,500	
Octroi	12,000	
Commission @10%	1,20,000	(1,38,000)
Total		10,62,000
Less: Bill Accepted		7,50,000
Less: Bank draft enclosed		3,12,000
<div style="display: flex; justify-content: space-between; align-items: flex-end; padding-top: 20px;"> <div>E & O E Mumbai</div> <div>sd/- For Vijay & Company</div> </div>		

Solution:

Dr. Consignment to Pune Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Goods Sent on Consignment A/c	13,44,000	By, M/s Jyoti Electric House's A/c	12,00,000
To, Bank A/c (freight, Insurance & Sundries)	12,000	By, Goods Sent on Consignment A/c (loading)	2,24,000
To, M/s Jyoti Electric House's A/c		By, Consignment Stock A/c (@ invoice value)	3,42,000
Expenses	18,000		
Commission	120,000		
To, Stock Reserve A/c (loading on stock)	56,000		
To, P & L A/c	216,000		
	17,66,000		17,66,000

Dr. Jyoti Electric House's Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Consignment A/c	12,00,000	By, Consignment A/c (expenses)	18,000



Paper III: Financial Accounting-2

		By, Consignment A/c (commission)	1,20,000
		By, Bank A/c	3,12,000
		By, Bills Receivable A/c	7,50,000
	12,00,000		12,00,000

Dr.

Jyoti Electric House's Account

Cr.

Loading on consignment	Amount (Rs.)
Invoice price of fans consigned	1,680
Loading is 20% on cost	
Thus loading to be removed $20/120 \times 1680$	280
Total loading removed (800×280)	2,24,000
Value of closing Stock	
Original invoice value	13,44,000
Consignor's expenses	12,000
Consignee's non-recurring expenses (Octroi only)	12,000
Loading on consignment	13,68,000
Total fans sent	800
Less : Fans sold	600
In Stock	200
Hence, stock value $(13,68,000/800 \times 200)$	3,42,000
Loading to be removed (200×280)	56,000

Illustration 21

On 1.7.2020, Mantu of Chennai consigned goods of the value of Rs. 50,000 to Pandey of Patna. This was made by adding 25% on cost. Mantu paid that on Rs. 2,500 for freight and Rs. 1,500 for insurance.

During transit th of the goods was totally destroyed by fire and a sum of Rs. 2,400 was realised from the insurance company. On arrival of the goods, Pandey paid Rs. 1,800 as carriage to godown. During the year ended 30th June 2020, Pandey paid Rs. 3,600 for godown rent and Rs. 1,900 for selling expenses. th of the remaining goods was again destroyed by fire in godown and nothing was recorded from the insurance company. On 1.6.2013, Pandey sold half the original goods for Rs. 30,000 and changed a commission of 5% on sales as on 30.6.2020, Pandey sent a



Study Note - 5 : Accounting for Special Transactions

bank draft to Mantu for the amount so far due from him.

You are required to prepare the following ledger accounts in the books of Mantu of Chennai for the year ended 30.6.2020.

- (a) Consignment to Patna Account; (b) Goods Destroyed by Fire Account; and (c) Personal Account of Pandey.

Solution :

In the books of Mantu of Chennai Consignment to Patna Account

Dr.

Cr.

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
To Goods Sent on Consignment A/c		50,000	By, Goods Sent on Consignment A/c.	10,000
To, Bank A/c :			- Loading	
Freight	2,500			
Insurance	1,500	4,000	By, Pandey A/c :	30,000
To, Pandey A/c :			Sale Proceeds	
Carriage Inward	1,800		By, Goods Destroyed by Fire A/c	11,000
Godown Rent	3,600		By, Stock on Consignment A/c	16,800
Selling Expenses	1,900	7,300		
To, Pandey A/c :				
Commission (5% on Rs. 30,000)		1,500		
To, Goods Destroyed :		2,000		
by Fire A/c Loading				
To, Stock Suspense A/c :		3,000		
Loading on unsold stock				
		67,800		67,800

Note: There is no normal Profit or Loss on Consignment.

Dr.

Goods Destroyed by Fire Account

Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
-------------	-----------------	-------------	-----------------



Paper III: Financial Accounting-2

To, Consignment to Patna A/c :		By, Consignment to Patna A/c :	2,000
In transit	5,400	By, Bank A/c - Insurance claim	2,400
In Godown Loading	5,600	By, Profit & Loss A/c	
	11,000		11,000

Dr.		Pandey Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Consignment to Patna A/c		By, Consignment to Patna A/c :			
Sale proceeds	30,000	Expense	7,000		
		Commission	1,500		
		By, Draft A/c	21,200		
	30,000		30,000		

Working:

Valuation of goods destroyed by fire and unsold stock

Particulars	Amount (Rs.)
Total Insurance Claim	50,000
Add: Consignor's Expenses	4,000
	54,000
Less: Lost-in-Transit ($\frac{1}{10} \times \text{Rs. } 54,000$)	5,400
Goods received ($\frac{9}{10}$ th of Rs. 54,000)	48,600
Add: Non- recurring expenses of Pandey	1,800
	50,400
Less: Value of goods destroyed by fire in godown	5,600
(th $\frac{1}{9}$ of Rs. 50,400)	
Value of $\frac{8}{10}$ th	44,800

Study Note - 5 : Accounting for Special Transactions

$$\therefore \text{Value of unsold stock } \frac{9}{10} - \left(\frac{1}{9} \text{th of } \frac{9}{10} \right) = \frac{9}{10} - \frac{1}{10} = \frac{8}{10}$$

$$\text{Goods sold } \frac{1}{2} \text{ i.e. } = \frac{8}{10} - \frac{1}{2} = \frac{3}{10} \text{th}$$

$$\therefore \text{Value of unsold stock Rs. } 44,800 \times \frac{3}{10} - \frac{10}{8} = \text{Rs. } 16,800$$

$$\text{Loading on goods destroyed} = \text{Rs. } 10,000 \times \frac{2}{10} = \text{Rs. } 2,000$$

$$\text{Loading on goods destroyed} = \text{Rs. } 10,000 \times \frac{3}{10} = \text{Rs. } 3,000$$

Illustration 22.

Usha sent goods costing Rs. 75,50,000 on consignment basis to Gayatri on 1st Feb 2020 @ 8.5% commission. Usha spent Rs. 8,25,000 on transportation. Gayatri spent Rs. 5,25,000 on unloading. Gayatri sold 88% of the goods for Rs. 90,00,000, 10% of the goods for Rs. 10,00,000 and the balance are taken over by her at 10% below the cost price. She sent a cheque to Usha for the amount due after deducting commission.

Show Consignment to Gayatri A/c and Gayatri's A/c in the books of Usha.

Solution

Calculation of sales	Cost (Rs.)	Invoice (Rs.)
Goods sent	75,50,000	
88% of the goods	66,44,000	90,00,000
10% of goods	7,55,000	10,00,000
Total sales	73,99,000	1,00,00,000
Goods taken over by Gayatri	1,51,000	1,35,900

There is no closing stock here as all unsold goods were taken over by Gayatri. The commission is payable only on sales to outsiders and not on goods taken over by Gayatri.

Thus, commission is 8.5% on Rs. 10,00,000 i.e. Rs. 8,50,000

The required ledger A/cs are shown below:

Dr.

Consignment to Gayatri Account

Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Goods Sent on Consignment A/c	75,50,000	By Gayatri's A/c (sales)	10,00,000



Paper III: Financial Accounting-2

To Bank A/c (transportation)	8,25,000	By Gayatri's A/c (goods taken over)	1,35,900
To Gayatri's A/c :			
Unloading charges	5,25,000		
Commission	8,50,000		
To P & L A/c	3,85,900		
	1,01,35,900		1,01,35,900

Dr.		Gayatri's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To Consignment A/c	1,01,35,900	By Consignment A/c (expenses)	5,25,000		
		By Consignment A/c (commission)	8,50,000		
		By Bank A/c	87,60,900		
	1,01,35,900		1,01,35,900		

Illustration 23.

Shri Babubhai oil mills of Baroda sent 10000 kg of oil to M/s Gupta & Sons in Delhi. The cost of oil is Rs. 40 per kg. Babubhai paid Rs. 5,000 as freight and Rs. 2,500 as insurance. In transit 250 kg of oil was accidentally destroyed for which insurance company paid Rs. 450 in full settlement to Babubhai.

M/s Gupta & Sons took delivery of the balance. Later they reported that 7500 kg was sold @ Rs. 60 per kg. Expenses incurred by them were rent Rs. 2,000, advertisement Rs. 5,000 and salaries Rs. 5000. M/s Gupta & Sons are entitled to commission of 3% and Del Credre commission of 1.5%. One customer who purchased 1000 kg paid only 80% of the amount due. M/s Gupta & Sons also reported loss of 100 kg due to leakage. The final amount due was settled. Prepare necessary ledger accounts in the books of Babubhai.

Solution

In the Books of Shri Babubhai Consignment to Delhi Account

Dr.		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)



Study Note - 5 : Accounting for Special Transactions

To, Goods Sent on Consignment A/c	4,00,000	By, M/s Gupta & Sons' A/c (sales)	4,50,000
To, Bank A/c (Freight and Insurance)	7,500	By, Abnormal Loss A/c	10,188
To, M/s Gupta & Sons' A/c :		By, Consignment Stock A/c	86,849
Expenses	12,000		
Commission	20,250		
To P & L A/c (Balancing figure)	1,07,287		
	5,47,037		547,037

Dr.

M/s Gupta & Sons' Account

Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Consignment A/c	4,50,000	By, Consignment A/c (expenses)	12,000
		By, Consignment A/c (commission)	20,250
		By, Bank A/c	4,17,750
	4,50,000		450,000

Calculation of Abnormal Loss: 250 kg of oil lost in transit

Cost of 250 kg @ 40/kg		10,000
Proportionate expenses of Babubhai (250/10000*7500)	188	10,1988
Calculation of closing stock	Kg.	
Oil consigned to Delhi		10,000
Less: Lost in transit		(250)
Less: Normal loss due to leakage	(100)	
Less: Quantity sold		(7,500)
Stock in hand	2,150	
Basic cost of stock consigned @Rs. 40	400,000	
Less : Cost of abnormal loss	(10,188)	



Cost of stock after normal loss of 100kg	389,812	
Thus cost of 2150 kg (389812/9650*2150)	86,849	
Calculation of commission		
Ordinary @ 3% on 450000	13,500	
Del Credre @ 1.5% on 450000	6,750	
	20,250	

As the consignee has paid Del Credre Commission, the responsibility of bad debts is his. Hence no entry is needed to be passed in the books of consignor.

Illustration 24.

Sangita Machine Corporation sent 200 sewing machines to Rita agencies. It spent Rs. 7500 on packing. The cost of each machine was Rs. 2,000, but it was invoiced at 20% above cost. 20 machines were lost in transit & insurance company accepted claim of Rs. 20,000 only.

Rita agencies paid freight of Rs. 9,000, carriage Rs. 3,600, Octroi Rs. 1,800 and rent Rs. 1800. They sold 150 machines at Rs. 3,500 per machine. They were entitled to commission of 5% on invoice price and additional 20% of any excess realized on invoice price and 2% Del Credre commission. They accepted a bill drawn by Sangita Machine Corporation for Rs. 3,00,000 and remitted the balance by demand draft along with account sale. Draw up necessary ledger accounts in the books of Sangita Machine Corporation and Rita Agencies.

Solution :

Books of Sangita Machine Corporation Consignment to Rita Agencies Account

Dr.

Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Goods Sent on Consignment A/c	4,80,000	By Rita Agencies A/c (Sales 150 @ 3500)	5,25,000
To, Bank A/c : (Packing Expenses)	7,500	By Abnormal Loss A/c	48,750
To Rita Agencies A/c :		By Consignment Stock A/c	75,525
Freight	9,000	By Goods Sent on Consignment A/c (leading)	80,000
Carriage	3,600		
Octroi	1,800		
Rent	1,800		



Study Note - 5 : Accounting for Special Transactions

Commission	61,500		
To Abnormal loss A/c (load removed)	8,000		
To Stock Reserve A/c	12,000		
To P & L A/c (balancing figure)	1,44,075		
	7,29,275		7,29,275

Dr. Rita Agencies Account Cr.			
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Consignment A/c	5,25,000	By Consignment A/c (expenses)	16,200
		By Consignment A/c (commission)	61,500
		By Bills Receivable A/c	3,00,000
		By Bank A/c (balancing figure)	1,47,300
	5,25,000		5,25,000

Calculation of abnormal loss 20 machines lost in transit (Rs.)

Cost of 20 machines @ Rs. 2400	48,000
Proportionate expenses of Babubhai (20/200*7500)	750
	48,750

Calculation of Closing Stock (Rs.)

Invoice value of 30 machines @ 2400	72,000
Add : Consignor's proportionate expenses	1,125
Add : Consignee's proportionate expenses	2,400
	75,525
Stock reserve 30 machines @ Rs.400	12,000

Calculation of Commission (Rs.)

Invoice price of machines sold (2400*150)	360,000	
Commission @ 5% on this	Rs. 18,000	(a)
Excess over invoice value (525000-360000)	165,000	
Commission @ 20% on this	33,000	(b)
Del Credre Commission @ 2% on 525000	10,500	(c)
Total Commission (a+b+c)	61,500	



Books of Rita Agencies

Dr.

Sangita Machine Corporation Account

Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Cash A/c (expenses)	16,200	By, Consignment A/c (sales)	5,25,000
To, Commission A/c	61,500		
To, Bills Payable A/c	3,00,000		
To, Bank A/c (balancing figure)	1,47,300		
	5,25,000		5,25,000

5.2.9 Advance from Consignee as Security Money:

Usually the consignor takes certain some of money as advance by way of cash/draft/bill etc from the consignee against the goods that are sent for sale to the consignee. The so called advance money is automatically adjusted against the total dues in order to determine the net amount payable. If the advance money is not treated as security money, then the entire amount of advance money may be adjusted even if a part of goods are sold. But if the advance money is treated as security money, in that case, the proportionate amount of such advance money will be carried forward as the same is treated to the unsold stock. The entries in the books of both companies and consignor will be:

In the books of Consignor		In the books of Consignee	
Cash/ Draft/Bill Receivable A/c	Dr.	Consignor A/c	Dr.
To, Consignee's Personal A/c		To, Cash/ Draft/B/P A/c	

Illustration 25:

Ram of Patna consigns to Shyam of Delhi for sale at invoice price or over. Shyam is entitled to a commission @ 5% on invoice price and 25% of any surplus price realized. Ram draws on Shyam at 90 days sight for 80% of the invoice price as security money. Shyam remits the balance of proceeds after sales, deducting his commission by sight draft.

Goods consigned by Ram to Shyam costing ₹20,900 including freight and were invoiced at ₹28,400. Sales made by Shyam were ₹26,760 and goods in his hand unsold at 31st Dec, represented an invoice price of ₹6,920. (Original cost including freight ₹5,220). Sight draft received by Ram from Shyam upto 31st Dec was ₹ 6,280. Others were in- transit.

Prepare necessary any Ledger Accounts.



Study Note - 5 : Accounting for Special Transactions

Solution:

In the books of Ram

Dr. Consignment to Delhi Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Goods Sent on Consignment A/c	28,400	By, Goods Sent on Consignment A/c (Loading) Rs. (28,400- 20,900)	7,500
To, Y A/c - Commission	2,394	By, Shyam A/c - Sale proceeds	26,760
To, Stock Reserve A/c Rs. (6,920 - 5,220)	1,700	By, Stock on Consignment A/c	6,920
To, Profit and Loss A/c- Profit on consignment transferred	8,686		
	41,180		41,180

Dr. Shyam Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Consignment to Delhi A/c	26,760	By, Bills Receivable A/c	22,720
To, Balance c/d (` 6,920 x 80%)	5,536	By, Consignment to Delhi A/c - commission	2,394
		By, Draft A/c	6,280
		By, Draft- in- Transit A/c	902
	32,296		32,296

Dr. Goods sent on Consignment Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Consignment to Delhi A/c	7,500	By, Consignment to Delhi A/c	28,400
To, Trading A/c (bal.fig)	20,900		
	28,400		28,400

Workings:

Calculation of Commission:

Rs.

Invoice value of goods

28,400



Less: Unsold stock	6,920
Invoice value of goods sold	21,480
Total sale proceeds	26,760
Less: Invoice value of goods sold	21,480
Surplus price	5,280
Commission @ 5% on Rs. 21,480	= 1,074
Add: @ 25% on Rs. 5,280	= 1,320
	2,394

5.3 JOINT VENTURE ACCOUNTS

5.3.1 Introduction

Joint Venture is a temporary form of business organization. There are certain business activities or projects that may involve higher risks; higher investments and even they demand multi-skills. In such cases, an individual person may not be able to muster all resources. Hence two or more people having requisite skill sets come together to form a temporary partnership. This is called a Joint Venture. There is a Memorandum of Undertaking (MOU) signed for this purpose.

The business activities for which Joint Ventures (JV) are formed could be :

- Construction of dams, bridges, roads etc
- Buying & selling of goods for a particular season
- Producing a film
- Purchasing land selling plots

The basic features of a Joint Venture business are :

- (i) It is done for a specific purpose and hence has a limited duration.
- (ii) The partners are called co-venturers.
- (iii) The profit or loss on joint venture is shared between the co-venturers in the agreed ratio.
- (iv) The co-venturers may or may not contribute initial capital.
- (v) The JV is dissolved once the purpose of the business is over.
- (vi) The accounts of the co-venturers are settled immediately on dissolution.
- (vii) A joint venture has no name.

5.3.2 Accounting Entries

There may be three ways of maintaining the books of account for the joint venture business. They are:

Study Note - 5 : Accounting for Special Transactions

- (a) Where separate books of accounts are maintained
- (b) Where no separate books of accounts are maintained
- (c) Memorandum Joint Venture

5.3.2.1 (a) When Separate Books are Maintained

As the business duration is short, the books of accounts are not very comprehensive. The basic purpose is to know profit or loss on account of the joint venture.

- (a) Like a normal P&L A/c, a "Joint Venture A/c" is opened which records all transactions related to the activities carried out. The net result of this a/c will be either profit or loss.
- (b) To record cash/bank transactions a "Joint Bank A/c" is maintained. This could take a form of cash book with cash and bank column. It will record, the initial contributions made by each co-venturer, proceeds of sales, expenses and distribution of net balances among co-venturers on dissolution of the venture.
- (c) To record transaction related to co-venturers, "Co-Venturers' personal A/cs" are also maintained.

The accounting entries are normally as follows:

No.	Transaction	Entry	
1	Contribution of co-venturers	Joint Bank A/c	Dr.
		To, Co-Venturers A/c	
2	Goods sent by co-venturer out of his own stock	Joint Venture A/c	Dr.
		To, Co-Venturers A/c	
3	Expenses paid by co-venturers	Joint Venture A/c	Dr.
		To, Co-Venturers A/c	
4	Materials purchased out of joint venture funds	Joint Venture A/c	Dr.
		To Joint Bank A/c	
5	For expenses out of joint bank A/c	Joint Venture A/c	Dr.
		To Joint Bank A/c	
6	For goods sold for cash	Joint Bank A/c	Dr.
		To Joint Venture A/c	
7	Contract / sale price received in form of shares / cash	Joint Bank A/c	Dr.
		Shares A/c	Dr.
		To Joint Venture A/c	



8	Commission / salary to co-venturers	Joint Venture A/c	
		To Co-Venturers A/c	Dr.
9	Unsold goods taken over by co-venturers	Co-Venturers A/c	Dr.
		To Joint Venture A/c	Dr.
10	Shares taken over by co-venturers	Co-Venturers A/c	
		To Shares	
11	If shares are sold in open market	Joint Bank A/c	Dr.
		To Shares	
12	For profit on joint venture	Joint Venture A/c	Dr.
		To Co-Venturers A/c	
13	For loss on joint venture	Co-Venturers A/c	Dr.
		To Joint Venture A/c	
14	For final distribution of funds	Co-Venturers A/c	Dr.
		To Joint Bank A/c	

Illustration 26

Aditya and Amit entered into a joint venture to buy and sale Ganesh idols for the Ganesh festival. They opened a Joint Bank A/c. Aditya deposited Rs. 2,00,000 and Amit Rs. 1,50,000. Aditya supplied Ganesh idols worth Rs. 25,000 and Amit supplied decoration material worth Rs. 15,000.

The following payments were made by the venture:

- Cost of Ganesh idols purchased Rs. 2,50,000
- Transportation charges Rs. 12,000
- Advertising Rs. 7,500 and Sundry Expenses Rs. 2,500

They sold idols for Rs. 4,00,000 for cash. Aditya took over some idols for Rs. 30,000 and Amit took over remaining for Rs. 10,000. The profit or losses were to be shared equally between co-venturers. Prepare Joint Venture A/c, Joint Bank A/c and each Co-Venturer's A/c.

Solution

Dr.		Joint Venture Account		Cr.	
Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
To, Aditya Materials A/c		25,000	By, Joint Bank A/c -sales		4,00,000
To, Amit Materials A/c		15,000	By, Aditya A/c		30,000



Study Note - 5 : Accounting for Special Transactions

To, Joint Bank Material A/c	2,50,000	By, Amit A/c	10,000
To, Joint Bank Transport A/c	12,000		
To, Joint Bank Advertising A/c	7,500		
To, Joint Bank sundry A/c	2,500		
To, Profit on Venture A/c :			
Aditya	64,000		
Amit	64,000		
	4,40,000		4,40,000

Dr. Joint Bank Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Aditya A/c	2,00,000	By, Joint Venture A/c : materials	2,50,000
To, Amit A/c	150,000	By, Joint Venture A/c : transport	12,000
To, Joint Venture A/c - sales	400,000	By, Joint Venture A/c : advertising	7,500
		By, Joint Venture A/c : sundry	2,500
		By, Aditya A/c : closing	2,59,000
		By, Amit A/c : closing	2,19,000
	7,50,000		7,50,000

Dr. Aditya's Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Joint Venture A/c - material	30,000	By, Joint Bank	2,00,000
To Joint Bank A/c - closing	2,59,000	By, Joint Venture - materials	25,000
		By, Joint Venture - profit	64,000
	2,89,000		2,89,000

Dr. Amit's Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Joint Venture A/c - material	10,000	By Joint Bank A/c	1,50,000
To Joint Bank A/c - closing	2,19,000	By Joint Venture A/c - materials	15,000



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		By Joint Venture A/c- profit	64,000
	2,29,000		2,29,000

Illustration 27

Prabir and Mihir doing business separately as building contractors undertake jointly to build a skyscraper for a newly started public limited company for a contract price of Rs.1,00,00,000 payable as Rs. 80,00,000 in cash and the balance by way of fully paid equity shares of the new company. A Bank A/c was opened for this purpose in which Prabir paid Rs. 25,00,000 and Mihir Rs.1,50,00,00. The profit sharing ratio was agreed as 2:1 between Prabir and Mihir. The transactions were:

- Advance received from the company Rs. 50,00,000
- Wages to contractors Rs. 10,00,000
- Bought materials Rs. 60,00,000
- Material supplied by Prabir Rs. 10,00,000
- Material supplied by Mihir Rs. 1,500,000
- Architect's fees paid from Joint Bank account Rs. 21,00,000

The contract was completed and the price was duly paid. The joint venture was duly closed by Prabir taking all the shares at Rs. 18,00,000 and Mihir taking over the balance material for Rs.3,00,000. Prepare the Joint Venture A/c, Joint Bank A/c, Co-venturer's A/cs and Shares A/c.

Solution:

Dr.		Joint Venture Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Joint Bank A/c - wages	10,00,000	By, Joint Bank A/c - advance	50,00,000		
To, Joint Bank A/c - material	60,00,000	By, Joint Bank A/c - balance price	30,00,000		
To, Joint Banks A/c - Architect	21,00,000	By, Shares A/c - received	20,00,000		
To, Prabir A/c - material	10,00,000	By, Mihir A/c - stock taken	300,000		
To, Mihir A/c - material	15,00,000	By, Prabir A/c - 2/3rd loss	10,00,000		
To, Shares A/c - loss	2,00,000	By, Mihir A/c - 1/3rd loss	5,00,000		
	1,18,00,000		1,18,00,000		

Dr.		Joint Bank Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		



Study Note - 5 : Accounting for Special Transactions

To, Prabir A/c	25,00,000	By, Joint Venture A/c - wages	10,00,000
To, Mihir A/c	15,00,000	By, Joint Venture A/c - materials	60,00,000
To, Joint Venture A/c - advance	50,00,000	By, Joint Venture A/c - Architect	21,00,000
To, Joint Venture A/c - balance	30,00,000	By, Prabir A/c - balance paid	7,00,000
		By, Mihir A/c - balance paid	22,00,000
	1,20,00,000		1,20,00,000

Dr.		Prabir's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Shares A/c - taken	18,00,000	By, Joint Bank A/c	25,00,000		
To, Joint Venture A/c - loss	10,00,000				
To, Joint Bank A/c - Balance paid	7,00,000	By, Joint Venture A/c - material	10,00,000		
	35,00,000		35,00,000		

Dr.		Mihir's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Joint Venture A/c - stock taken	300,000	By, Joint Bank A/c	15,00,000		
To, Joint Venture A/c - Loss	500,000				
To, Joint Bank A/c - Balance paid	22,00,000	By, Joint Venture - material	15,00,000		
	30,00,000		30,00,000		

Dr.		Shares Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Joint Venture A/c	20,00,000	By, Prabir A/c	18,00,000		
		By, Joint Venture A/c - loss	2,00,000		
	20,00,000		20,00,000		

Illustration 28.

P and Q entered into a joint venture for underwriting the subscription at par of 25,000 shares of Rs. 10 each of a Joint Stock Company. They agreed to share profits or losses in the ratio of 3/5 and 2/5 respectively.



The consideration for guaranteeing the subscription was 250 other shares of Rs. 10 each fully paid to be issued to them.

The public took up 24,000 of the shares and the remaining shares of the guaranteed issue were taken up by P and Q who provide cash equally. The entire shareholding of the venture was then sold through other brokers, 60% at a price of Rs. 9.50 less brokerage 50 paise per share, 20% at a price of Rs. 9.75 less brokerage 50 paise per share and the balance were taken over by P and Q equally at Rs. 9.00 per share.

Prepare a Joint Venture Account, the Joint Bank Account, and Capital Accounts of P and Q.

Soloution :

**In the books of P and Q
Joint Venture Account**

Dr.	Joint Venture Account		Cr.
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Joint Bank A/c	10,000	By, Joint Bank A/c	9,063
Cost of 1,000 shares @ Rs. 10		Sale proceeds of shares	
		By, P's Capital A/c	
To, Capital A/c	1,313	Shares taken	1,125
- Profit on Venture :		By, Q's Capital A/c	1,125
- P-788		Shares taken	
- Q-525			
	11,313		11,313

Dr.	Joint Bank Account		Cr.
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, P's Capital A/c	5,000	By, Joint Venture A/c	10,000
To, Q's Capital A/c	5,000	(Cost of shares)	
To, Joint Venture A/c	9,063	By, P's Capital A/c	4,662
		By, Q's Capital A/c	4,400
	19,063		19,063

Study Note - 5 : Accounting for Special Transactions

Dr.		Capital Account		Cr.	
	P	Q		P	Q
Particulars	Amount (Rs.)	Amount (Rs.)	Particulars	Amount (Rs.)	Amount (Rs.)
To, Joint Venture A/c	1,125	1,125	By Joint Book A/c		
- Shares taken			(Cost of shares)	5,000	5,000
"Joint Bank A/c	4,663		"Joint Venture Profit A/c	788	
- Final Payment		4,400	"Joint Venture Profit A/c		525
	5,788	5,525		5,788	5,525

Working :

Cost of 1,000 shares @ Rs. 10 = Rs. 10,000 to be contributed by P and Q equally, i.e., Rs. 5,000 each

Calculation of sale proceeds : Rs.

Share purchased 1,000

Taken as Com. 250

1,250

60% of 1,250 = 750 × Rs. 9 (i.e. Rs. 9.50 - .50) = Rs. 6,750

20% of 1,250 = 250 × Rs. 9.25 (i.e. Rs. 9.75 - .50) = 80% Rs. 2,313

Rs. 9,063

20% of 1,250 = 250 × Rs. 9 = Rs. 2,250 to be taken by P and Q equally, i.e. Rs. 1,125 each.

5.3.2.2 (b) When no Separate Books of Accounts are Maintained

The co-venturers may decide not to keep separate books of account for the venture if it is for a very short period of time. In this case, all co-venturers will have account for the transactions in their own books. Here no Joint Bank A/c is opened and the co-venturers do not contribute in cash. Goods are supplied by them from out of their stocks and expenses for the venture are also settled the same way.

Each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Naturally, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into A/c all transactions i.e. done by himself and by his co-venturer as well.

The accounting entries are:



In books of Co-venturer A		In books of co-venturer B	
When goods are supplied and expenses paid by A			
Joint Venture A/c	Dr.	Joint Venture A/c	Dr.
To, Goods A/c		To, A's A/c	
To, Cash / Bank A/c			
When goods are supplied by B and expenses paid by B			
Joint Venture A/c	Dr.	Joint Venture A/c	Dr.
To, B's A/c		To, Goods A/c	
		To, Cash / Bank A/c	
When advance is given by A to B or bill accepted by A			
B's A/c	Dr.	Cash / Bank A/c	Dr.
To, Cash / Bank A/c		B/R A/c	Dr.
To, B/P A/c		To, A's A/c	
When sale proceeds are received by A			
Cash / Bank A/c	Dr.	A's A/c	Dr.
To, Joint Venture A/c		To, Joint Venture A/c	
When sale proceeds are received by B			
B's A/c	Dr.	Cash / Bank A/c	Dr.
To, Joint Venture A/c		To, Joint Venture A/c	
For unsold goods taken over by A			
Goods A/c	Dr.	A's A/c	Dr.
To Joint Venture A/c		To Joint Venture A/c	
For unsold goods taken over by B			
B's A/c	Dr.	Goods A/c	Dr.
To, Joint Venture A/c		To, Joint Venture A/c	
For profit on joint venture business			
Joint Venture A/c	Dr.	Joint Venture A/c	Dr.
To, B's A/c		To, A's A/c	
To, P & L A/c		To, P & L A/c	
For loss on joint venture business			
B's A/c	Dr.	A's A/c	Dr.
P & L A/c	Dr.	P & L A/c	Dr.
To, Joint Venture A/c		To, Joint Venture A/c	

Study Note - 5 : Accounting for Special Transactions

After closure the business of joint venture, the co-venturer who has received surplus cash will remit it to the other co-venturer.

As a variation from this system, the co-venturers may decide to maintain a separate 'Memorandum Joint Venture A/c' in joint books. In this transactions made by each co-venturer is shown against their name. This A/c will show profit or loss. The co-venturers will keep an account called "Joint venture with co-venturer A/c" wherein all transactions done by him only are recorded.

Illustration 29:

John and Smith entered into a joint venture business to buy and sale garments to share profits or losses in the ratio of 5:3. John supplied 400 bales of shirting at Rs. 500 each and also paid Rs. 18,000 as carriage & insurance. Smith supplied 500 bales of suiting at Rs. 480 each and paid Rs. 22,000 as advertisement & carriage. John paid Rs. 50,000 as advance to Smith.

John sold 500 bales of suiting at Rs. 600 each for cash and also all 400 bales of shirting at Rs. 650 each for cash. John is entitles for commission of 2.5% on total sales plus an allowance of Rs. 2,000 for looking after business. The joint venture was closed and the claims were settled.

Prepare Joint Venture A/c and Smith's A/c in the books of John and John's A/c in the books of Smith.

Solution :

Books of John			
Dr.	Joint Venture Account		Cr.
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Goods A/c - shirting (400x500)	2,00,000	By, Cash A/c - sales	
		shirting (500 x 600)	3,00,000
		suiting (400 x 650)	2,60,000
To, Bank A/c - carriage & insurance	18,000		
To, Smith A/c - suiting (500x480)	2,40,000		
To, Smith A/c - advt & Carriage	22,000		
To, Commission A/c - 2.5%	14,000		
To, Allowance A/c	2,000		
To, P & L A/c (5/8th share)	40,000		
To, Smith A/c (3/8th share)	24,000		
	5,60,000		5,60,000



Dr. Smith's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Cash A/c - advance	50,000	By, Joint Venture A/c - suiting	240,000
To, Cash A/c - balance paid	2,36,000	By, Joint Venture A/c - expenses	22,000
		By, Joint Venture A/c - profit	24,000
	2,86,000		2,86,000

Dr. Books of Smith John's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Joint Venture A/c - sales	560,000	By, Cash A/c - advance	50,000
		By, Joint Venture A/c - shirting	2,00,000
		By, Joint Venture A/c - expenses	18,000
		By, Joint Venture A/c-commission	14,000
		By, Joint Venture A/c - Allowance	2,000
		By, Joint Venture A/c - profit	40,000
		By, Cash A/c - balance paid	2,36,000
	560,000		5,60,000

5.3.2.3 (c) Memorandum Joint Venture Account

When all the parties keep accounts, the method adopted for recording the transactions relating to joint venture, is called Memorandum Joint venture method. Here each Co-Venturer records only those joint venture transactions which are affected by him with the help of a personal account designed as 'Joint Venture with.....(Name of the other Co-Venturer).....Account'. It is debited with the amount of purchases/supplies made and expenses incurred by the Venturer.

Each Co-Venturer sends a periodic statement of joint venture transactions effected by him only, to the other Co-Venturer and on receipt of the aforesaid statement, each Co-Venturer prepares Memorandum Joint Venture Account in order to ascertain the profit/loss on Joint Venture transactions.

Since this account is in fact, not a part and parcel of double entry system the word 'memorandum' is prefixed.

Journal Entries: The journal entries which may be required at any point of time, are summarized below:

Study Note - 5 : Accounting for Special Transactions

1.(a)	On receipt of any amount/Bills Receivable from other Co-		
	Venturer:		
	Cash/Bank/Bills Receivable A/c	Dr.	
	To, Joint Venture withA/c		
1.(b)	On discounting Bills Receivable:		
	Bank A/c	Dr.	(with net proceeds)
	Joint Venture withA/c	Dr.	(with discount)
	To, Bills Receivable A/c		(with total)
2.	On purchase of goods:		
	Joint Venture withA/c	Dr.	(with total)
	To, Cash/Bank A/c		(with cash purchase)
	To, Supplier's A/c		(with credit purchase)
3.	On making payment to supplier		
	Supplier's A/c	Dr.	(with total)
	To, Cash/Bank/Bills Payable A/c		(with payment made)
	To, Joint Venture withA/c		(with discount received)
4.	On supply of goods out of own stock:		
	Joint Venture withA/c	Dr.	(if supplies at cost)
	To, Purchases/Goods sent on		(if supplies at profit)
	Joint Venture A/c		
	To, Sales A/c		
5.	On payment of expenses:		
	Joint Venture withA/c		(with total)
	Dr. To, Cash/Bank A/c		(with cash expenses)
	To, Creditor's A/c		(with outstanding expenses)
6.	On sale of goods:		
	Cash/Bank A/c	Dr.	(with cash sales)
	Customer's A/c	Dr.	(with credit sales)
	To, Joint Venture withA/c		(with total)
7.	On receiving payment from a customer:		
	Cash/Bank A/c	Dr.	(with the payment received)
	Joint Venture withA/c	Dr.	(discount allowed/bad debt)
	To, Customer's A/c		(with total)
8.	On taking away of unsold goods:		



	Goods sent on Joint Venture A/c		
	Dr. To, Joint Venture withA/c		
9.	On considering some commission/salary to the Co-Venturer:		
	Joint Venture withA/c		
	Dr. To, Commission/Salary A/c		
10.	On recording the share of Profit/Loss:		
(a)	When profit-		
	Joint Venture withA/c	Dr.	
	To, Profit & Loss A/c		
(b)	When loss-		
	Profit & Loss A/c	Dr.	
	To, Joint Venture withA/c		
11.	On settlement of balance of Joint Venture withA/c:		
(a)	When there is a debit balance:		
	Cash/Bank A/c	Dr.	
	To, Joint Venture withA/c		
(b)	When there is a credit balance:		
	Joint Venture withA/c	Dr.	
	To, Cash/Bank A/c		

Illustration 30

Ravi and Suresh entered into a Joint Venture for purchase and sale of electronic goods, sharing profit & loss in this ratio of 3:2. They also agreed to receive 5% commission on their individual sales and the following information was extracted from the records.

- July 1, 2020 : Ravi purchased goods worth Rs. 1,90,000 financed to the extent of 90% out of his funds and balance by load from his uncle Shyam.
- Aug. 1 2020 : Ravi sent goods costing Rs. 1,70,000 to Suresh and paid Rs. 1,410 as freight. Suresh paid Rs. 13,410 to Ravi.
- Oct. 1 2020 : Suresh sold all the goods sent to him. Ravi paid the loan takes from his uncle including interest of Rs. 350.

All sales by either party were made at as uniform profit of 40% after cost. On Nov. 30, 2020, they decided to close the venture by transforming the balance of goods unsold lying with Ravi at a cost of Rs. 9,000 to a wholesale dealer. You are required to prepare the Memorandum Joint Venture Account, Joint Venture with Ravi in the books of Suresh and Joint Venture with Suresh in the books of Ravi. They further disclosed that goods worth Rs. 4,000 were taken personally by Ravi at an agreed price of Rs. 5,000.



Study Note - 5 : Accounting for Special Transactions

Dr. **Suspense Account** Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020			2020		
2020 July 1.	To, Ravi - Purchase 1,71,000		2020 Oct.1	By, Suresh-Sale	2,38,000
	To, Loan - Purchase 19,000	1,90,000	Nov.20	Proceeds (Rs. 1,70,000+40%)	5,000
Aug.1	To, Ravi - Freight	1,410		By, Ravi-Stock taken	5,000
Oct. 1	To, Ravi - Interest on Loan	350		By, Ravi-Sale Proceeds (Rs.1,90,000 – Rs. 17,000 Rs. 9,000 – Rs. 4,000) = Rs. 7,000 + 40% of 7,000	9,800
	To, Suresh - Commission (5% on Rs. 2,38,000)	11,900		By, Ravi - Stock (Transferred to wholesale dealer)	9,000
Nov.30	To, Ravi - Commission (5% on Rs. 9,800)	490			
	To, Profit on Venture:				
	Ravi - (3/5) 34,590				
	Suresh - (2/5) 23,060	57,650			
		2,61,800			2,61,800

In the books of Ravi

Dr. **Joint Venture with Suresh** Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020			2020		
July 1.	To, Bank (Purchase of goods)	1,90,000	Aug.1	By, Cash	13,410
Aug. 1.	To, Bank (freight)	1,410	Nov.30	By, Stock taken	5,000
Oct. 1.	To, Bank (Interest on loan)	350		By Stock transferred to Wholesale dealer	9,000



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Nov.30	To, Commission	490		By, Bank (Sale Proceeds)	9,8000
	To, Share of Profit	34,590		By, Bank (Final settlement)	1,89,630
		2,26,840			2,26,840

In the books of Suresh

Dr.

Joint Venture with Ravi

Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020			2020		
Aug. 1.	To Cash	13,410	Oct.1	By Bank (Sale Proceeds)	2,38,000
Oct. 1	" Commission	11,900			
Nov.30	" Share of Profit	23,060			
	" Bank (Final settlement)	1,89,630			
		2,38,000			2,38,000

Illustration 31.

M and N decided to work in partnership with the following scheme, agreeing to share profits as under :

M - $\frac{3}{4}$ th share.

N - $\frac{1}{4}$ th share.

They guaranteed the subscription at par of 10,00,000 shares of Rs. 1 each in U. Ltd. And to pay all expenses up to allotment in consideration of U. Ltd. issuing to them 50,000 other shares of Rs. 1 each fully paid together with a commission @ 5% in cash which will be taken by M and N in 3 : 2.

M and N introduced cash as follows:

	Rs.
M- Stamp Charges, etc.,	4,000
Advertising Charges	3,000
Printing Charges	3,000
N- Rent	2,000
Solicitor's Charges	3,000

Application fell short of the 10,00,000 shares by 30,000 shares and N introduced Rs. 30,000 for the purchase of those shares.

The guarantee having been fulfilled, U. Ltd. handed over to the venturers 50,000 shares and also paid the commission in cash. All their holdings were subsequently sold by the venturer N receiving Rs. 18,000 and M Rs. 50,000.



Study Note - 5 : Accounting for Special Transactions

Write-up necessary accounts in the books of both the parties on the presumption that Memorandum Joint Venture Account is opened for the purpose.

Memorandum Joint Venture Account					
Dr.					Cr.
Particulars	Amount (Rs.)	Amount (Rs.)	Particulars	Amount (Rs.)	Amount (Rs.)
To, N : Cost or Shares		30,000			
To, M : Stamp Charges etc,	4,000				
Advertising Charges	3,000		N : Commission (2/3)		30,000
Printing Charges	3,000	10,000	By M : Sale Proceeds		20,000
To, N : Rent	2,000				
Solicitor's Charges	3,000	5,000			
To, Profit on Venture :					
To, M - $\frac{3}{4}$	54,750				
To, N - $\frac{1}{4}$	18,250	73,000			
		1,18,000			1,18,000

In the books of M

Joint Venture with N			
Dr.			Cr.
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Bank : Stamp, Adv. And Printing Charges	10,000	By, Bank : Commission	30,000
To, Share of Profit	54,750	By, Bank : Sale Proceeds	50,000
To, Bank (Remittance)	15,250		
	80,000		80,000

In the books of N

Joint Venture with M			
Dr.			Cr.
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Bank : Cost of Shares	30,000	By, Bank : Commission	20,000
To, Bank : Rent and Solicitor's Charges	5,000	By, Bank : Sale Proceeds	18,000
To, Share of Profit	18,250	By, Bank (Remittance)	15,250
	53,250		53,250



5.3.3 Joint Venture Business on Consignment Principle

The co-venturers may decide to appoint an agent for selling goods on their behalf on consignment basis. He is allowed expenses and commission on sales. The agent would remit the cash to co-venturers. In such case in addition to Joint Venture A/c and the co-venturer's A/c a separate Account is maintained for the agent as well.

The Agent's A/c is debited with the sales proceeds received by him and credited with the expenses incurred and commission payable to him.

Hence additional entries are:

- (i) Goods sold by the agent

Agent's A/c	Dr.
To, Joint Venture A/c	

- (ii) Expenses & commission entitled to agent

Joint Venture A/c	Dr.
To, Agent's A/c	

- (iii) Payment received from agent

Bank A/c	Dr.
To, Agent's A/c	

- (iv) Cash paid by agent to co-venturers

Co-Venturers' A/c	Dr.
To, Agent's A/c	

Illustration 32

Sahani and Sahu entered into a joint venture to sale 800 bags of food grains. The business risks are to be shared in the ratio of 3:2 between them. Sahani supplied 400 bags at Rs. 800 per bag and paid freight Rs. 8,000 and insurance Rs. 2,000. Sahu sent 400 bags at Rs. 1,000 per bag. He paid Rs. 2,500 as freight, Insurance Rs. 8,000 and sundry expenses as Rs. 500. Sahani paid Rs. 50,000 as advance to Sahu.

They appointed Sandeep as agent for sale of grains. Sandeep sold all bags at Rs. 1,200 per bag. He deducted Rs. 21,000 as his expenses and commission of 5% on sales. He remitted Rs. 6,00,000 by cheque to Sahani and the balance to Sahu by way of a bill of exchange. The co-venturers settled their accounts. Prepare Joint Venture A/c Sahu's A/c and Sandeep's A/c in the books of Mr. Sahani.



Study Note - 5 : Accounting for Special Transactions

Solution:

Books of Sahani

Dr.		Joint Venture Account		Cr.	
Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
To, Food grains A/c (400*800)		3,20,000	By, Sandeep A/c - sales (800*1200)		9,60,000
To, Bank A/c - freight & insurance		10,000			
To, Sahu A/c - food grains (400*1000)		4,00,000			
To, Sahu A/c - expenses		11,000			
To, Sandeep A/c - expenses		21,000			
To, Sandeep A/c - commission 5%		48,000			
To, Profit & Loss A/c 3/5th share		90,000			
To, Sahu A/c 2/5th share		60,000			
		9,60,000			9,60,000

Dr.		Sahu's Account (Co-venturer)		Cr.			
Particulars		Amount (Rs.)		Particulars		Amount (Rs.)	
To, Bank A/c - advance		50,000		By, Joint Venture A/c - grains		400,000	
To, Sandeep A/c - bill		2,91,000		By, Joint Venture A/c - expenses		11,000	
To, Bank A/c - final balance		1,30,000		By, Joint Venture A/c - profit share		60,000	
		4,71,000				4,71,000	

Dr.		Sandeep's Account (Agent)		Cr.	
Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
To, Joint Venture A/c - sales		9,60,000	By, Joint Venture A/c - expenses		21,000
			By, Joint Venture A/c - commission		48,000
			By, Bank A/c - cheque received		6,00,000
			By, Sahu A/c - Bill		2,91,000
		9,60,000			9,60,000

**5.3.4 Conversion of Consignment in to JV**

A variation could be that an ongoing consignment arrangement may get converted into a joint venture arrangement. In Such case, a normal accounting for consignment business is done till the conversion. Upon the conversion, the balance stock on consignment is transferred to the Joint Venture A/c and from that day onwards, accounting is done on the basis of principles followed for joint venture.

Illustration 33.

Daga of Kolkata sent to Lodha of Kanpur goods costing Rs. 40,000 on consignment at a commission of 5% on gross sales. The packaging and forwarding charges incurred by consignor amounted to Rs. 4,000. The consignee paid freight and carriage of Rs. 1,000 at Kanpur. Three-fourth of the goods were sold for Rs. 48,000. Then the consignee remitted the amount due from him to consignor along with the account sale, but he desired to return the goods still lying unsold with him as he was not agreeable to continue the arrangement of consignment. He was then persuaded to continue on joint venture basis sharing profit or loss as Daga 3/5th and Lodha 2/5th.

Daga then supplied another lot of goods of Rs. 20,000 and Lodha sold out all the goods in his hand for Rs. 50,000 (gross). Daga paid expenses Rs. 2,000 and Lodha Rs. 1,700 for the second lot of goods.

Show necessary Ledger A/c in the books of both parties. No final settlement of balance due is yet made.

Solution:**Books of Daga**

Dr.		Consignment to Lodha Account		Cr.	
Particulars		Amount (Rs.)	Particulars		Amount (Rs.)
To, Goods Sent on Consignment A/c		40,000	By, Lodha's A/c (sales)		48,000
To, Bank A/c (packing & dispatching)		4,000	By, Joint Venture with Lodha A/c		
To, Lodha's A/c :			(stock transferred on conversion to JV)		11,250
Freight & Carriage		1,000			
Commission		2,400			
To, P & L A/c		11,850			
		59,250			59,250



Study Note - 5 : Accounting for Special Transactions

Dr. Lodha's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Consignment A/c - sales	48,000	By, Consignment A/c- expenses	1,000
		By, Consignment A/c - commission	2,400
		By, Cash A/c	44,600
	48,000		48,000

Dr. Joint Venture with Lodha Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Consignment to Lodha A/c	11,250	By, Balance c/d	42,280
To, Goods A/c	20,000		
To, Bank A/c - expenses	2,000		
To, P & L A/c (profit)	9,030		
	42,280		42,280

Books of Lodha

Dr. Daga's Account (as consignor)		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Cash A/c- expenses	1,000	By, Bank A/c - sales	48,000
To, Commission A/c	2,400		
To, Bank A/c - remittance	44,600		
	48,000		48,000

Dr. Joint Venture with Daga Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To, Cash A/c - expenses	1,700	By, Bank A/c - sales	50,000
To, P & L A/c (profit)	6,020		
To, Balance c/d	42,280		
	50,000		50,000



Working note:

Dr.		Memorandum Joint Venture Account		Cr.
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)	
To, Daga A/c - goods	11,250	By, Lodha A/c - sales	50,000	
To, Daga A/c- goods	20,000			
To, Daga A/c- expenses	2,000			
To, Lodha A/c- expenses	1,700			
To, Net Profit :				
Daga 3/5th Share	9,030			
Lodha 2/5th share	6,020			
	50,000		50,000	

Illustration 34

Satish and Sunit made a JV to underwrite the subscription at par of the equity share capital of Soft Systems Ltd. consisting of 100,000 shares of Rs. 10 each. They agreed to pay all expenses up to the allotment of shares. They agreed to share profits or losses in the ratio of 3:2. The consideration in return for this underwriting was allotment of 12,000 other shares of Rs. 10 each at par to be issued to them fully paid. Satish provided for Rs. 12,000 registration fees, Rs. 11,000 advertisement, Rs. 7,500 for printing & distributing prospectus and Rs. 2,000 for printing & stationery. Sunit paid Rs. 3,000 office rent, Rs. 13,750 as legal charges, and Rs. 9,000 salary of clerks. The issue fell short by 15,000 shares. Satish took these over on joint A/c by paying for the same in full. He sold the entire holding at Rs. 12 (net). Sunit sold the 12,000 shares allotted as consideration at the same price.

Prepare necessary ledger accounts in the books of both parties.

Solution:

Dr.		Books of Satish Joint Venture Account		Cr.
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)	
To, Bank A/c - expenses :	12,000	By, Bank A/c- sales		
Registration Fees Advertising	11,000	15000 shares @12	1,80,000	
Prospectus Printing	7,500	By, Sunit's A/c - sales		
		12000 shares @12	1,44,000	
Printing & Stationery	2,000			



Study Note - 5 : Accounting for Special Transactions

To, Sunit's A/c - expenses :			
Office rent	3,000		
Legal charges	13,750		
Salary	9,000		
To, Bank A/c - 15,000 shares @ 10	1,50,000		
To, P & L A/c (3/5th share)	69,450		
To, Sunit A/c (2/5th share)	46,300		
	3,24,000		3,24,000

Dr.		Sunit's Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Joint Venture A/c - sales	1,44,000	By, Joint Venture A/c - expenses	25,750		
		By, Joint Venture A/c - profit	46,300		
		By, Bank A/c - balance paid	71,950		
	1,44,000		1,44,000		

Dr.		Books of Sunit (Satish's Account)		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)		
To, Joint Venture A/c - sales	1,80,000	By, Joint Venture A/c - expenses	32,500		
To, Bank A/c - balance paid	71,950	By, Joint Venture A/c - cost of shares	1,50,000		
		By, Joint Venture A/c - profit	69,450		
	2,51,950		2,51,950		

5.4 SALE OF GOODS ON APPROVAL OR RETURN BASIS

5.4.1 Introduction

Sometimes goods are sent to Customs with an option either to accept the goods or to reject the goods within a stipulated time. This type of transactions is known as "Sale on Approval Basis" or "Sale on Return Basis". The main purpose of this type of sale is to boost up sales although this facility usually goes to very few reliable customers.



It must be remembered that when goods are sold on approval basis it is nothing but a mere transfer of goods and not the ownership. Since the ownership is not transferred it cannot be called a sale. It will be treated as a sale only when the approval of customer is received about the goods.

5.4.2 Methods of Accounting

Three methods of accounting are usually followed for recording "sale on approval or return basis" transactions, viz.

- (a) When there are only a few transactions
- (b) When there are considerable number of transactions
- (c) When there are many transactions.
- (a) When there are only a Few Transactions Accounting steps

- (i) When goods are sent

Debtors A/c.	Dr.
To, Sales A/c.	

- (ii) If goods are taken or approval is received NO ENTRY

- (iii) When goods are returned

Sales A/c.	Dr.
To, Debtors A/c.	

- (iv) When goods are not taken or returned

Closing stock A/c.	Dr.
To, Trading A/c.	

(at cost price)

- (v) If the consent of the customer is not yet received

(a) Sales A/c.	Dr.
To, Customer A/c.	

(b) Closing stock A/c.	Dr.
To, Trading A/c.	

Illustration 35.

Mr. Haridas sends goods to his customers on sale or return basis. The following transactions took place during the month of April 2020 :



Study Note - 5 : Accounting for Special Transactions

April 4.	Goods sent on Sale or Return basis at cost plus 20%	60,000
8.	Goods returned by customers	15,000
20.	Sale information received from customers	30,000
30.	No intimation received about the goods (i.e., neither sold nor returned)	12,000

Assume that the accounts are closed on 31st March every year and Haridas records the above transactions as ordinary sales basis.

Solution:

In the books of Haridas

Date	Particulars		L.F.	Dr. (Rs.)	Cr. (Rs.)
4.4.2020	Debtors A/c	Dr.		60,000	
	To, Sales A/c				60,000
	(Being goods sent on sale or approval basis and treated as sales))				
8.4.2020	Returns Inward/ Sales A/c	Dr.		15,000	
	To, Debtors A/c				15,000
	(Being goods returned by customers)				
20.4.2020	NO ENTRY			1,000	
					1,000
30.4.2020	Sales A/c.	Dr.		12,000	
	To, Trading A/c.				12,000
	(Being the cancellation entry)				
	Closing Stock A/c.	Dr.		10,000	
	To, Trading A/c. (Recorded at cost price)				10,000

(b) When there are Considerable Number of Transactions

Under the circumstances, the recording of transactions is not done as per above method. In this case, a separate Sales or Return Day Book is maintained. It is divided into four parts viz.,

- First column - for recording goods sent on approval
- Second column - for recording goods which are sold
- Third column - for recording goods which are returned, and
- Fourth column - for recording balance of stock of goods



Illustration 36.

Mr. X sends out the following goods to his customers on sale or return basis in the month of April 2020. You are requested to prepare Sale or Return Day Book for the month of April 2020 for the following transactions assuming that the transactions are in considerable numbers.

Date 2020	Particulars	Amount	Date 2020	Particulars
April 1	A Sen	2,000	April 5	Retained all
5	P Das	1,000	9	Returned all
12	T Mukherjee	3,000	20	50% retained and 50% returned
18	H Banerjee	500	25	Goods returned value Rs. 400 and no intimation was received for the balance
30	C Saha	1800		Neither intimation received nor goods returned

Solution:

Sale or Return Day Book

Goods sent out			Goods sold			Goods returned		Balance
Date 2020	Particulars	Amount (Rs.)	Date 2020	LF	Amount (Rs.)	Date 2020	Amount (Rs.)	Amount (Rs.)
April 1	A Sen	2,000	April 5		2,000			
5	P Das	1,000				April 9	1,000	
12	T Mukherjee	3,000	20		1,500	20	1,500	
18	H Banerjee	500				25	400	100
30	C Saha	1,800						1,800

Value of stock amounted to Rs1,900 and valuation should be made on the basis of cost price or market price whichever is lower.

(c) When there are many Transactions

This method is applicable where the number of transactions in a period is fairly large and numerous in

character. Under this circumstances, the following three books are opened :

- (i) Sale or return Day Book;
- (ii) Sale or Return Journal; and
- (iii) Sale or Return Ledger

- (i) Sale or Return Day Book;

Study Note - 5 : Accounting for Special Transactions

Sale or Return Day Book records the transactions relating to goods sent on sale or return on approval basis where such transactions are accrued. This book can be compared with the subsidiary books, viz. Sale Day Book, Purchase Day Book, etc.

Format of Sale or Return Day Book is given below :

(i) Sale or Return Day Book

Date	Particulars, Name of the Parties	Sale or return ledger Folio No.	Amount

(ii) Sale or Return Journal

Goods sold					Goods returned			
Date	Particulars	Sale of return LF No.	Sales LF No.	Amount (Rs.)	Date	Particulars	Sale of return LF No.	Amount (Rs.)

(iii) Sale or Return Ledger:

Like ordinary sale, i.e., when sales are made, they are at first recorded in Sales Book and then personal account is debited and Sales Account is credited. In the same manner, transactions which are recorded in the Sale or Return Book, i.e., personal account are debited and Sale or Return account credited. Thus, a separate ledger viz., Sale or Return ledger is opened for recording the transactions of the parties to whom goods have been sent on Sale or Return Basis.

Illustration 37.

X Ltd. sends out the following goods to their customers during the period April 2020 on Sale or Return basis.

Date 2020	Particulars	Amount	Date 2020	Particulars
April 1	S Bose	2,000	April 8	Retained all
5	S Basu	1,000	12	Returned all
8	S Sen	500	18	Goods sold for Rs. 400 and the balance returned
20	S Mukherjee	1,500	25	Goods returned Rs. 800 but no intimation regarding the balance
25	S Das	1,200		



Paper III: Financial Accounting-2

Show how the transactions will be recorded in the books of the firm assuming that the transactions are large in number.

Solution :

In the books of X Ltd. Sale or Return Day Book

Date	Particulars, Name of the Parties	Sale or return Folio No.	Amount
April 1	S Bose	15	2,000
5	S Basu	16	1,000
8	S Sen	17	500
20	S Mukherjee	18	1,500
25	S Das	19	1,200
			6,200
S or R L.F. No. 1			

Sale or Return Journal

Goods sold					Goods returned			
Date	Particulars	Sale of return LF No.	Sales LF No.	Amount (Rs.)	Date	Particulars	Sale of return LF No.	Amount (Rs.)
April 1	S Bose	15	40	2,000	April 12	S Basu		1,000
8	S Sen	17	45	400	8	S Sen		100
					25	S Mukherjee		800
				2,400				1,900
				S or Ret LF No. 1				S or Ret LF No. 1

Sale or Return Ledger

Dr. Goods on Sale or Return Account Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020			2020		
April	To, Sundries (Sales)	2,400	April	By Sundries	6,200
	To, Sundries (Returns)	1,900			
	To, Balance c/d	1,900			
		6,200			6,200



Study Note - 5 : Accounting for Special Transactions

Dr. S Bose Account			Cr.		
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020			2020		
April 1	To, Goods on Sale or	2,000	April 8	By, Goods on Sale or	
	Return A/c.			Return A/c. (Sales)	2,000
		2,000			2,000

Dr. S Basu Account			Cr.		
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
April 5	To, Goods on Sale or	1,000	April 12	By, Goods on Sale or	1,000
	Return A/c.			Return A/c. (Returns)	
		1,000			1,000

Dr. S Sen Account			Cr.		
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020			2020		
April 5	To, Goods on Sale or	500	April 18	By, Goods on Sale or	400
	Return A/c.			Return A/c. (Sales)	
				By, Balance c/d	100
		500			500

Dr. S Mukherjee Account			Cr.		
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
Apr. 20	To, Goods on Sale or	1,500	Apr. 25	By, Goods on Sale or	800
	Return A/c.			Return A/c	
				By, Balance c/d	700
		1,500			1,500

Dr. S Das Account			Cr.		
Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
Apr. 1	To, Goods on Sale or	2,000	Apr. 25	By, Goods on Sale or	2,000
	Return A/c.			Return A/c (Sales)	
					2,000
		2,000			2,000



Trial Balance as at 30th April 2020

Heads of Income	Debit (Rs.)	Credit (Rs.)
Goods on Sale or Return A/c. S Mukherjee A/c.		1,900
S Mukherjee A/c.	700	
S Das A/c	1,200	
	1,900	1,900

Illustration 38

S Ltd. sells goods on Sale or Return basis. Customers having the choice of returning the goods within 9 months. During April 2020, the following are the details of the goods sent.

Date 2020	Customers	Value (Rs.)	Proforma Invoice No.
April 2	G	20,000	002
4	H	36,000	005
16	I	50,000	017
20	J	16,000	020
24	K	42,000	031
28	L	60,000	060

Within the stipulated time G and I returned the goods while H, J and K informed that they have accepted the goods. Show the following accounts in the books of the firm.

Sale on Approval Account and Customers for Sale on Approval Account as on 15th May 2020.

Solution.

In the books of S Ltd.

Dr.

Sale on Approval Account

Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
2020			2020		
April	To, Customers for Sale on Approval A/c.		April	By, Customer for Sale on Approval A/c.	
2	- Returned by G	20,000		- G	20,000
4	- Sold to H	36,000		- H	36,000
16	- Returned by I	50,000		- I	50,000
20	- Sold to J	16,000		- J	16,000
24	- Sold to K	42,000		- K	42,000
30	To, Balance c/d	60,000		- L	60,000
		2,24,000			2,24,000



Study Note - 5 : Accounting for Special Transactions

Dr.

Customers for Sale on Approval Account

Cr.

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
April	To, Sale on Approval		April	By, Sale on Approval A/c.	
	A/c.			- Returned by G	20,000
2	- G	20,000		- Sold to H	36,000
4	- H	36,000		- Returned by I	50,000
16	- I	50,000		- Sold to J	16,000
20	- J	16,000		- Sold to K	42,000
24	- K	42,000		By, Balance c/d	60,000
	- L	60,000			
		2,24,000			2,24,000



This image shows a full page of white paper with horizontal dotted lines. The lines are evenly spaced and run across the width of the page, providing a guide for handwriting practice. There are no margins, text, or other markings on the page.