IVC Course Code : 212

ACCOUNTING & TAXATION (A & T)

SECOND YEAR

(w.e.f.2019 – 20)

Intermediate Vocational Course

Paper I	:	**Auditing**
Paper II	:	**Accontancy And Tally**
Paper III	:	**Taxation - II**

STATE INSTITUTE OF VOCATIONAL EDUCATION

BOARD OF INTERMEDIATE EDUCATION, A.P.

Text Book Development Committee

Paper -I Auditing

AUTHOR

Subhakar Pedapudi M.Com, M.B.A, LL.B, B.Ed,.,
Lecturer in Commerce
P.B. Siddhartha College of Arts & Science,
VIJAYAWADA

Paper-II Accountancy And Tally

AUTHOR

Dr.G. Venkatesh, M.Com, M.Phil, Ph.D.,
Junior Lecturer in Accountancy And Taxation
Govt Junior College,
Kothacheruvu, ANANTAPUR

Paper-III Taxation- II

AUTHOR

E. Suvarnanjali, M.Com.,
Lecturer in Commerce
P.B. Siddhartha College of Arts & Science,
VIJAYAWADA

EDITOR

K. Narayana Rao, M.Com, M.B.A, M.Phil.,
Head, Department of Commerce
P.B. Siddhartha College of Arts & Science,
VIJAYAWADA

ACCOUNTING & TAXATION (A & T)

TEXT BOOK DEVELOPMENT COMMITTEE

S.No	Name	Designation	Signature
1	K. Narayana Rao Head, Department of Commerce P.B. Siddhartha College of Arts & Science, VIJAYAWADA	Editor	
2	Subhakar Pedapudi Lecturer in Commerce P.B. Siddhartha College of Arts & Science, VIJAYAWADA	Author	
3	Dr. G. Venkatesh Junior Lecturer in Accountancy And Taxation Govt Junior College, Kothacheruvu, ANANTAPUR	Author	
4.	E. Suvarnanjali Lecturer in Commerce P.B. Siddhartha College of Arts & Science, VIJAYAWADA	Author	

Smt. B.UDAYA LAKSHMI, I.A.S.

Commissioner & Secretary

Intermediate Education

ANDHRA PRADESH

GUNTUR

S.I.V.E Co – Ordinating Committee

Sri. Podili Yerraiah, M.Sc., B.Ed.
Professor
State Institute of Vocational Education
Commissioner of Intermediate Education, Guntur

Sri. B. Nageswara B.Com, B.L.,
Joint Secretary (Vocational)
Board of Intermediate Education, Vijayawada

Sri. Dr.G.V.S.R. Murthy, M.SC., Ph.D.
Lecturer
State Institute of Vocational Education
Commissioner of Intermediate Education, Guntur

DTP

Thuraka Ravi Kumar BA,B.Ed., PGDCA

ACCOUNTING & TAXATION (A & T)

Paper – I

Auditing

INDEX

UNIT 1

INTRODUCTION OF AUDITING

Introduction of Auditing: *Meaning of Auditing – Importance of auditing – Advantages of auditing – Difference between auditing and accountancy – Meaning of investigation – Difference between auditing and investigation – Circumstances investigation conducted.*

Structure

1.1 Meaning of auditing
1.2 Importance of auditing
1.3 Advantages of auditing
1.4 Difference between auditing and accountancy
1.5 Meaning of investigation
1.6 Difference between auditing and investigation
1.7 Circumstances investigation conducted.

Learning Objectives

After studying this unit the student will be able to

- Understand the meaning and importance of auditing
- Understand the differences between auditing and accountancy
- Understand the meaning of investigation
- Understand the differences between auditing and investigation

1.1. Meaning of auditing

The word 'Audit' is derived from the Latin word "Audire" which means to hear. An audit is a simple form developed with the organized system of accounting. In early period person appointed to check the accounts used to hear from the bookkeeper matter relating to the transaction of the business. In course of time the mode of audit changed according to accounting system of different types of business. Auditing is a specialized function having complex, legal, economic implications.

Auditing is concerned with the verification of accounting data with determining the accuracy and reliability of accounting statements. Verificationof accounting data involves a careful evaluation of evidence available to the auditor in support of monetary transactions. The auditor examines internal evidence i.e. the records vouchers and books of accounts. Auditing thus primarily involves testing the reliability, competency and adequacy of evidence in support of financial transaction of an organization. It is not mechanical ticking of entries in books of accounts with the vouchers of the other records.

Auditing is the process of testing and weighting of evidence. It is analytical, critical and investigative. It has its principle roots not in accounting which it reviews but in logic on which it leans heavily for ideas and method. As well laid out and implemented audit programme helps in auditor to arrive at proper conclusion regarding the accounting statements and they help him to formulate his opinion.

Definition

Auditing is concerned with the checking of the accounts of the business with a view to find out correctness of the entries recorded in the books of accounts truthful of the transactions and of the result of the business. Some important definitions of auditing may now be examined.

The most commonly accepted definition of audit is given by **Spicer and Pegler**. According to them can audit is such as examination of the books, accounts and voucher of business as will enable the auditor to satisfy himself that the balance sheet is properly drawn up, so as to give and fair view of the state of the affairs of the business and whether the profit and loss accounts gives a true and fair view profit or loss for the financial period, according to the best of the his information and the explanation given to him and as shown in books, and if not, in what respects he is not satisfied.

The institute of Chartered Accountants of India defines "Auditing is a systematic and independent examination of data, statements records operations and performance (financial or otherwise) of an enterprise". In any auditing situations the auditor perceives and recognizes the preposition before him for examination collects evidence evaluations the same and on this basis, formulated his judgment which it's communicated through his Audit Report.

Lawrence R.Dicksee defines "Auditing is an examination of accounting records undertaken with a view to establishing whether they correctly and completely reflect the transaction to which they relate. In some instance it may be necessary to ascertain whether the transaction themselves are supported by authority".

Montgomery defines "Auditing is a systematic examination of the books and the records of a business in order to ascertain or verify and the report upon the facts regarding its financial operations and the result thereof".

R.K.Mautz "Auditing is concerned with the verification of accounting data, determining the accuracy and reliability of accounting statements and reports".

Batliboi defined a "Audit as an intelligent and critical scrutiny the books of accounts with the documents an vouchers for which they relied upon for the purpose of ascertaining whether the working result for a particular periods as shown by the profit and loss account and also the exact financial condition of the business as reflected in the balance sheet are truly determine and presented by those responsible for their compilations".

A close analysis of the above definitions brings out clearly the following essential of auditing:

1. It is scientific thorough systematic examination of books and financial and legal records of the organization.
2. The purpose of this examination is to ascertain how far they present a true and correct a view of the state of affairs of particular concern.
3. The accounts have to be prepared by other and not by auditor.
4. The auditor must satisfy himself and honestly report the reliability and authenticity of the financial statements drawn from them.
5. The examination of accounting record may be made throughout the year of periodically and
6. The scope of audit is not limited only to the business concern but it may be duly to non-commercial concern also.

1.2 Importance of Auditing

With the rapid increase in the number of companies in the present century, this profession has assumed an ever-increasing role in the business community. It was so because the auditor played a vital role in instilling confidence in the public at large with regard to company form or organization by revealing the fact to them and imposing to check the upon the management . Its strides forwards have been tremendous since various countries passed Company legislation with provision making the adult of joint stock companies compulsory. This turned out to be instrumental in establishing it as major profession. This trend was also reinforced by after statutory enactments.

The scope and importance of auditing has been further enlarged by the provisions in the budget of 1948, besides the Joint stock companies, the audit has been made compulsory for other business firms and profession also. It has been provided that in all cases, where the annual turnover exceeds Rs.20 lakhs or where the gross from profession excess Rs.10 lakhs the audit of the accounts would be compulsory. This has been provided to ensure that the books of accounting and often records are properly finalized and faithfully reflect the true income of the Tex. players. Thus a large number of business firms and professional would have to get their books on accounts compulsory audited now.

1.3 Advantages of Auditing

There are advantages in auditing the accounts even when there is no legal obligation for doing so. Some of the advantages are listed below.

1. Audited accounts are readily accepted in Government authorities like income Tax Dept., Sales Tax dept., Land Revenue departments, banks etc.

2. By auditing the accounts Errors and frauds can be detected and rectified in time.
3. Audited accounts carry greater authority than the accounts which have not been audited.
4. For obtaining loan from financial institutions like Banks, LIC, HUDCO, HDFC, IFCI etc., previous years audited accounts evaluated for determining the capability of returning the loan.
5. Regular audit of account create fear among the employees in the accounts department and exercise a great moral influence on clients staff thereby restraining them from commit frauds and errors.
6. Audited accounts facilitate settlement of claims on the retirement/ death of a partner.
7. In the event of loss of property by fire or on happening of the event insured against, Audited accounts help in the early settlement of claims from the insurance company.
8. In case of joint Stock Company where ownership is separated from management, audit of accounts ensure the shareholders that accounts have been properly maintained, funds are utilized for the right purpose and the management have not taken any undue advantage of their position.
9. To determine the value of the business in the event of purchase or sales of the business, audited account will be the treated as the base for the evaluation.
10. The audit of accounts by a qualified auditor also help the management to understand the financial position of the business and also it will help the management to take decision on various matters like report in internal control system of the organization or setting up of an internal audit department etc.
11. If the accounts have been audited by an independent person, disputes between the management and labor unions on payment of bonus and higher wages can be settled amicably.

In the event of admission of a new partner, audited accounts will facilitate the formation of terms and conditions for joining the new partner. Last 3 years audited accounts and balance sheet will give a general idea about the growth and financial position of the business to the new partner.

Limitations of Auditing

Even though it offers many advantages to the various sections of the society; still it suffers from the following limitations.

1. **Auditing does not reveal the complete picture:** Auditor has todepend on the facts shown by the books. Auditing may not reveal the manipulation of accounts.
2. **May not get complete or correct information or full explanation:** Auditor has to depend on the explanation and information from the client. As such his report may become handicap.

3. **An auditor is not expected to be expert in all the areas:** He cannot be supposed to have the knowledge of an engineer or an advocate in practice. Auditing may not serve any purpose unless until the auditor is quite independent and possess high moral standards.

4. **No guarantee of correctness:** Auditing does not give any guarantee as to correctness of the financial account of the concern.

5. **Even the audited accounts may be incorrect sometimes:** Sometimes the audited accounts may not be correct.

6. **Auditing is more like a postmortem examination:** No use of past events of those already occurred. It is more helpful for past and less helpful for the future.

7. Audit work is under taken by auditor in a phased way and he is not able to remain independent.

8. Nothing to do with policies: Audit has nothings to do with policies, efficiency and effective management.

9. Auditor does not disclose to the owners as to how their capital might have been used in a better way.

Accountancy and Auditing

Book keeping is an art of recording all the business transaction in the books of account and is mainly related to books of original entry as well as Ledger. This work is, in general entrusted to junior employees under the direct supervision of accountants. They generally do not process any specialized training as the work of mechanical nature and in the advanced countries various machines are used for such jobs, Accountancy is mainly concerned with the preparation of summaries and analysis of the records furnished by book keeping.

Earlier no differentiation was made between accountancy and book keeping but with the increase in size and complexity of busyness became essential.
Accountancy begins where book keeping ends. It is concerned with

a. Ensuring that all financial transaction have been correctly recorded in the books of account.
b. Preparing trial balance.
c. Preparing profit and loss account and balance sheet.
d. Passing adjustments and rectification of entries.

Auditing begins where accounting ends. Auditing is quite distinct from book keeping and accountancy as they differ in their respective objects and nature. This distinguished feature of auditing is that it analytical and essentially retrospective where as accountancy is primarily constructive and concerned with current recording of business facts. The auditor examines the books of accounts, the profit and loss of account and balance sheet prepared by the accountant. An accountant is constructive where as auditor is primarily an analyst. Auditing is mostly carried out by trained professional accountants organized to offer their services to the public. In

India an auditor should be Chartered Accountant but such qualification is not necessary for an accountant responsible for the preparation of account of a concern.

1.4 Difference between Accountancy and Audit

Book – Keeping: It is the art of recording day-to-day transactions systematically in books of accounts. This part of work is performed by book-keeper. His job includes journalizing, posting, totaling and balancing of ledger accounts.

Accountancy: The work of accountant is to check arithmetical accuracy of accounts prepared by book-keeper. If any error or omission arises, it should be rectified. Finally, accountant is to prepare Trail balance, Trading and profit & loss A/c and Balance Sheet, incorporating necessary adjustments there in.

Auditing: He is concerned with critical examination and verification of accounts prepared by others. After completing his work, auditor has to submit a report of fact whether or not profit & loss a/c and balance sheet exhibit true and fair position of business.

The various points of differences between accountancy and auditing are as follows:

S. No.	Basis of Difference	Accountancy	Auditing
1.	Nature	In accounting, final accounts are prepared. Accountancy is constructive.	Auditing aims at examining the correctness of accounts prepared by Accountant. Auditing is analytical.
2.	Scope	Its scope is restricted to preparation of financial statements and their interpretation.	It is determined by the agreement between auditor and his client.
3.	Qualification	As accountant need not be a Chartered Accountant.	An auditor must be a Chartered Accountant.
4.	Object	The primary object of accountancy is to ascertain the trading results of business during a financial year and show the financial position of the concern.	The primary object of auditing is to certify the correctness and justification of financial statements prepared by accountant.
5.	Commencement	Accountancy begins where Book-keeping ends.	Audit begins where accountancy ends.
6.	Reporting	The accountant is not required to submit a report on accounts and statements prepared by him.	The auditor has to submit a report about correctness and presentation of accounts audited by him.
7.	Basis of Remuneration	The accountant is paid monthly salary.	The Auditor gets a fixed amount as per agreement with his client.
8.	Appointment	The accounting work is done by an employee of the concern and works directly under the control of management.	The auditor is an independent outsider appointed on contractual basis for a year.
9.	Level of Knowledge	An Accountant is not required to have knowledge of audit techniques and	An Auditor must have knowledge of accounting as well audit techniques and

		procedures.	procedures.
10.	Position	An accountant cannot act as an auditor. Therefore, not every accountant is an auditor.	But, every auditor is an accountant. An auditor can also act as an accountant.
11.	Status	An accountant is a permanent employee of the business concern.	An auditor is not a permanent employee of the concern.
12.	Duration	Accounting work is undertaken throughout the year.	Auditing is generally done at the end of financial year.
13.	Regulations applicable	Accounting is governed by any professional regulations.	Auditing is governed by code of conduct and standards laid down by the ICAI.
14.	Compulsion	Keeping of accounts is a must to know exact financial position and profitability of business at the end of financial year.	Audit is not compulsory except where this is required by the statute.

1.5 Meaning of Investigation

As investigation is a critical examination of the books and accounts with a specific objective, the following points should be kept in mind while doing the investigation:

a. It is essential for an investigator to make himself familiar with all the important details, documents, and contracts, books of accounts and legal documents about a business before the commencement of his work.
b. From time to time, the investigator should seek assistance of technical experts during the course of his enquiry.
c. The investigator in no way is influenced by the directors, managers and the senior officers of the business.
d. All details, reports, records should be kept secret by the investigator.

Definition

Following are some of the definitions given by various authorities on the subject:

"The term 'investigation' implies an examination of the accounts of a business for some special purpose". **– Spicer and Pegler.**

"Investigation involves enquiry into the facts behind the accounts, i.e., into the technical, financial and economic position of the business organisation". **– Taylor and Perry.**

1.6 Auditing Vs. Investigation

Auditing is distinct from investigation. Investigation is the examination of the books of account for a specific purpose Ex. Detection of suspected fraud, continuing losses. High labour turnover inadequate working capital etc. Investigation may be conducted in addition to the regular audit of accounts. Investigation cover several year say 2, 4, 5 or 6 years to find out the average earning capacity financial position, etc., of concern while audit usually relates to one year.

Investigation may be carried out on behalf outsider while audit is conducted on behalf of the proprietor only. However investigation may also be carried out on behalf of proprietor in some cases where fraud is suspected. Given the specific nature objective an investigator is required to be more skilled, critical and cautions. The information required for this work may not be available ready-made. His inquiry for the necessary evidence will have to be beyond what appears in the books and records. Accordingly he must possess an alert, open eyed quality to distinguish the clues which may help him in getting at the tuff. Unlike the auditor he does not accept any fact or figure at its face value. He subjects it to close scrutiny. After careful analysis of the relevant evidence, he develops it to serve the interest of the person on whose behalf he has undertaken the work.

Account of Joint Stock Company must be audited according to law while investigation is not compulsory. The investigation is too concerned whether the financial policy of the company is being followed or not but in the case of auditor, he has to state that fact ex. Whether the method of the valuation of stock is being consistently followed or not, or whether there has been change in the method of providing depreciation and its effect on the profit etc.

1.7 **Circumstances investigation conducted**

The need of investigation may arise in many cases but there are some of the circumstances where the investigation is most frequently called for:

1. Investigation on behalf of a person who is interested to join a partnership firm as a partner.
2. Investigation on behalf of a person or company which wants to purchase a running business.
3. Investigation on behalf of a person who wants to lend money to business and is interested to know its financial position.
4. Investigation, in case the proprietor of the business, suspects a fraud.
5. Investigation on behalf of prospective shareholder who wishes to make a valuation of shares of a limited company.
6. An investigation when a person seeks different avenues of investment.
7. An investment under the Indian Companies Act. i.e., the statutory investigation.

Short Answer type Questions (2 Marks)

1. What is an Audit?
2. What is meant by Accounting?
3. Define Investigation.

Long Answer type Questions (6 Marks)

1. Explain the importance of Auditing.
2. Explain the Advantages of Auditing.
3. Explain the difference between accounting and Auditing.
4. What are the limitations of Auditing?
5. What are the differences between auditing and investigation?

Ψ

UNIT 2

OBJECTS OF AUDITING

Objects of Auditing: *Main objects – subsidiary objects – Detection of Errors and Frauds – Prevention of errors and fraud.*

Structure

Learning Objectives

After studying this unit the student will be able to

- Understand about main and subsidiary objects of auditing
- Understand the concept of detection and prevention of errors
- Understand the concept of detection and prevention of frauds

2.1 Objectives of Auditing

The fundamental object of auditing accounts is to find out after going through the books of accounts whether the balance sheet is prepared according to the prescribed from and it is exhibiting the correct and true financial position of the concern on the date on which it is prepared. The second object is to see whether the profit and loss accounts is properly prepared according to the companies Act and it is showing the correct and ex, act profit and loss of the concern for the period for which it is prepared.

Thus the primary object of audit always is the establishment of the degree of reliability of the financial statements and produces a report on the organization's financial condition and profitability. An auditor in order to satisfy himself about the accuracy of the books of accounts so that he may report upon the actual financial position and the working result of the organization must.

1. Examine the system of internal check.
2. Check the arithmetical accuracy of the books of accounts by verification the posting, casting and balancing etc.
3. Verify the authenticity and validity of transactions entered into the books with the relevant supporting documents.
4. Ascertain that proper distinction has been made between items of capital nature and those of a revenue nature and that the amounts of various items of income and expenditure corresponding to the accounting period.

5. Confirm the existence and value of assets and to verify liabilities.
6. Verify whether all the statuary requirements as regards the books of accounts that should be maintained as well as the form the form in which the final accounts should be drawn up have been duly complied with.

The main object of Auditing in the past was detection and prevention of frauds and errors. But changes in the nature and scope of auditing have brought about changes in the objects of auditing.The objects of modern audit are divided into two types, namely primary objects and subsidiary objects.

2.1.1 Primary Objects: The main or primary objective of auditing is to report whether the balance sheet presents a true and fair view of the state of affairs, and the profit and loss account present a true and fair view of the profit or loss for the financial period. According to **Taylor and Perry** "Today the main object of audit is to ensure that the accounts reveal a true and fair view of the business and its transactions".

2.1.2 Subsidiary Objects: While examining and verifying the accounts certain errors or frauds or both may be detected. Such detection and prevention of errors and frauds can be regarded as subsidiary object.The subsidiary objects of modern audit, are as follows:

1. Detection of errors.
2. Detection of frauds.
3. Prevention of errors and frauds.

2.2 Detection of errors: Thus the subsidiary objects of the auditing are

A. Detection of Errors: This is the fundamental objectfor the sole traders and partnership firms, it is the duty of the Auditor must pay attention for every error how much innocent it may be.The following are the types of errors

1. Error of omission
2. Error of commission
3. Error of principle
4. Compensating or offsetting errors
5. Error of duplication

1. **Error of Omission:** These errors arise when the transaction is entirely omitted from the books. The failure to record the sales in the sale book means the account if the customer who received the goods will not be debited and the sales account will not be credited by the amount of the omitted sale. Errors of omission do not in any way effect the trial balance.
2. **Error of Commission:** These are the most common errors. These errors consist of wrong entries, posting, additions, transfers etc. The following are the example of such error.
   a. Making a wrong entry in a book of original entry.
   b. An item for which double entry is not completed.
   c. An item posted to the wrong side of an account.

d. The same amount posted twice to an account.
e. Error in taking out balances of ledger accounts.
f. Error of commission may or may not affect the trial balance.

3. **Error of Principle:** These errors of principle arises when a particular entry of course has not been recorded according to the principles of double entry, of course errors of principle do not made between capital and revenue. An item of expenses may be debited to an asset account instead of to an expenses account or vice versa.
4. **Compensating Errors:** These are the error that counteracts each other. If is much difficult to discover such errors. These errors cannot.
5. **Errors of Duplication:** Such errors arise when a transaction is entered twice in the books or original entry and posted twice to the concerned ledger accounts. This may be either due to failure on the post of recording clerks to distinctly mark the invoices and other vouchers after these have been entered in the books of original entry.

   It is difficult to detect such errors as they will not affect the trial balance. Vouching should be done very carefully to detect such errors.

2.3 Detection of Fraud: Fraud means false representation of entry made intentionally or without belief in its truth with a view to defraud somebody. Detection of fraud is considered to be of the important duties of an auditor. As a matter of fact, originally audit was conducted mainly with a view to detect fraud whenever it was suspected. The system of internal check aims at the prevention of fraud. If the auditor finds that the internal check system is defective and will not prevent the commission of frauds, he should suggest a better system.

The following are the chief ways in which fraud may be perpetrated:

1. Embezzlement of Cash;
2. Misappropriation of Goods; and
3. Fraudulent manipulation of Accounts.

1. **Embezzlement of Cash:** There is greater possibility of defalcation of money in a big business house than in the case of a small proprietary business where the proprietor has a direct control over the receipts and payments of cash. In a big business house, the system of receipt and payment of cash should be such that the work of one clerk in automatically checked by another clerk. Such a system is known as auditing as “internal Check” system which will be dealt with in detail later on. It is easier to misappropriate cash, and, therefore, the auditor will do well to pay particular attention towards cash transactions.

Cash may be misappropriated by

a. Omitting to enter any cash which has been received: or
b. Entering less amount than what has been actually received; or
c. Making fictitious entries on the payment side of the cash book; or
d. Entering more amounts on the payment side of the cash book than what has been actually paid.

In order to discover fraud under (A) and (b) above, the auditor should check the debit side of the cash book and with rough cash, salesmen’s reports, counterfoils of the receipt books, agents’ returns and other original records while the fraud under (c) and (d) can be discovered by reference to the vouchers, wage sheets, salary book, invoice, etc.

2. **Misappropriation of Goods:** Again, fraud may be in respect of goods i.e., misappropriation of goods. This type of fraud is very difficult to detect especially when the goods are less bulky and are of higher value. Proper methods of keeping accounts in regard to purchases and sales, stock taking, periodical checking of stocks, comparing the percentage of gross profit to sales of two periods, necessity for collusion will help to avoid misappropriation of goods.

3. **Fraudulent manipulation of Accounts:** This type of fraud is more difficult to discover as it is usually committed by directors or managers or other responsible officials with the object of showing more profits than what actually they are:
   a. So that if they get commission on profits, they may get more commission or
   b. Their service may be retained by showing to the shareholders that because of their efficiency they have shown more profits and thus maintain the confidence of the shareholders or
   c. If they hold shares, they may sell them at high price by declaring higher dividends or
   d. To obtain further credit by showing the financial position of the business better than what actually it is or
   e. To attract more subscribers for the sale of the shares of the company, etc.

2.4 Prevention of Errors and Frauds: Prevention of errors and frauds is as important as detection. **But audit is a post mortem examination.** So an auditor cannot prevent the occurrence of errors and frauds. He does not do anything directly as far as prevention of frauds and errors is concerned. He can only report the defects in the accounting system to the management. He can advise his client to adopt certain methods to prevent their future occurrences. If his advice is taken in the right spirit chances of errors and frauds can be minimized internal check and controls can reduce the chances of errors and frauds.

Short Answer Type Questions (2 Marks)

1. Define Error.
2. What is Error of Omission?
3. What is Error of Commission?
4. What is Error of Duplication?
5. What is Error of Principle?
6. What is Compensative Error?
7. Define fraud.
8. What is Misappropriation of goods?
9. What is Cash embezzlement?

Long Answer Type Questions (6 Marks)

1. Explain the objectives of Auditing.
2. Define Error. Explain different types of errors.
3. Define fraud. Explain various types of frauds.

Ψ

UNIT 3

TYPES OF AUDIT

Types of Audit: *Types of audit – conduct of audit – methods of audit – Audit programme – Advantages and disadvantages of audit programme.*

Structure

Learning Objectives

After studying this unit the student will be able to

- Understand about various types of audit
- Understand about how to conduct the audit
- Understand the different types of auditing methods
- Understand about meaning and definition of audit programme
- Understand about advantages and disadvantages of audit programme

3.1 Type of Audit: The classification is meant to give understanding of the approaches to look upon the exercise of audit.

A. On the basis of scope: An audit examination can be general or specific. A general audit will cover all areas of business. On the other hand specific audit concentrates on particular areas or object. It can be further classified as follows.

1. **Partial audit:** When an auditor is asked to audit certain category of transactions or transactions made during a part of period it is known as partial audit. Ex: The auditor may be asked to audit the payment side of cash book.
2. **Occasional audit:** It is conducted as a special event, normally in those organizations where routine audits are not taking place. Ex: Where government orders a special audit to investigate into certain matters.
3. **Interim audit:** When an audit is conducted between two annual audits, such audit is known as interim audit. Sometimes it is concluded to enable directors to declare an interim dividend and also for purpose of dealing with interim figures of sales.
4. **Cost audit:** Cost audit is the complete checking and verification of cost accounts, to see whether the concern has followed cost accounting principles or not.
5. **Management audit:** A detailed and critical review of all objectives, policies, procedures and functions of management is made with a view to bring about an overall improvement in managerial efficiency.

6. **Performance audit:** Performance audit is to determine whether the various activities of organization are being carried out efficiently. It is aimed at ensuring an effective control in the organization.
7. **Standard audit:** The standard audit is defined as, "a complete check and analysis of certain items and contingent upon effective check, an appropriate test check on remaining items, the whole of the work being in accordance with general audit standards quite adequate to justify an unqualified opinion." Thus, it is a sample checking after a satisfactory and detailed checking of some of the items.
8. **Audit in depth:** It is another type of sample checking. In this type of audit selected transactions are subjected to a detailed stepwise verification. Such an audit gives the understanding of the procedures being adopted to carry out any transactions.
9. **Post and vouch audit:**It involves verification of every transaction from book of original entry and it's posting in ledger. The auditor uses different types of ticks for each aspect of examination like, posting and balancing etc. This type of audit can be adopted in small organizations and is not advisable in large organizations.
10. **Operational audit:** This audit aims at improving the operations of business. It is an aid to management in the following ways: A. To make recommendations for improvement of profitability of organization. B. To help in achieving other objectives of business such as worker's satisfaction, improvement in company's image etc.
11. **Cash audit:** When an audit is conducted of all the items of cash book, it is known as cash audit. Auditor will check receipt and payments made by cash and bank with the vouchers and other documents. It is only partial audit.
12. **Tax audit:** Sometimes, specific information may be required by certain people, which may not be available in financial statements. Under Income Tax Act, profits shown by profit and loss account have to be adjusted as per the provisions of the Act. In this way profits for accounting and profits for taxation are not the same. Some of the causes of difference in such profits are: A. Method of depreciation may differ. B. Only actual expenses and bad debts are allowed under Income Tax Act.
13. **Secretarial audit:** Secretarial audit is concerned with verification compliance by the company of various provisions of companies act and other relevant laws, any default thereof may attract leaves penalties for the company, directors and other officials. The secretarial audit report includes 1. Whether various books are maintained as per Companies Act, 1956. 2. Whether necessary approval as required from Central government, company law board were obtained. 3. Whether meetings of shareholders and directors were held as per law and necessary records thereof maintained.

B. **On the basis of nature of activity:** The activities which are the subject matter of an audit may be commercial or non-commercial. While the audit of profit motive organizations can be called commercial audit. The audit of nonprofit organizations will fall under non-commercial audit.

C. **On the basis of form of organization:** On this basis audit may be classified as Private and Government. Audit of Government offices and departments is covered under this heading. A separate department is maintained by Government of India, known as Accounts and Audit Department. This department is headed by comptroller and Auditor General of India. When the audit is not a statutory requirement, but is conducted at the desire of owners, such audit is a private audit.

D. **On the basis of who conducts the audit:** On this basis, audit is classified into independent and internal audit. An independent audit is conducted by an independent, professionally qualified person who is not an employee of organization. On the other hand internal audit is conducted by employees of organization to enable better exercise of managerial control.

E. **On the basis legal necessity:** On this basis audit can be classified into statutory and non-statutory audit. An audit by qualified persons which is a compulsory requirement under law is known as statutory audit. The various matters relating to conduct of audit appointments, duties, and rights, liabilities of auditors are provided in concerned statute. Ex: Co-operatives, Trust, Banking, Insurance and electricity companies etc. Where audit is conducted without any legal necessity or requirement, audit is called non-statutory audit such as individuals and others.

F. **On the basis of method of examination:** On this basis audit can be classified as continuous audit and completed audit. When auditor and his staff are constantly engaged in work during whole year or period at regular or irregular intervals, the audit is known as continuous audit. On the other hand the audit conducted after annual closure of accounts is known completed, periodical, annual or final audit. When the audit is concerned with items of balance sheet only it is called balance sheet audit.

An audit examination may be performed in many ways, depending on needs and convenience of the enterprise. It may be once in year after the financial statements have been prepared or continuously round the year at regular or irregular intervals. On the basis of organizational structure of the enterprises under audit, independent audit may be classified as statutory audit and private audit.

a. Statutory Audit: Where audit in the case of an enterprise is made compulsory by law it is called statutory audit. Statutory audit is carried out in the case of following organizations.

a. Joint stock companies registered under the companies act.
b. Banking companies regulated under the banking companies act of 1949.
c. Insurance companies governed by insurance at 1938.
d. Cooperative societies registered under various religious societies act of the states.
e. Public and charitable trust registered under various religious and endowment acts.
f. Public corporations set up under the act of parliament or state legislatures.

Important Features: The main features of statutory audit are as under

a. The audit is to be carried out only by person who are qualified under the Chartered Accountant Act of 1949.
b. The rights duties and liabilities of an independent auditor are governed by the law. They cannot be curtailed by the owner, share holder of the enterprise.
c. An independent auditor is to represent the share holder owners, and is not to sub serve the interest of the management of the enterprise.
d. A statutory audit cannot be partial or incomplete in any respect.

Advantages: The share holders of company have no access to the books of account and therefore the accounts which have been maintained by the director are audited by an auditor. Share holder naturally look up to the auditor for his expert opinion as to the claims made by the management regarding of business operation and financial conditions of the enterprises. Moreover in the present day world these are multifarious means of credit available to company and the economic importance of its business activities has vastly increased. As such a compulsory independent reporting on its statements by a professionally qualified and competent person is only proper. An auditor acts as check upon dishonest employees whose number may be very large in the organization.

In case of cooperative societies or societies registered under the societies registration act, a compulsory audit serves the triple purpose of

a. Being a check against frauds by the managing committee.
b. Helping in the proper maintenance of books and accounts and
c. Shielding the member of the managing committee against uniformed and baseless criticism.

In case of statutory corporation the need and importance of a compulsory independent audit cannot be over emphasized because they are financed by public money.

b. Audit of Trustee Accounts: Trust is created for the benefit of some institutions, widows, orphans, minor etc. The trustee looks after the property left over by the testator. They collect the results of the property dividends on the areas etc., and distribute the income of the beneficiaries according to the terms of the trust deed. As the widows, minor etc., for the benefit of whom these trust are created are not in position have access to the books of account or criticize them they may be defrauded by the trustees. Hence a compulsory independent audit is necessary not only to protect the interest of the beneficiaries against possible frauds by the trustee, but also in the interest of the trustee themselves has who may not possess adequate knowledge of the Trust law.

c. Private Audit: Where audit in the case of enterprises is not compulsory by law, though it is opted for by the enterprises in view of the several benefits resulting from it, is called private audit. The purpose of audit of each form of private enterprises differs according to its need. However in the case of audit private firms and proprietors concern, the auditor follows standard audit practices conventions in accounting and applied care and skill to the same degree which he applied to other audits.

Advantages: The following are the main advantages of private audit.

a. Audited statements and accounts like make a reliable basis for assessment of tax liability under the various laws, such as income tax, wealth tax, sales tax etc., as the tax authorities readily believe them.
b. Audited statements and accounts are valuable in settlement of claims and disputes between partners.
c. Audit by a professional auditor serves as an assurance to the owners that the accounts of business transactions are being properly maintained and that are no frauds and errors by employees of the concern.

d. Audited statements and accounts facilitate the process of raising loan and advance from financiers and
e. The clients also get a number of other advantages of audit when their accounts are audited.

3.2 Conduct of Audit methods: Audit may be conducted under different method. The methods of audit refer to the extent of work to be performed and or the manner of its execution. The method which the auditor or the business unit manner adopt on depend on the nature of the business the volume of worker and the purpose of audit. Whatever may be method the object is to ensure the correctness and truthfulness of the accounts audited. Generally the methods of audit are as follows:

a. Continuous audit
b. Periodical audit
c. Interim audit
d. Occasional audit
e. Standard audit
f. Balance sheet audit

In the selection of any method the client must be instructed to the suitability form the point of view of cast and purpose of audit. A detailed analysis of some important method is made with a view to find out the suitability of the methods for the different types of business units.

a. Continuous of Audit: It is also called Audit or Running audit. A continuously audit is one in which the audit staff in engaged continuously in checking the accounts of the client during the current financial year. It is of great help to relatively bigger concern. It is not much use of small concern assists accounts can be audited at the end of the financial year without much loss of time. A continuous audit is applicable in the following cases.

a. Where the volume of the transaction of very large.
b. Where the management require the view of financial position of their concern monthly or quarterly.
c. Where not satisfactory system of internal check is in position and
d. Where it is desired to present the account just after the close of the financial year, as in the case of the bank.

Advantages of continuous audit: Following are some of the main advantages of continuous audit:

1. **Efficient:** The auditor of his staff gets sufficient time for the audit work. The account books are properly inspected and checked in detail. The auditing work would never be done in a hurry. So the audit will be more efficient and detailed.
2. **Quick discovery of errors:** Errors and frauds can be discovered easily and quickly as the auditor checks the accounts as regular intervals. As the auditor visit his clients, say after a month or two or so, the number of transactions will be small and hence the errors will be detected easily and quickly.

3. **Relief to auditor:** In a continuous audit, the several visit paid by the auditor to the client office enable his work to proceed easily and smoothly. It also boots his confidence in his capacity to handle his work with efficiency and effectiveness.
4. **Knowledge of Technical details:** Since the auditor remains more in touch with the business he is in position to know the technical and hence it can be great help to his clients by making valuable suggestions.
5. **Moral check:** In continuous audit the auditor may also pay surprises visit to the client office. This exercises undoubtedly a great moral check on the staff of the client who are overt confident because of the ever present apprehension of an impending visit by the auditor.
6. **Interim dividend:** Where the director of a company wish to declare an interim dividend continuous audit will help in the preparation of the interim accounts without much delay.
7. **Keep the client staff regular:** As the auditor visit the client at regular intervals the clerks will be very regular in keeping the accounts up-to-date.

Disadvantage of continuous audit: Inspite of several advantages of continuous audit there are certain disadvantages of such an audit which are as under

1. **Dislocation of work:** Auditor frequent visit dislocate the work of the client staff. The efficiency of the client staff may be affected.
2. **Alternation of figures:** The record of the transaction may be altered fraudulently after they have been audited.
3. **Queries may remain outstanding:** The audit clear may lose the thread of his work and the remain outstanding as there might be long internal between the two visit.
4. **Expensive:** Continuous audit is very costly due to heat audit fees and other incidental expenses connected with the audit staff.
5. **Unhealthy relationship:** Unhealthy relationship is developing between the audit staff and the staff of the client due to the frequent visit of at the audit staff.

b. **Periodical Audit:** This is also known as final audit or annual audit. The audit is very useful to small concerns. It is common understood as an audit which is carried out often at the close of the accounting year. Most of the companies have audited their accounts under this system.

But in the case of large concerns it takes more time to complete the audit and hence presentation of accounts to the share holder is delayed. The share holder are usually very anxious for it dividends which cannot be declared until the final accounts have become prepared and audited.

Advantages of periodical audit: The following are some of the main advantages of periodical audit

1. **Economical Period:** Periodical audit is economical and suitable particularly small sized business units.

   Smooth flow of work: The work of the audit proceeds in uninterrupted manner and there are no intervals in the case of continuous audit.
2. **Little chance of collusion:** There is no possibility of friendly ties developed between the audit staff and the client staff and as such the chances of any collusion between them are minimized.

3. **No loose of interest:** There is no loss of link in the work as the entire audit is completed in a single continuous session.

Disadvantages of periodical audit: Some of the disadvantages of periodical audit are given below

1. **Delay:** As the work of audit usually takes along time to be completed, the presentation of final accounts in the annual general meeting is likely to be delayed.
2. **Unsuitability:** In large concern where the numbers of transactions are voluminous and often quite complex, periodical audit is not practicable and for this reason, it is often not preferred by them.
3. **Non detection of errors and frauds:** For lack of detailed checking, errors and frauds may continue to remain undetected.

c. **Interim Audit:** Interim audit means an audit which is conduct in between two annual audits. Its objectives is to enable the company declare an interim dividend. It involves a complete examination a review of the accounts and records of the business up to the date of the interim audit. Thus interim audit may be ordered for a quarter or six months.

Advantages of interim audit: The advantages of interim audit are given below:

1. Errors and frauds can be more quickly found and detected during the course of the year.
2. This type of audit is good where the pollution of the interim figure is necessary.
3. There is a moral check on the staff of the client as the accounts are checked say, after three or six months.
4. The final audit can be completed very soon, if there has been a interim audit.

Disadvantages: The disadvantages are as follows:

a. Interim audit may prove expensive because it involves addition work on the partof the auditor.
b. Figure may be altered in the account which have already been done audit.
c. It will mean that the audit staff will have to prepare notes which they furnish interim audit.
d. Generally the students might confuse the interim audit with continuous audit; we give below the point’s distinction between the two types of audits.

d. **Occasional Audit:**The name itself indicates that it is a type of audit which will be done now and then especially when the possibility of misappropriation or fraud is suspected. This type of audit will be followed by the sole traders and firms.

e. **Standard Audit:** This type of audit refers where some of the important items are audited thoroughly and other items by test checking. This will be used only where there is a perfect internal check system is in operation.

f. **Balance Sheet Audit:** In this type of audit the audit is commenced from the balance sheet working back to the books of original entry and relative documents. This system is recently developed in U.S.A. This is essentially a partial audit, since it verifies the items appearing in the balance sheet and does not start the work of verification with primary books. This type of audit can be successful in those organizations where an effective internal check is in operation.

3.3 Meaning and definition of Audit Programme

Proper implementation of any plan depends upon a good programme. Audit programme represents an outline of procedure to be followed to support an opinion on financial statements. It is the auditor's plan of action. It provides a plan of the work of examination and a set of audit procedures.

Definition: According to **Howard Stettler**, "An Auditor programme is an outline of all procedures to be followed in order to arrive at an opinion concerning the client's financial statements".

3.4 Advantages and disadvantages of Audit Programme

Advantagesof audit programme: Some of the important advantages of conducting an audit programme according to pre-determined audit programme are:

a. The auditor can be certain that the audit staff will cover the whole of the ground and if, in future years, different members of the staff are engaged upon the audit, they can see the reference to the programme exactly what work they are required to perform.
b. Audit assistants know their clear cut duties.
c. Efficiency of the audit assistants increases.
d. It enables the auditor to keep in touch with the work done and general progress of the work.
e. Fixing of the responsibility of audit assistants becomes easier.
f. It serves as evidence, if at any time an action is brought against the auditor alleging negligence in the performance of his duties.
g. The routine gets systematic.
h. It provides a check against the possibility of certain important items requiring verification which are being omitted.
i. Continuity is not lost even if the person on duty is changed.
j. The chief auditor is saved from botheration of issuing instructions to the staff repeatedly.

Disadvantages of audit programme: An audit programme tends to introduce monotony in the work, which may result into mechanical performance by the staff without any sense of responsibility. The possible disadvantages of an Audit Programme are listed below:

a. The task becomes mechanical; as a result initiative and efficiency are adversely affected.
b. The task may be finished hurriedly to completely it within the scheduled time.
c. It does not serve any purpose in the audit of a small organisation.

d. Uniformity of the audit programmes cannot be applied extensively, as the nature of work in the audit of different organizations cannot be exactly the same.
e. It tends to introduce rigidity.
f. Inefficient audit assistants may also take shelter behind the programme.

Short Answer Type Questions (2 Marks)

1. What is meant by Audit Programme?
2. What is continuous Audit?
3. Define periodical Audit?
4. What is occasional Audit?
5. What is meant by Interim Audit?

Long Answer Type Questions (6 Marks)

1. Explain briefly various types of Audit.
2. Explain the important features and advantages of Statutory Audit.
3. What are the advantages of private Audit?
4. Explain the advantages of continuous Audit.
5. What are the disadvantages of continuous Audit?
6. What are the advantages of periodical Audit?
7. Explain briefly about different types of audit methods.
8. What are the advantages and disadvantages of audit programme?

Ψ

UNIT 4

QUALIFICATION AND DISQUALIFICATION OF AUDITOR

Qualification and Disqualification of Auditor: *Provisions of The Companies Act, 2013 relating to qualification and disqualification of auditor – Appointment and removal of auditor – Various methods of appointment of auditor –Provisions of The Companies Act, 2013 relating to appointment and removal of auditor.*

Structure

Learning Objectives

After studying this unit the student will be able to

- Understand about the qualifications, qualities and disqualifications of an auditor as per Companies Act, 2013
- Understand about various methods and provisions of the Companies Act, 2013 regarding appointment of an auditor
- Understand about provisions of the Companies Act, 2013 regarding removal of an auditor.

4.1 Provisions of the Companies Act, 2013 relating to qualifications and qualities of an auditor

According to Provisions of Section 141 (1) of the Companies Act, 2013 “a person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant within the meaning of Chartered Accountants Act, 1949 and hold a valid Certificate of Practice and acting in capacity as

a. Individual
b. Partnership Firm
c. Limited Liability Partnership

Provided that a firm whereof majority of partners practicing in Indian are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

4.2 Provisions of the Companies Act, 2013 relating to disqualifications of an auditor

According to Provisions of Section 141(3) of the Companies Act, 2013, following persons shall not be eligible as auditor of the company:

a. A body corporate other than LLP registered under the LLP Act, 2008.
b. An officer or employee of the company.
c. A person who is partner or who in the employment, of an officer or employee of the company.
d. A person who or his relative or partner.
    1. Is holding any security/interest in the company or its subsidiary or of its holding or associate company or subsidiary of such holding company. It has been further provided that a relative may hold security or interest in the company of face value not exceeding one lakh rupees.
    2. Is in debted to the company or its subsidiary, or its holding or associate company or subsidiary of such holding company, in excess of Rs.5lakhs rupees
    3. Has given guarantee or provide any security in connection with the in debtness of any third person to the company or its subsidiary, or its holding or associate company or a subsidiary of such holding company for value in excess of Rs.1 lakhs.
e. A person or a firm who (whether directly or indirectly) has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company.

    Here the business relationship shall be construed as any transactions enter into for a commercial purpose except:
    a. Commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm by the professional bodies regulated such members.
    b. Commercial transactions which are in ordinary course of business of the company at a rm's length price as customer.
f. A person whose relative is a director or is in the employment of the company as a director or key managerial personnel.
g. A person
    a. Who is in full time employment else where or
    b. A person or a partner holding appointment as its auditor is at the date of such appointment or reappointment holding appointment as auditor for more than 20 companies.

h. A person who has been convicted by a court of an offence involving fraud and a period of ten years has note lapsed from the date of such conviction.
i. Any person whose subsidiary or associate company or any other form of entity is engaged as on the date of appointment in consulting or specialised services in reference to provision of Section144of the Companies Act, 2013.

Further According to Provisions of Section 141(4) of the Companies Act, 2013, where a person appointed as auditor of the company incurs any of the disqualification mentioned in Section 141(3) of the Companies Act, 2013 after his appointment, he shall vacate his office as such auditor and such vacancy shall be deemed to be casual vacancy in the officer of the auditor.

It must be noted that the a fore said provisions are applicable to all types of auditors i.e. cost auditors, statutory auditor sand secretarial auditors.

4.3 Provisions of the Companies Act, 2013 relating to appointment of an auditor

The provisions regarding appointment of the auditor are contained in Section 139 of the Companies Act, 2013.

1. **Appointment of First Auditor of a Company other than Government Company (Sec. 139(6)):** The first auditor of a company other than Government Company shall be appointed by Board of Directors within 30 days of registration of company. If the Board fails to appoint first auditor, it shall inform the members of company, who shall appoint auditor within 90 days at extra ordinary general meeting who shall hold office till the conclusion of first annual general meeting.
2. **Appointment of First Auditor in case of Government Company (Sec. 139(7)):**It shall be appointed by Comptroller and Auditor-General within sixty days of registration of company. In case of its failure to appoint first auditor, then Board of Directors shall appoint the auditor within next thirty days. The company shall inform the member, if the Board fails to appoint first auditor who shall appoint the auditor within sixty days at extra ordinary general meeting, holding office till conclusion of first annual general meeting.
3. **Appointment of subsequent Auditor in case of Non-Government Company (Sec. 139(1):**
   a. A company shall appoint an individual as an auditor at the first annual general meeting and each subsequent sixth annual general meeting.
   b. Such auditor shall hold office till conclusion of sixth annual general meeting.
   c. The manner and procedure of selection of auditor by the members at such meeting may be as prescribed.
   d. Such appointment shall be place before members at each annual general meeting for ratification. Like 2nd, 3rd, 4th& 5th Annual General meeting.
   e. It at any annual general meeting, appointment of auditor is not ratified by the members, Board of Directors shall appoint an other auditor by following the procedure as per the Act.
   f. Before such appointment of auditor a written consent to appointment and a certificate from him that it is in accordance with conditions as may be prescribed shall be obtained from the auditor.

g. The certificate shall indicate that auditor satisfies eligibility and qualifications criteria under Sec. 141.
h. The company shall inform the auditor of his appointment and send notice to registrar within fifteen days of such meeting regarding the appointment of auditor.

4. **Appointment of subsequent Auditors in case of Government Companies (Sec. 139(5)):**In case of government company or any other company owned or controlled by the Central Government or any State Government, the Comptroller and Auditor General of India shall appoint an auditor duly qualified under this Act within a period of 180 days from the commencement of financial year, who shall hold the office till the conclusion of annual general meeting. The auditor shall hold office till conclusion of next annual general meeting.
5. **Casual Vacancy of an Auditor (Sec. 139(8)):**
   a. The casual vacancy of auditor, except in case of Government Company, shall be filled by Board of Directors within thirty days but if it arises as a result of resignation of the auditor it shall be approved by the company at general meeting convened within three months of recommendation of Board. Such auditor shall hold office till conclusion of next annual general meeting.
   b. Casual vacancy in case of Government Company shall be filled by Comptroller and Auditor General with thirty days if he fails to fill the vacancy, the Board shall fill the vacancy within next thirty days.
   c. **Casual vacancy by resignation (Sec. 140(2)):** In case the auditor has resigned from the company, he shall file a statement in the prescribed form within 30 days from the date of resignation with the company and the registrar and in case of government company he shall also file such statement with C & AG specifying the reasons and facts regarding his resignation. If he fails in this regard, he shall be punishable with fine not less than fifty thousand rupees which may be extended to five lakh rupees.
   d. The auditor appointed against a casual vacancy will hold the office up to conclusion of next annual general meeting.
6. **Reappointment of Retiring Auditor (Sec. 139(9)):**Such auditor can be reappointed at annual general meeting if:
   a. He is not disqualified for reappointment.
   b. He has not given notice to company of his unwillingness.
   c. A special resolution has not been passed at annual general meeting appointing some other person or providing expressly that he shall not be reappointed.
   All the above is subject to the provisions of Sec. 139(1).
7. **Where no Auditor is appointed or reappointed at Annual General Meeting (Sec. 139(10):**The existing auditor shall continue to be the auditor of company.
8. **Recommendations of Audit Committee Sec 139(11):** If Auditor Committee under Sec. 177, in constituted, all appointments of auditor shall be made after considering recommendations of such committee.

4.4 Provisions of the Companies Act, 2013 relating to removal of an auditor

1. **Removal, resignation of auditor and giving of special notice Sec. 140(1):** The auditor appointed under section 139 may be removed from his office before the expiry of his term

only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf in the prescribed manner:

Provided that before taking any action under this sub-section, the auditor concerned shall be given a reasonable opportunity of being heard.

2. **Resignation by Auditor Sec. 140(2) & (3):** The auditor who has resigned from the company shall file within a period of thirty days from the date of resignation, a statement in the prescribed form with the company and the Registrar, and in case of companies referred to in sub-section (5) of section 139, the auditor shall also file such statement with the Comptroller and Auditor General of India, indicating the reasons and other facts as may be relevant with regard to his resignation.

If the auditor does not comply with sub-section (2), he or it shall be punishable with fine this shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

3. **Special notice for not reappointing the retiring auditor:**
   a. Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, Such special notice is not required when the retiring auditor has completed, as per sub-section(2)ofsection139consecutive tenure of five years or, as the case may be.
   b. On receipt of notice of such a resolution, the company shall forth with send a copy there of to the retiring auditor.
   c. The retiring auditor has right of representation against his removal. The representation shall be in writing and shall be sent to the company. He may request the company that his representation shall be circulated to the members of the company.
   d. In the notice of the resolution given to the members of the company, the fact that retiring auditor has made representation against his removal shall be stated unless representation received by the company is too late.
   e. In case copy of resolution is not sent to the members because it is received too late, the auditor may require the representation to be read in the morning.
   f. Provided that if a copy of representation is not sent as aforesaid, a copy there of shall be filed with the Registrar:

      Provided further that if the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub-section are being abused by the auditor, then, the copy of the representation may not be sent and there presentation need not be read out at the meeting.

4. **Removal by Central Government:**

   Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or a betted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors:

Provided that if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint an other auditor in his place:

Provided further that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section, shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

It is here by clarified that the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

Short Answer Type Questions (2 Marks)

1. Who is an Auditor?
2. What is educational qualification of an Auditor?
3. Mention various methods of appointment of an auditor.
4. What is meant by casual vacancy?
5. What are the qualifications of an auditor?
6. What is meant by reappointment of an auditor?

Long Answer Type Questions (6 Marks)

1. What are the qualifications of an auditor according to Companies Act, 2013?
2. What are the disqualifications of an auditor according to Companies Act, 2013?
3. What are the qualities of an auditor?
4. What are the provisions for appointment of an auditor according to Companies Act, 2013?
5. What are the provisions for removal of an auditor according to Companies Act, 2013?

Ψ

UNIT 5

REMUNERATION, RIGHTS AND DUTIES OF AUDITOR

Remuneration, Rights and Duties of Auditor: *Remuneration of auditor – Duties of auditor – Rights and powers of auditor.*

Structure

5.1 Remuneration of auditor
5.2 Duties of auditor
5.3 Rights and powers of auditor

Learning Objectives

After studying this unit the student will be able to

- Understand about the concept of remuneration of auditor
- Understand about duties of an auditor
- Understands about rights and powers of an auditor

5.1 Remuneration of an auditor

According to Sec. 142

a. The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined in general meeting.

b. The remuneration under Sub-section (1) shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

c. In case of first auditor appointed by the Board the remuneration of auditor shall be fixed by the board.

d. The Central Government appoints an auditor it may fix the remuneration.

Apart from the routine audit work and auditor may be entrust able with the task of taxation, writing up of the account's books and other professional services. In such case the auditor and the board may fix up mutually the extra remuneration payable to the auditor. For this purpose, the approval of shareholders shall not be required.

5.2 Duties of auditor

The duties of an auditor of a company are discussed below:

I. Duties under Section 143(1): An auditor is required to enquire:

1. Whether loans and advances made by company on basis of security have been properly secured and terms on which they have been made are not prejudicial to the interest of company or its members.
2. Whether transactions of company which are represented merely by book entries are not prejudicial to the interest of company.
3. Whether company is not an investment company or banking company, whether so many of assets of company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by company.
4. Whether loans and advances made by company have been shown as deposits.
5. Whether personal expenses have been charged to revenue account.
6. Whether it is stated in books and papers of company that any shares have been allotted for cash, has actually been so received, whether the position as stated in account books and balance sheet is correct, regular and not misleading.

If any of the above matters is answered in negative auditor's report must state reasons.

II. Duties to make report of shareholders Sec. 143(2): The auditor shall make a report to the members of the company on the accounts examined by him and every financial statement to be laid before the company in general meeting. The report shall take into account provisions of this Act, the accounting and audit standards.

III. Duties regarding Auditor's Report to state Sec. 143(3):

1. On the accounts examined by him he has to state in his report, whether, in his opinion, proper books of accounts as required by law have been kept by the company.
2. Whether he has obtained all information and explanations required by him for the purpose of his audit.
3. Whether reports on the accounts of any branch office audited by a person other than company auditor has been forwarded to him.
4. Whether or not balance sheet and profit & loss a/c have been drawn up according to requirements of the Companies Act and whether balance sheet and profit & loss a/c gives a true and fair view of company's affairs and profit or loss for its financial year.
5. Whether in his, opinion, financial statements comply with the accounting standards.
6. Whether Company's balance sheet and profit and loss account dealt with in the report are in agreement with books of account and returns.
7. Whether any director is disqualified from being appointed as director u/s 164(2).
8. The auditor has to mention in his report if he is not satisfied with information and explanations given to him with regard to any points.

IV. Other Duties under the Companies Act:

The auditor has following other duties under the Companies Act.

1. According to sec 145 it is duty of an auditor, or a partner of firm of accountants practicing in India to sign audit report.
2. It is duty of an auditor to report on certain matters included in prospectus. Sec 26.

3. If a company goes into voluntary winding up, directors are required to file a declaration of solvency. It is duty of an auditor to give a report to be attached to such a declaration. Sec 305.
4. It is duty of an auditor "to preserve and produce to an inspector or any other person authorized by him in this behalf with previous approval of central government all books and papers relating to company which are in their custody and to give inspector all assistance in connection with investigation.

V. **Duty to sign Audit Report Sec. 143:** The company's auditor shall sign the audit report and sign or certify any other document of the company.

VI. **Duty to attend general meeting Sec.146:** The auditor shall attend, except exempted, either himself or through authorized representative any general meeting and shall have right to be heard at such meeting on any part of business which concerns him.

VII. **Contractual Duties:** A professional accountant may be hired by a company for the purposes other than statutory audit. In all such cases duty of auditor will depend upon terms and conditions of his appointment.

Duty of Care: An auditor of a company must be honest and must exercise reasonable skill and care; otherwise he may be sued for damages.

Duties of Auditor in Relation to Mandatory Accounting Standards: According to decision of Council of ICAI, it is duty of auditor, to ensure that Accounting Standards are implemented in presentation of financial statements. In the event of any deviation from standards, it will also be their duty to make adequate disclosures in their reports.

Duty to Know the Duties: It is duty of an auditor to become aware of their duties under the Companies Act. Sometimes they may contain some additional duties. Their ignorance will not be an excuse to avoid liability on account of negligence.

Professional Duties: Every profession governs itself through code of conduct. The auditors are also expected to observe ethics given to them by the ICAI.

5.3 Rights and Powers of auditors

A person who has been given certain duties to perform is also provided with some powers and rights which is essential requirement for performance of the duties. Similarly, the company auditor has been given certain powers and rights under Companies Act 2013 for the proper discharge of his duties.

1. **Right to access books of accounts:** The auditor shall have right to free and complete access at all times to the books, accounts and vouchers of company. The term 'vouchers' includes all documents, agreement etc. The term 'all times' means only during normal business hours.

2. **Rights to obtain information and explanation:** An auditor is authorized "to receive from the officers of the company such information and explanation for the performance of his duties as auditor". If he does not get the proper information, he should mention this fact in his report.

3. **Right to visit branches and to inspect books of accounts:** The Companies Act provides specific rights to the auditor, where accounts of any branch office are audited by a person

other than company's auditor, he shall be entitled to visit branch office. He shall also have access at all times to the books, accounts and vouchers at a branch office.

4. **Right to receive branch Audit Report:** The company auditor has right to receive audit report of branch accounts prepared by the branch auditor for his consideration and to consider it while preparing audit report of the company.
5. **Right to receive notices and attend General Meeting:** Section 146 states that the auditor is entitled to receive a notice of and to attend any meeting of the shareholder. He has to right to speak at such meeting when the accounts are being discussed.
6. **Right to seek legal and technical advice:** The auditor has a right to take legal, expert or technical advice on any matter relating to business, in order to perform his work satisfactorily. But he must give his own opinion in report and not that of experts.
7. **Right to claim remuneration:** The remuneration in addition to fees payable to the auditor includes expenses incurred by the auditor in connection with the audit of the company. The auditor has a right to claim remuneration for the work done by him as per the contract.
8. **Right to be indemnified:** For many purposes, an auditor is considered to be an officer of company. He has a right to be indemnified out of assets of company against any liability incurred by him in defending himself against any civil or criminal proceedings by the company.
9. **Right to sign the audit report:** According to sec 145, only person appointed as auditor of the company, or where a firm is so appointed only a partner in the firm practicing in India, may sign the audit report. The auditor is to make report to members of company and not to Board. Auditor has the right to recommend to board the change in accounting system which may be necessary. If his recommendations are not acted upon, he has right to report the fact to members through his report.
10. **Right of Lien:** The auditor has no right of lien on the books of accounts. However, he can exercise lien on working papers. The rights of an auditor cannot be limited by the Articles or by resolution of the members. The Companies Act doesn't provide for such right of lien of an auditor but there are number of legal judgments in this regard.

Short Answer Type Questions (2 Marks)

1. What is meant by Auditors remuneration?

Long Answer Type Questions (6 Marks)

1. What are the duties of an auditor?
2. Explain the rights and power of an auditor

Ψ

UNIT 6

VOUCHING, ERRORS AND FRAUDS

Vouching, Errors and Frauds: *Meaning of vouching – Objects and importance of vouching – Measures to be taken for vouching – Meaning of Error and Fraud – Types of Errors and frauds.*

Structure

6.1 Meaning and definition of Vouching
6.2 Objects of Vouching
6.3 Importance of Vouching
6.4 Measures to be take for Vouching
6.5 Meaning and definition of error and its types
6.6 Meaning and definition of frauds and its types

Learning Objectives

After studying this unit the student will be able to

- Understand about the meaning, objects and importance of vouching
- Understand about various measures to be taken for vouching
- Understand the meaning of error and fraud
- Understand about various types of errors and frauds

6.1 Meaning and Definition of Vouching:

Vouching is concerned with examining documentary evidence to ascertain authenticity of entries in books of accounts. In other words, it is an inspection by the auditor of evidence supporting the transaction made in the books. Vouching is a technique used by an auditor to judge the truth of entries appearing in the books of accounts.

Accounting entries are made in the books of account. All such entries must be supported by a document. An accountant is not supposed to make any accounting entry unless he is having a documentary evidence to support. If proper documentary evidence is not available or such evidence is not fully supporting accounting entries made, auditor has every reason to doubt about the existence of error, fraud or manipulation of accounts, goods or cash. Every transaction must be supported by a voucher.

Thus, vouching is a technique in which an auditor verifies authenticity and authority of transactions recorded in the books and on basis of which submits a report, indicating that accounts are correct, free from errors or fraud and complete.

Success of an audit depends on the efficiency with which vouching has been used. Without vouching auditing is incomplete. Vouching is not only examining the documentary evidence but sometimes auditor has to go behind recorded evidence to eliminate any possibility of fraud.

Definition:

"*Vouching is an act of comparing entries in the books of accounts with documentary evidence in support thereof*". **–DICKSEE**

"Vouching means testing the truth of items appearing in the books of original entry".

– J.R. Batliboi.

6.2 Objects of Vouching:

The main objectives of vouching are as follows:

1. All transactions which are connected with business have been recorded in books of accounts properly.
2. To verify that transactions recorded in book are supported by documentary evidence.
3. Vouchers which support entries are legally valid from the view point that they are authentic addressed to business and properly dated.
4. To verify that no fraud or error has been committed while recording transactions in books of accounts.
5. Vouchers have been processed through various stages of internal check system.
6. Every transaction recorded has been adequately authenticated by a responsible person.
7. While recording transaction whether distinction has been made between capital and revenue items.
8. Whether accuracy has been observed while totaling, carrying forward and recording an amount in account.

6.3 Importance of Vouching

Vouching is an important part of auditor's duty. As in accounting, passing an original entry is very important, if this is done in a wrong way, any further work done will also be wrong or defective. Similarly in the process of auditing, vouching plays the same role.

Vouching is the backbone of auditing. It should be noted that various frauds can be detected only if vouching is conducted in an intelligent manner. Whenever an auditor doubts a fraud, he should also verify source of documentary evidence. If vouching is done intelligently and faithfully, it will be a help in establishing reliability of Profit and Loss account and Balance Sheet. In big organization with effective and sound system of internal control, auditor may apply test checks and scientifically selecting number of transactions, and vouch these transactions in-depth and if it reveals compliance of internal transactions. Vouching of selected transactions is not desirable in following cases:

1. When internal control system is weak and inadequate as per assessment by auditor.
2. Where division of duties is not adequate as in case of small organizations.
3. Where transactions under audit are of specialized nature and number of transactions therein are limited where test checks will be failure.

6.4 **Measures to be taken for Vouching:** The following points an auditor should look into when examining vouchers:

1. Auditor should see that all vouchers are numbered serially, dated and filed. If these are not arranged serially, time will be lost in locating a particular voucher.
2. The voucher, which has been checked by auditor, should be stamped or tick marked with a special sign, so that it may not be used again for a fictitious transaction.
3. The amount in receipt must be shown in words and figures. If two differs, then it should be investigated.
4. If voucher is in personal name of partners, director or any other person, it should be seen that proper treatment for such transaction has been provided in books.
5. If voucher is doubtful, he should proceed cautiously and use special ticks for them.
6. It should be seen that every voucher is certified by a responsible officer of business.
7. For missing vouchers, auditor should ask for explanation from concerned official. If no satisfactory reply is received, then it should be further investigated.
8. While vouching, auditor should not take any help from client's staff.
9. Auditor should examine that all expenses pertain to the business.
10. A receipt obtained from a party for Rs.20/- or more should bear the revenue stamp.
11. The auditor should see that proper account is debited or credited and proper classification of accounts has been done.
12. While vouching transaction auditor should keep in mind the distinction is made between capital and revenue items.
13. For certain transactions, auditor may refer resolutions passed at meeting of shareholders or directors. Sometimes agreement made with a party may serve as documentary evidence for transactions arising out of this agreement.
14. When purchases are made on cash basis, auditor should see that such transactions are not recorded twice, once in cash book and then in purchase book.
15. Auditor shall not resort to test checking unless a satisfactory internal control system exists in the organization.

16. As far as possible vouching of a book of accounts of a particular period must be completed in one continuous sitting.
17. Alterations in the vouchers must be supported by the concerned officer's initials.
18. There may be certain payments such as wages, salaries and petty expenses for which vouchers are not available. These should be checked with wages register, salaries book, petty cash book etc.
19. Overwriting or erosion on a voucher should not be accepted and it must be supported by concerned officer's initials.

6.5 Meaning and definition of error and its types

Generally errors are the result of carelessness on the part of the person preparing the accounts. Sometimes errors may be the result of fraudulent manipulation of accounts. Auditor should be very careful because sometimes an accounting manipulation may appear to be an error. During the course of auditing, errors may be detected, through auditing does not ensure detection of all errors and frauds.

Errors may be defined as "a mistake of negligence or misjudgement without an intention to defraud".

a. **Errors of Omission:** This type of error arises when a transaction is either not recorded at all or is recorded partly. For example, goods worth Rs. 200/- are sold to Kumar. In case this transaction is not at all recorded, it is called error of mission. Such error will not affect the trial balance. If can be detected only with a careful examination. But partial omission can be detected easily as the trial balance will not agree.
b. **Errors of Commission:** This type of error arises when a transaction is incorrectly recorded. Wrong entries, posting, castings, calculations, etc., are good examples. This type of error will affect the trial balance. So, it can be detected easily.
c. **Error of Duplication:** This type of error arises when a transaction is entered twice in the journal, or posted twice to the ledger. For example, a credit purchase of Rs. 500 may be entered twice in the purchase book and posted twice to the concerned accounts in the ledger. It will not affect the trial balance. So detection is not easy. More care is required to detect the error of duplication.
d. **Compensating Error:**It is also called **"off-setting error".** When one is counter-balanced or compensated by another error, it is called a "compensating error". If one account is under debited by Rs. 100/- and if another account is over debited by Rs. 100/- then it is considered as compensating error. It is a dangerous type of error. It may or may not affect the profit or loss of the business. It will not affect the trial balance. So detection is not easy.
e. **Error of Principle:** This type of error arises when a transaction is not recorded in the books according to the fundamental and accepted principles of accountancy. Wrong allocation of expenditure between capital and revenue, wrong valuation of assets, and incorrect provision for depreciation are some of the examples. This error may be

committed intentionally or unintentionally. It will affect the profit and loss account, and the balance sheet. But it will not affect the trial balance. So detection is not easy. It can be detected by a careful examination of the accounts.

6.6 Meaning and definition of fraud and its types

Fraud means **"The wilful misrepresentation made with an intention ofdeceiving others".** It is intentional. It is knowingly committed to defraud the proprietors of the concern. Detection of fraud is more difficult than detection of errors. The success of detection of fraud depends upon the efficiency of internal check in operation. Fraud may be committed in any of the following ways.

a. Misappropriation of cash or embezzlement of cash
b. Misappropriation of goods
c. Manipulation of accounts.

a. Misappropriation of cash: It is also called **"defalcation of money".** It is very common in every business. Persons handling cash may misappropriate money. Misappropriation of cash may be made :

1) by omission of cash receipts; or
2) by recording receipts less than actually received. or
3) by including fictitious payments, or
4) by entering payments more than actually made.

Omission of receipts can be detected by checking the debit side of the cash book. Rough cash book, salesman's reports and counter foils or receipts. Inclusion of fictitious payments can be detected by checking the invoices, vouchers, wage-sheets etc.

b. Misappropriation of goods: This type of fraud is also very common. It is committed by the employees of the concern. The employees may take some goods when they leave the concern after the day's work. They may sell such goods and misappropriate money. To cover up this. They alter the figures in the stock registers. It is difficult to detect misappropriation of goods. This type of fraud can be detected if stores. Purchases and sales records are maintained properly and stock checking is undertaken frequently.

c. Manipulation of accounts: Fraud does not necessarily involve misappropriation of cash or goods. It may involve manipulation of account. It is also called **"falsification of account".** Accounts are manipulated to show more or less profit. The position of the company may be shown better or rosier than what is actually. This type of fraud is generally committed by directors or responsible officials. So detection is difficult. By means of efficient checking and by making searching enquiries; the auditor will be able to detect such frauds.

Short Answer Type Questions (2 Marks)

1. Define the term ‘Vouching’.
2. Define the term ‘Error’.
3. Define the term ‘Fraud’.
4. What is the importance of Vouching?

Long answer questions (6 Marks)

1. What are the objectives of vouching?
2. What are the points to be considered while vouching?
3. What are the different types of errors?
4. What are the different types of frauds?

Ψ

UNIT 7

AUDIT PROGRAMME

Audit Programme: *Meaning – Advantages & Disadvantages – Audit Notebook – Audit Working papers – Audit Markings – Advantages of Audit Markings.*

Structure

Learning Objectives

After studying this unit the student will be able to

- Understand about the meaning, features, advantages and disadvantages of Audi Programme
- Understand about the meaning and contents of Audit Note book
- Understand about meaning and contents of Audit Working Papers
- Understands about audit markings and its advantages

7.1 Meaning and definition of Audit Programme

Before starting an audit a programme of work is generally drawn by the auditor. This programme is known as the "audit programme". **An audit programme is an essential preliminary to an efficient audit.** It is a written scheme of the extant details of the work to be done by the auditor and his staff in connection with a particular audit. In other words, it is the **auditor's plan of work.** It is description, memorandum or an outline of the work to be done, prepared by an auditor for the guidance and control of his assistants.

The audit programme cannot be the same for all business units. The programme is to be drawn on the basis of the nature and type of business. Factors, such as organizational structure, internal control system in existence and the accounting procedure are to be considered. In the case of a new audit and the auditor must find out whether the conditions of accounts and that of internal control are good.

Definitions

According to **Montgomery** "An Audit programme is a list, generally in detail, of steps to be performed in the course of examination. It controls the nature and extent and examination, aids in arranging, timing and distributing the work, guards against possible omissions and supplications and provides part of evidence of work done".

According to **professor Meigs**, "As audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item in the financial statement and giving the estimated time required".

These definitions clearly beings out the nature and scope of audit programme. An Audit programme is a written plan containing exact details with regard to the conduct of a particular audit. It consists of procedures undertaken on the particular work done by an accountant in carrying out an audit. It is description memorandum or an outline of the work to be done prepared by an auditor for the guidance and control of assistants.

An audit programme guides in arranging and distributing of work and in checking against the possibility of the omissions. It is necessary for planning and supervision of an engagement under the first standard of field work.

An Audit programme is often used as a guide for audit examinations in future. But it is true mainly in case of repeat audits because in an initial audit, the audit programme is tentatively designed on the basis of the information obtained from the client. But even in a repeat audit, the past year's audit programme cannot automatically be adopted for audit examination in the current year. It will have to be modified in the light of the changes that may have taken place since the last engagement.

Modification in case of fixed audit programme is slightly difficult as the senior audit clerk is allowed to make only minor changes therein, and for any major change he has to get the approval of the Auditor.

Features of Audit program: The following are the main feature of audit program

1. A well conceived carefully and executed audit program gives order points and coherence to the audit.
2. The audit program involve considerable amount of thinking and planning on the basis of past experience.

3. The audit program contain the work to be done, member of the staff responsible for the work and the time allotted and consumed in each section of the audit.
4. An experienced auditor may get active cooperation from his staff with the help of a sound scheme drawn out by him.
5. The audit program should be flexible it must be chalked in such a manner that if there may be need for revision may be carried out without difficulty. Unless as frequently used it may become outdated also. Thus the audit program not become routine and should not cut the initiative of the audit staff.
6. The audit program should encourage audit staff to conduct surprise check outside of the program.
7. The juniors who are actually undertaking audit work should encourage coming forward with their suggestions.
8. The common function to all audits needs the preparation involves verification, examination and vouching of the books of accounting. The audit program must contain these common functions special points to be observed in the case of different types of business also.

7.2 Advantages of Audit Programme

The audit program is helpful to the auditor in many respects. The merits of such an audit programme may be outlined as below:

1. **Efficient distribution of work:** The audit program may be prepared keeping in mind the level of competence and experience of each staff member of the audit team. While senior audit clerk are given relatively complex assignments, the junior are made responsible for routine work. This makes for smooth and efficient execution of the work.
2. **Staff on leave:** The auditor can keep consistently in touch with the work done by his staff. Even if a junior auditor or audit staff is absent from duty, it would be possible for the information available in the programme.
3. **Systematic manner:** Naturally the programme avoids the possibility of leaving out verification of certain information and records relating to the business. Thus it ensures that is carried out in a systematic manner.
4. **Responsibility:** In case of fraud or error has remained un detected the responsibility for negligence can be fixed on the clerk who had performed that work.
5. **Ground work for audit operations:** It has down a firm's basis for audit operation in the current as well as future years. Even if there is a change in the staff conducting the audit, the new staff will have no difficulty in knowing what is required to be done by them in any audit operations.
6. **Uniformity:** It may also result uniformity in the work done by similar programme from time to time. The work done by audit staff will be uniform and standard quality because all of them follow the programme prepared by the same auditor.

7. **Basis of subsequent revision:** It serves as the basis for revision in the audit programme in the light of any charges taking place within the enterprise as also experience gained in the course of conduction the past audit.

8. **Control:** It serves as ready checklist of procedures to be applied and the work already finished. Supervision and control of the work can be undertaken and conveniently as every work is undertaken in plant way.
9. **Guidance:** It is a kind guidance to the audit clerk for the work he has to perform. Thus it is kind of assurance of the auditor the junior will not overlook, essential points while checking the accounts.
10. **Evidence:** It may be used as evidence by the auditor in the court, in case of charge against him that he has done some work. That is in court of law, the audit programme serves as material evidence justifying the working of the auditor.

7.3 Disadvantages of Audit Programme

The following are some of the demerits of audit programme.

1. **Lack of initiative:** Audit programme may cut in the initiative an efficient junior auditor as he has to follow the predetermined plan of audit work. The auditor has to do what he is asked to do and not what he feels like doing.
2. **Mechanical:** Audit work becomes too mechanical audit work is carried out in a routine manner and within the time limit in hurried way.
3. **Lack of Uniformity:** Even the most detailed and comprehensive audit programme cannot possibly provide for each and every aspect of different enterprises for the simple reason that each them may be following its own accounting procedures.
4. **Lack of original approach:** As the audit staff has to stick the programme in all cases, it does not think it necessary to any independent thinking. As such it does not display initiative in exploring new ways of performing the work in hand.
5. **Incomplete audit:** Even if the audit programme is well drawn it may cover everything that might come up during the course of audit.
6. **Inefficiency:** Inefficient audit clerks may cover up the in efficiency under the shelter of audit programme.

The above disadvantages can be overcome by impressing up the audit clerk that the audit programme is only guidance and he show use his initiative and intelligence during the course of audit. He should have encouraged making suggestion. Further the audit programme should be modified from time to time and made up to date according the experience and changes made in business. Besides this the select of items for audit should be at random so that no one else may form the idea about the way audit is going to take place.

7.4 Meaning and contents of Audit Note Book

Audit Note Book is a diary or register maintained by audit staff to note errors, doubtful queries and difficulties. The purpose is to note down various points which need to be either clarified with the client or the chief auditor. The audit note book is also used for recording important points to be included in the Auditor's Report. It is a complete record of doubts and their clarification.

Contents of an Audit Note Book: The contents of an audit note book are as follows:

1. A list of books of accounts maintained.
2. The names, duties and responsibilities of principal officers.
3. The particulars of missing receipts and vouchers.
4. Mistakes and errors detected.
5. The points calling for clarifications and explanations.
6. The points deserving the attention of the auditor.
7. Various totals and balances.
8. Extracts from the minutes and contracts.
9. The points to be part of the Auditor's Report.
10. Date of commencement and completion of the audit.

Advantages of Audit Note-Book:

1. It ensures uniformity and helps in knowing the amount of work performed.
2. Important matters relating to the audit work may be easily recalled.
3. Facilitates the preparation of the audit report.
4. In case in charge is changed, no difficulty is faced in continuing incomplete work.
5. The responsibility for errors undetected can be fixed on clerk concerned.
6. It is reliable evidence in court of law, in an auditor has to defend himself.
7. Ensures audit programme has been sincerely followed and deviations can be noticed.
8. It shows extent of interest and pains taken by audit staff and helps in their appraisal.

Limitations of Audit Note Book: In case audit work is conducted negligently by the staff of an auditor, audit note-book can act as evidence against the auditor himself. However, it is a document for perfections and imperfections in audit work.

7.5 Meaning and contents of Audit Working Papers

The term audit working papers designate the files of analyses, summaries, comments and correspondence built up by an auditor during the course of the field work of an audit engagement. These papers contain essential facts about accounts which are under audit.

Definition

Arnold W. Johnson defines that "Audit working papers are the written private materials, which an auditor prepares for each audit. They describe the accounting information which he receives from his client, the methods of examination used, his conclusions and the financial statements".

Classification of Working Papers: Working papers can be classified into three categories:

- **a.** Permanent file papers.
- **b.** Audit administrative papers, and
- **c.** Audit evidence papers.

a. **Permanent File Papers:** The permanent file contains papers of continuing interest over many years audit of the same client. The file can be used year after year. It is a ready source of information for the first time familiarisation with the client for the staff sent for the audit.

b. **Audit Administrative Papers:** Administrative records contain the fruit of early planning phases of the audit. Usually these papers are bound together with the current year's audit evidence papers.

c. **Audit Evidence Papers:** The current year audit evidence working papers contain the record of the procedures followed, the tests performed, the evidence obtained and the decisions made in the course of audit. These papers themselves are communications of the quality of audit. Therefore, these must be client, concise, complete, well-indexed and informative.

Purpose of working papers: The working papers serve the following purposes:

a. They represent the volume of work performed by the auditor and his staff, which helps in preparing the report.
b. They show the extent of adherence to accounting principles and auditing standards.
c. They are useful as evidence against the charge of negligence.
d. They act as guide for subsequent examinations.
e. They enable the auditor to know the weakness of the internal check system in operation as also the accounting system.
f. They assist the auditor in co-ordinating and organising the work of audit clerks.
g. They assist in planning and performance of the audit work.

Forms and contents of working papers: The following are the contents of audit working papers.

1. The working papers should record the audit plan, the nature, timing and extent of auditing procedures performed and the conclusion drawn from the evidence obtained.
2. The exact form and content of working papers are affected by various matters like:
   a. The nature of the engagement.
   b. The form of the audit report.
   c. The nature and complexity of clients business.

d. The nature and condition of the client's records and degree of reliance on internal controls.
e. The need in particular circumstances for direction, supervision and review of work performed by assistants.

3. Working papers should be designed and properly organised to meet the circumstances of each audit and the auditors need in respect thereof. The standardisation of working papers.
4. Working papers should be sufficiently complete and detailed for an auditor to obtain an overall understanding of the audit.
5. All significant matters which require the exercise of judgement, together with the auditors' conclusions thereon, should be included in the auditor's working papers.
6. In the case of recurring audits, some working papers may be classified as permanent audit files as distinct from current audit files relating primarily to the audit of a single period.

7.6 Meaning of audit markings and its advantages

Meaning: While examining the records and documents certain making are used by the auditor, indicating that these have been checked. Audit markings are important to the auditor. It is an evidence that auditor has performed his work. The auditor can take the help of audit marking to determine the work performed by his staff. The documents bearing audit markings cannot be reproduced in support of another transaction. The transactions, books, records, and documents which bear audit marking can be distinguished from those which have not been examined.

Advantages: The following are the advantages of audit markings:

1. It ensures uniformity and helps in knowing the amount of work performed.
2. In case the assistant in-charge is changed, no difficulty is faced in continuing the incomplete work.
3. It is not easy for the company staff to make any changes because they do not understand the meaning of respective markings.

Short answer questions (2 Marks)

1. Define the term Audit Programme.
2. What is meant by Audit Note Book?
3. What is meant by Audit Working Papers?
4. What is meant by Audit Markings?

Long answer questions (6 Marks)

1. What is meant by audit program? Explain briefly about its features.
2. What are the advantages of Audit Programme?
3. What are the disadvantages of Audit Programme?
4. What are the contents of Audit Note Book? Explain about its advantages.
5. What are the contents of Audit Working Papers?

Ψ

UNIT 8

AUDIT REPORT

***Audit Report** – Meaning – Contents of Audit Reports – Types of Audit Reports – Characteristics of a Good Audit Report – Audit Report vs. Audit Certificate.*

Structure

Learning Objectives

After studying this unit the student will be able to

- Understand about the meaning and definition of Audit Report
- Understand about the contents of Audit Report
- Understand about various types of Audit Reports
- Understand the characteristics of a good Audit Report
- Understand the differences between Audit Report and Audit Certificate

8.1 Meaning and definition of Audit Report

An auditor's report is the format result of all the effort that goes into an audit. Communicating the auditor's findings to interested users is part of all audits. Thus, the final phase of an audit involves preparing that communication, which is known as the auditor's report. The report is the specific identifiable focal point for the auditor and for all those who rely on his work.

The language and words used in audit reports are of great importance. The extent of liability of the auditor for negligence and frauds depends upon the working of the report.

Definition:

"A statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject-matter of the report". – **LANCASTER.**

Importance of Auditor's Report: The actual ownership of the company lies in the hands of shareholders and not in the hands of management. One of the report on which the shareholders depend for forming their opinion about the management is auditor's report. Although, auditor's report does not guarantee as to the accuracy of detailed accounts of company, yet everybody obtains a clean chit from the auditor.

8.2 **Elements of Audit Report:** On the basis of SA 700 (Revised): Forming an opinion and reporting on Financial Statement, following are the elements of audit report.

1. **Title:** An appropriate title such as Auditor's Report, helps the reader to identify the report and to distinguish it from reports issued by others.
2. **Addressees:** It shall be addressed to the person as per circumstance, of his engagement like members/shareholders or those changed with governance.
3. **Introductory Paragraph:** It shall include entity whose financial statement have been audited, title of each component of financial statement, accounting policies and explanatory information, data and period covered by each statement and the fact that financial statements have been audited.
4. **Managements responsibilities for financial statement:** In this section of auditor's report it is described that management is responsible for preparation of financial statements as per financial reporting frame work. This responsibility includes design, implementation and maintenance of internal control relevant to preparation of financial statements that are free from material misstatement whether due to fraud or error.
5. **Auditor's Responsibility:** The auditor report shall state that responsibility of auditor is to express an opinion on financial statement on the basis of audit.
6. **Auditor's Opinion:** The auditor while giving unmodified opinion, such opinion shall be that financial statements give a true and fair view in accordance with financial reporting framework.
7. **Date and place of Auditor's Report:** The auditors report shall be dated not earlier than the date on which audit evidence has been obtained for the purpose of auditor's opinion on financial statement. The report shall also name specific location usually the city where auditor maintains office.
8. **Auditor's Signature:** The auditor's report shall be signed along with membership number of Institute of Chartered Accountants of India.
9. **Reading and inspection of auditor's report:** Report of the auditor must be read before the shareholders in general meeting and kept open for inspection of every member of the company. It shall also be attached to every balance sheet placed before every annual general meeting and annexed to every annual return.

8.3 Contents of Audit Report

According to Sec 143(3) of companies Act an auditor is required to make a report to shareholders of company on accounts examined by him and on every balance sheet, and profit

&loss a/c. Such a report is known as the 'Auditor's Report'. It is the medium through which an auditor expresses his opinion on financial statements. It is nothing but a statement of facts.

Contents of the Audit Report of Companies: The auditor's report has to contain certain matters. It must be clear and concise. It should be based on factual information. It should be convincing. The auditor has to take utmost care and caution in drafting his report. The Company balance sheet and profit & loss a/c should be first approved by directors and signed by them before they are submitted to auditors for scrutiny and his report thereon. According to sec 143(3) of the Act, auditor's report shall state:

1. Whether, in his opinion the accounts give the information required by the Act and give a 'true and fair' view of the state of the company's affairs in the case of balance sheet as at the end of the financial year, and in the case of profit and loss account of profit or loss for its financial year.
2. Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit.
3. Whether in his opinion, proper books of account as required by law have been kept by the company so far as it appears from the examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him.
4. Whether the report on the accounts of any branch office audited by a person other than the company's auditor has been forwarded to him.
5. Whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of accounts and returns.
6. Whether the financial statements comply with the Accounting Standards prescribed under section 133 of the Act.
   The auditor's report shall also include a statement on such additional matters as specified by the Central Government. If any those of matters as referred to in SA 700 answered in the negative the auditor have to state in his report the reasons for such adverse remarks.

8.4 Types of Audit Reports

Auditor's opinion as expressed in report may be classified as:

According to legal requirements an audit report consists of two parts namely (1) scope of the audit and (2) opinion of auditor as regards the financial statements.

1. **Scope part:** The first part of audit report describes audit and financial statements examined are mentioned. Usually subject matter of audit includes accounts, balance sheet and profit & loss a/c. The scope of examination cannot in any way be reduced.
2. **Opinion part:** The second part of audit reports consists of auditor's opinion with regard to the state of affairs of company. The opinion covers the truth and fairness of accounts and financial statements, their conformity with generally accepted accounting principles and legal provisions.
   1. **Unqualified or Clean Report:** If auditor is satisfied that profit & loss a/c and balance sheet are prepared in conformity with accounting principles and statutory requirements and

if he is satisfied that they do present a true and fair picture of state of affairs of company, then he will give a clean or unqualified opinion.

2. **Qualified Report:** Whenever auditor is not satisfied with certain matters of company then he will give a qualified opinion. It will be given where: a. The balance sheet and profit & loss a/c do not present truly and fairly the state of affairs and results of operations either due to lack of conformity with generally accepted accounting principles of they are incomplete as per statutory requirements, and b. When proper books of accounts as required by law have not been maintained. Auditor should exercise independent judgment and express his opinion irrespective of view held by directors. Though it is an unpleasant task to render a qualified report, he has to perform it and he can't in any circumstance escape it. He cannot refuse to submit report as he is appointed to safeguard interest of shareholders.
3. **Adverse or Negative opinion:** An adverse opinion is just reverse of a clean report. It will be given when there is a sufficient basis for auditor to form an opinion that accounts and financial statements, taken as a whole, do not present a true and fair view of the financial conditions and the results of operation. Such report should be made only in rare cases.
   As per SA 705, that an auditor may give adverse report on the following grounds:
   a. A substantial departure from the generally accepted accounting principles, or
   b. There is a material misstatement in the statements, or
   c. There is an omission of a material disclosure, or
   d. When sufficient evidence to form an opinion is available that financial statements do not give true and fair view of financial position and operation results of the company.
   e. When financial statements do not comply with the Provisions of Companies Act, 2013.
4. **Disclaimer of opinion:** Whenever auditor expresses an opinion, whether it is unqualified, qualified or adverse, it is implicit that the auditor has obtained sufficient, appropriate audit evidence which enables him to draw his conclusions. As per SA 705 there may, however be situations where auditor is not in a position to collect sufficient appropriate evidence, in such a case it may be proper for him to disclaim an opinion due to lack of sufficient evidence. Where auditor expresses a disclaimer of opinion, he should also state in his report reasons for the same, so that readers can access their significance and effect.

8.5 Characteristics of a good Audit Report

It is essential to have thorough knowledge of various principles of accounting and auditing to draft a good report. Apart from this following are the important points to keep in mind while preparing a good report.

1. **Sincerity of purpose:** Auditor should express his opinion whether financial statements of company reveals true and fair view of company's affairs in conformity with accounting principles and legal requirements. He should prepare report without influence of others.

2. **Clarity in thinking:** Clarity of expression is a pre-requisite for preparing report. The report is meant for a wide variety of people who may be otherwise quite intelligent, but all of them are not acquainted with terms of financial statements. Therefore, report of auditor must correctly and clearly inform them about state of affairs of company.
3. **Accuracy:** Data collected, interpreted and resented in audit report must be accurate.
4. **Simplicity:** Complicated style of writing should not be used while drafting an audit report. Auditor must be able to present even complicated information in a simple way.
5. **Brevity:** Brevity in words, in phrase and in sentence will always make report live and interesting. Moreover, it will save its readers who are busy to get at the substance of matter at once. This can be achieved by revising report again and again and cutting out the unnecessary details and tying up the loose ends.

8.6 Audit Report vs. Audit Certificate

The following are the key differences between Audit Report and Audit Certificate:

S. No.	Audit Report	Audit Certificate
1.	It is an expression of opinion on financial statements at the end of the audit assignment.	It gives an impression that auditor is issuing a guarantee of absolute correctness and accuracy of certain facts.
2.	But in case of a report, he cannot be held responsible (unless professional negligence is proved) because whatever is reported is simply an opinion on working results of company.	If the certificate signed or issued by the auditor is wrong, then he will be held responsible.
3.	An auditor is required to report that financial statements are properly drawn up in accordance to the Companies act so as to give a 'true and fair view' of state of company's affairs and accounting and other records are properly maintained.	An auditor is not required to certify accounts that financial statements are properly drawn up in accordance to the Companies act so as to give a 'true and fair view' of the state of company's affairs and accounting and other records are properly maintained.

Short answer questions (2 Marks)

1. What is meant by Audit report?
2. What is meant by Audit certificate?
3. What is meant by disclaimer of opinion?
4. What is meant by Adverse opinion?
5. What is meant by clean report?

Long answer questions (6 Marks)

1. What are the elements of audit report?
2. What are the characteristics of a good audit report?
3. Explain briefly about the contents of audit report.
4. Explain in detail about the various types of audit reports.

Ψ

ACCOUNTING & TAXATION (A & T)

Paper – II

Accountancy And Tally

INDEX

UNIT 1

DEPRECIATION

Depreciation – Meaning and need of depreciation – Causes of depreciation – Methods of depreciation – Simple problems on depreciation (Straight line and diminishing balance method) – including problems.

Learning Objectives

After studying this Chapter, the student will be able to:

- Understand the meaning and definition of depreciation.
- Recognise the reasons and causes for providing depreciation.
- Identify various methods of depreciation.
- Determine the profit or loss at the time of sale of asset.
- Preparation of asset account and depreciation account under straight line and written down value methods.

1.0.INTRODUCTION:

All assets whose benefit is derived for a long period of time, usually more than one year period are called as **Fixed Assets**. These assets decrease in value year after year due to wear and tear or lapse of time. This reduction in value of Fixed Assets is called Depreciation.

Generally, the term 'depreciation' is used to denote decrease in value, but in accounting, this term is used to denote decrease in the book value of a fixed asset. Depreciation is the permanent and continuous decrease in the book value of a fixed asset due to use, effluxion of time, obsolescence, expiration of legal rights or any other cause.

For instance, a factory owner, owns a machinery worth Rs.1,00,000, may estimate the life of the machinery as five years. This means that the value of the asset is reducing every year. Hence, it is necessary to spread the cost over five years during which the benefit of the asset is derived. Thus depreciation Rs.20,000 (Rs.1,00,000 / 5 years) is to be treated as an expense, which is debited to Profit and Loss account.

1.1.DEFINTION:

In the words of Spicer and Pegler, "Depreciation is the measure of the exhaustion of the effective life of an asset from any cause during a given period".

Carter defines depreciation as "the gradual and permanent decrease in the value of an asset from any cause".

According to ICMA (Institute of Cost and Management Accountants - London) Terminology "Depreciation is the diminution in intrinsic value of asset due to use and / lapse of time".

The above definitions reveal that when fixed assets are used in business to generate income, they lose their production capacity or earning capacity and at a particular point of time they render themselves useless. This reduction in the production capacity or earning capacity is termed as depreciation.

1.2.NEED FOR PROVIDING DEPRECIATION: The need for providing depreciation in accounting records arises due to any one or more of the following reasons.

1. To ascertain correct profit / loss For proper matching of cost with revenues, it is necessary to charge depreciation against revenue in each accounting year, to calculate the correct net profit or net loss.
2. To present a true and fair view of the financial position If the amount of depreciation is not provided on fixed assets in the books of account, the value of fixed assets will be shown at a higher value than it's real value in the balance sheet. As such it will not reflect the true and fair financial position of the business. Hence, to present a true and fair view of the financial position of the business, it is necessary that depreciation must be deducted from the book value of the assets in the balance sheet.
3. To ascertain the real cost of production For ascertaining the real cost of production, it is necessary to provide depreciation.
4. To comply with legal requirements As per Section 205(1) of the Companies Act 1956, it is compulsory for companies to provide depreciation on fixed assets before it declares dividend.
5. To replace assets Depreciation is provided to replace the assets when it becomes useless.

1.3. CAUSES FOR DEPRECITION:

1. Wear and tear : The asset may decrease in its value because of constant use in the business. This is also caused because of erosion. When the asset is exposed to sun, wind or rain it may lose its value.

2. Lapse of Time: Assets may have a fixed life period. After the expiry of its life, the asset may become useless. This may happen in plant and machinery, lease. Copyright patents etc. After the expiry of the fixed life the asset may become useless.

3. Accident: The assets may reduce in value because of the accident. It is not gradual decrease, but there is a permanent loss in its value.

4. Inadequacy of Assets: The increase in the size or growth of the business may cause inadequacy of the asset. As a result the asset may be terminated.

5. Obsolescence : When the asset become outdated, it becomes useless in the business. So it is to be replaced by new and modern assets with the latest technology. Thus the old asset losses its value.

6. Depletion : Asset may be exhausted through its working e.g., mines, minerals, oil etc. These assets get exhausted because of extraction and exploitation. Hence the assets become useless.

1.4 FACTORS INFLUENCING DEPRECIATION:

1. Wear and tear due to constant use.
2. Decrease in the market value of the asset.
3. Due to obsolescence i.e., permanent change in the asset may be result in the uselessness of the asset.
4. Non-functioning of a machine may cause depreciation.
5. Accident and damage of an asset will caused depreciation.

1.5 METHODS OF PROVIDING DEPRECIATION: The following are the main methods of providing depreciation.

1. Fixed Instalment Method.
2. Diminishing Balance Method.
3. Depreciation Fund Method.

4. Insurance Policy Method.
5. Revaluation Method.
6. Annuity Method.
7. Depletion Method.
8. Machine Hour Rate Method.
9. Global Method.
10. Sum of Digits Method.

FIXED INSTALLMENT METHOD

This method is also known as "Straight Line" or "Original Cost Methods". Under, this method a fixed percentage of original value of the asset is written off every year. In this method depreciation is charged equally every year throughout the life of the asset. The depreciation charged on the asset is fixed throughout the effective life of the asset. At the end of the working life of the asset, balance in the asset account will be Zero. The amount of depreciation is calculated as follows:

$$\text{Annual Depreciation} = \frac{\text{Cost of the Asset} - \text{Scrap Value}}{\text{Estimated Life of the Asset}}$$

$$\text{Rate of Depreciation} = \frac{\text{Annual Depreciation}}{\text{Total cost of the Asset}} \times 100$$

Advantages:

1. This method is simple and easy to understand.
2. Calculation if depreciation is very easy. The value of asset can be written down to zero.
3. This method is very suitable to those which have a fixed life e.g., furniture and fixtures, lease etc.

Disadvantages:

1. It is difficult to estimate the life of certain asset with accuracy e.g. machinery.
2. The interest on the amount invested in the purchase of asset is not taken into consideration.
3. In this method, it becomes difficult to calculate the depreciation on additions made during the particular year.
4. The same amount of depreciation is charged every year irrespective of the use of the asset. Thus, it does not take into account the effective utilization of the asset.

Illustration : 1

A company purchased Machinery for Rs.1,00,000. Its installation costs amounted to Rs.10,000. It's estimated life is 5 years and the scrap value is Rs.5,000. Calculate the amount and rate of depreciation

Solution:

Total cost = Purchase Price + Installation Charges

= Rs.1,00,000 + Rs.10,000

= Rs. 1,10,000

$$\text{Annual Depreciation} = \frac{\text{Cost of the Asset} - \text{Scrap Value}}{\text{Estimated Life of the Asset}}$$

$$\text{Annual Depreciation} = \frac{110{,}000 - 5000}{5} = 21000$$

$$\text{Rate of Depreciation} = \frac{\text{Annual Depreciation}}{\text{Total cost of the Asset}} \times 100$$

If annual depreciation is Rs.21,000 and the cost of the asset is Rs.110,000

$$\text{Rate of Depreciation} = \frac{21000}{110{,}000} \times 100 = 19.09\%$$

JOURNAL ENTRIES

Date	Particulars	Dr. Amount ₹	Cr. Amount ₹
xx	When the asset is purchased		
	Asset Account Dr.	xxx	---
	To Bank Account	---	Xxx
	(Being the asset purchased)		
xx	When the depreciation is provided on the asset		
	Depreciation Account Dr.	xxx	---
	To Asset Account	---	Xxx
	(Being the depreciation calculated)		
xx	When the depreciation is transferred to P&L A/c		
	Profit & Loss A/c Dr.	xxx	---
	To Depreciation A/c	---	Xxx
	(Being the depreciation transferred to P&L A/c)		
xx	When the asset is sold after its working life		
	Bank Account Dr.	xxx	---
	To Asset Account	---	Xxx
	(Being the asset sold)		
xx	Profit earned on sale of Asset transferred to P&L A/c		
	Asset Account Dr.	xxx	---
	To Profit & Loss A/c	---	xxx
	(Being the profit transferred to P&L A/c)		
xx	When loss occurred on the sale of an Asset		
	Profit & Loss Account Dr.	xxx	---
	To Asset Account	---	xxx
	(Being the loss on sale transferred to P&L A/c)		

Illustration 2:

On 1st January 2014, a firm purchased plant and machinery costing Rs.52,000. It is estimated that its working life is 5 years and at the end of which it will fetch Rs.2,000. Show Plant and Machinery account for 3 years, if depreciation is charged according to straight line method.

Solution : Annual Depreciation = $\dfrac{\text{Cost of the Asset} - \text{Scrap Value}}{\text{Estimated Life of the asset}}$

$$\text{Annual Depreciation} = \frac{52{,}000 - 2{,}000}{5} = \text{Rs. } 10{,}000$$

Dr. Plant and Machinery Account Cr.

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
1.1.2014	To Bank	52,000	31.12.14	By Depreciation	10,000
				By Balanced c/d	42,000
		52,000			52,000
1.1.2015	To Balance b/d	42,000	31.12.15	By Depreciation	10,000
				By Balanced c/d	32,000
		42,000			42,000
1.1.2016	To Balance b/d	32,000	31.12.16	By Depreciation	10,000
				By Balanced c/d	22,000
		32000			32000
1.1.2017	To Balance b/d	32,000			

Illustration 3:

A machine was purchased on 1st July 2015 at a cost of Rs.18,000 and Rs.2,000 was spent on its installation. The depreciation was written off at the rate of 10% on its original cost. The books were closed on 31st December every year. Show the machinery account and depreciation account for three years.

Dr. Plant and Machinery Account Cr.

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
1.7.2015	To Bank a/c	18,000	31.12.15	By Depreciation	1,000
	To Bank a/c	2,000	,,	By Balanced c/d	19,000
		20,000			20,000
1.1.2016	To Balance b/d	19,000	31.12.16	By Depreciation	2,000
			,,	By Balanced c/d	17,000
		19,000			19,000
1.1.2017	To Balance b/d	17,000	31.12.17	By Depreciation	2,000
				By Balanced c/d	15,000
		17,000			17,000
1.1.2018	To Balance b/d	15,000			

Dr. Depreciation Account Cr.

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
31.12.15	To Machinery a/c	1,000	31.12.15	By P & L a/c	1,000
31.12.16	To Machinery a/c	2,000	31.12.16	By P & L a/c	2,000
31.12.17	To Machinery a/c	2,000	31.12.17	By P & L a/c	2,000

Illustration 4:

Jagadish purchased a second hand machine for Rs.57,000 on 01.05.2008 and spent Rs.3,000 for its repairs. On 31.12.2011 the machine became unsuitable and sold for Rs.40,000. The books were closed on 31st December every year. Prepare machinery account from 2008 to 2011 charging depreciation @ 12% p.a. Under fixed installment method.

Dr. Machinery Account Cr.

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
1.5.2008	To Bank a/c	57,000	31.12.08	By Depreciation	4,800
	To Bank (Repairs)	3,000	,,	By Balanced c/d	55,200
		60,000			60,000
31.11.09	To Balance b/d	55,200	31.12.09	By Depreciation	7,200
			,,	By Balanced c/d	48,000
		55,200			55,200
1.1.2010	To Balance b/d	48,000	31.12.10	By Depreciation	7,200
				By Balanced c/d	40,800
		48,000			48,000
1.1.2011	To Balance b/d	40,800	31.12.11	By Depreciation	7,200
31.12.11	To P &L A/c (Profit on sale)	6,400	,,	By Balance c/d	40,000
		47,200			47,200

Calculation of profit or loss on the sale of the asset:

Cost of the Asset	(57,000 + 3000)	60,00
Less: Total Depreciation (4800+(7200+7200+7200)		26,400
Written down value (W.D.V)		33,600
Less : Sale of machinery on 31.12.2011		40,000
Profit on Sale		6,400

Note : If the sale value is more than the W.D.V. of the asset, it is profit. If the sale value is less than the W.D.V. of the asset, it isloss.

DEMINISHING BALANCE METHOD

This Method is also known as "Written Down value Method" or "Reducing balance method" The depreciation under this method is calculated at a fixed percentage on the diminished value of the asset i.e. depreciation is calculated on the brought down balance of the asset. So the amount of depreciation at the beginning year will be more when compared to the later year. So the depreciation charged on every year goes on decreasing.

Advantages:

1. Fresh calculation of depreciation is not necessary as and when addition are made.
2. The Asset is never completely written off, so that charged is made to revenue every year.
3. Higher repair charges at the end of life of the asset are offset by lower amounts of depreciation.
4. The method is recognized by income tax authorities as well as Companies Amendment Act, 1988.

Disadvantages

1. In this method, the calculation of depreciation is slightly complicated.
2. The value of the asset cannot be brought down to zero.
3. This method lays too much emphasis on the historical cost.
4. It is difficult to determine the suitable rate of depreciation.
5. It does not provide funds to replace the assets.

Illustration No.5:

A trader purchased machinery for Rs.10.000 on 1.1.2009 Calculate depreciation @ 10% per annum under diminishing balance method for the first 4 years. Show the Machinery account.

Dr. **Machinery Account** **Cr.**

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
1.1.2009	To Bank a/c	10,000	31.12.09	By Depreciation	1,000
			,,	By Balanced c/d	9,000
		10,000			10,000
1.1.2010	To Balance b/d	9,000	31.12.10	By Depreciation	900
			,,	By Balanced c/d	8,100
		9,000			9,000
1.1.2011	To Balance b/d	8,100	31.12.11	By Depreciation	810
				By Balanced c/d	7,290
		8,100			8,100

1.1.2012	To Balance b/d	7,290	31.12.12	By Depreciation	729
		7,290	,,	By Balance c/d	6,561
1.1.2013	To Balance b/d	6,561			7,290

Illustration No.6:

Mr. Rao purchased a machine for Rs.44,000 on 1.7.2009 and spent Rs.6,000 on it erection on 31.12.2011 the machine became obsolete and was sold for Rs.40,000. Calculate depreciation @10% p.a. under Diminishing Balance Method. Show the Machinery account.

Profit Loss on sale of Assets :

Cost of Assets (44,000+6,000)	Rs.50,000
Less depreciation	
2009	2,500
2010	4,750
2011	4,275
W.D.V. as on 31.12.2012	Rs.38,475
Less amount realized on sale	Rs.40,000
Profit on the sale of machine	Rs.1,525

Dr. Machinery Account Cr.

Date	**Particulars**	**Amount ₹**	**Date**	**Particulars**	**Amount ₹**
1.7.2009	To Bank a/c	44,000	31.12.09	By Depreciation	2,500
	To Bank a/c	6,000	,,	By Balanced c/d	47,500
		50,000			50,000
1.1.2010	To Balance b/d	47,500	31.12.10	By Depreciation	4,750
			,,	By Balanced c/d	42,750
		47,500			47,500
1.1.2011	To Balance b/d	42,750	31.12.11	By Depreciation	4,275
	To P&L A/c (Profit on sale	1,525		By Bank a/c	40,000
		44,275			44,275

Illustration No.6:

On 1.1.2009 'X' purchased furniture worth Rs.25,000 on 1st July 2010. He purchased additional second hand furniture worth Rs.5,000 and spent Rs.2,000 for its repairs. Assuming the annual depreciation is charged @ 10% p.a. Prepare machinery account under diminishing Balance method for 3 years.

Purchased furniture on 01-01-2009 = 25,000

Purchased second hand furniture on 01-07-2010 = 5,000

Repairs = 2,000

Rs.7,000

Dr. **Furniture Account** **Cr.**

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
1.1.2009	To Bank a/c	25,000	31.12.09	By Depreciation	2,500
			,,	By Balanced c/d	22,500
		25,000			25,000
1.1.2010	To Balance b/d	22,500	31.12.10	By Depreciation	2,600
1.7.2010	To Bank a/c	5,000	,,	By Balanced c/d	26,900
	ToBank(Repairs)	2,000			47,500
		29,500			29,500
1.1.2011	To Balance b/d	26,900	31.12.11	By Depreciation	2,690
				By Bank a/c	24,210
		26,900			26,900
1.1.2012	To Balance b/c	24,210			

Illustration No.7:

On 1.4.2010 a company purchased a machinery for Rs.30,000, Depreciation was provided @ 10% per annum on straight line method at the end of the year. With effect from 1.1.2011 the company decided to change the method of depreciation to Diminishing Balance Method @12% per annum. On 31.3.2012 the machinery became useless and sold for Rs.21,000. Prepare Machinery Account.

Working Notes:

Machinery purchased on 1.4.2010 : Rs.30,000

Rate of depreciation 10%

From 1-1-2011 depreciation charged 12% under diminishing balance method.

On 31-03-2012, Machinery sold for Rs.21,000

Dr. **Machinery Account** **Cr.**

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
1.4.2010	To Bank a/c	30,000	31.12.10	By Depreciation	2,250
			,,	By Balanced c/d	27,750
		30,000			30,000
1.1.2011	To Balance b/d	27,750	31.12.11	By Depreciation	3,330
			,,	By Balanced c/d	24,420
		27,750			27,750
1.1.2012	To Balance b/d	24,420	31.03.12	By Depreciation	733
				By Bank a/c	21,000
				By P&L A/c(Loss)	2,687
		24,420			24,420

SHORT ANSWER QUESTIONS(2 Marks)

1. Define depreciation.
2. What are the causes of depreciation?
3. Write the main method of charging depreciation?
4. What is the need for providing depreciation?

EXERCISES

Fixed Installment Method:

1. Furniture is purchased for Rs.35,000/-. It is decided to depreciate the asset on straight line method at 10% per annum. Show furniture account for 5 years.

(Ans. Balance Rs.17,500)

2. A machine is purchased for Rs.50,000. The rate of depreciation is to be charged at 20% per annum. Prepare machinery account for four years under Fixed installment method.

(Ans. Balance Rs.10,000)

3. A firm purchased a machine for Rs.1,00,000 on 1.4.2014. Show the machinery account for 4 years charging depreciation on Fixed installment Method @ 15% p.a.

(Ans. Balance Rs.43,750)

4. Mr. Ravi purchased a mchine for Rs.68,000 on 1st January 2015. The residual value after 10 years is 8,000. Calculate depreciation chargeable under equal installment method at the end of 31st December of every year. Prepare machinery account for 3 years.

(Ans. Balance Rs.50,000)

5. A firm purchased a plant and machinery for Rs.40,000 on 1st January, 2015. The life of the asset was estimated to be four years and it was decided to depreciate 90% of the cost by straight line method over a period of estimated life. Show the plant and machinery account for 4 years.

(Ans. Annual Depreciation Rs.9,000, Balance on 1.1.19 Rs4,000)

Diminishing Balance Method:

6. On 1st January, 2016 a firm purchased a machine for Rs.30,000. Assuming the depreciation is charged @ 10% on diminishing balance method. Prepare machinery account for three years.

(Ans. Balance Rs.21,870)

7. A company purchased a plant worth Rs.25,000 on 31.3.2016 depreciation is calculate @10% per annum, under diminishing balance method. Show the machinery accounts up to 31st December, 2018.

(Ans. Balance Rs.18,731)

8. A company purchased a plant worth Rs.25,000 on 01.7.2015 the depreciation calculated @10% per annum. Under diminishing Balance Method. Show the machinery account up to 31st Dec 2018.

(Ans. Balance Rs.17,313)

9. Lee & Co. purchased a second hand machine costing Rs.45,000 on 1st Jan 2015 and spent Rs.5,000 on its repairs. The depreciation is charged @15% p.a. on diminishing balance method. Prepare machinery account for the first four years.(Ans. Bl. Rs.26,400)

Sale of Asset:

10. Machinery bought on 1st Jan 2015 for Rs.20,000 has become obsolete and sold on 31st Dec, 2012 for Rs.13,000. Calculate the profit or loss assuming depreciation is charged @ 15% p.a. on straight line method.

(Ans. Profit Rs.5,000)

11. Machinery purchased on 1.7.2009 for Rs.10,000 was sold on 31.12.2011 for Rs.5,000. Calculate the profit or loss of sale assuming depreciation is charged @ 10% per annum under fixed installment method.

(Ans. Loss Rs.2,500)

12. Furniture worth Rs.10,000 was purchased as on 1.1.2009. The furniture was sold on 31.12.2012 for Rs.6,000. Find the profit or loss on the sale of furniture charge depreciation @ 10% p.a. under diminishing balance method.

(Ans. Loss Rs.925)

13. A second hand machine was purchased for Rs.12,000 on 1.1.2009 and Rs.3,000 spent towards repairs. On 30.6.2012 the machine became unsuitable and was sole for Rs.10,000. Charge depreciation @15% on Diminishing Balance Method. Show the machinery account.

(Ans. Loss Rs.4,202)

14. Furniture worth Rs.20,000 was purchased on 1.1.2010 and on 1.4.2011 additional furniture worth Rs.8000 was purchased and Rs.2,000 was spent on its erection. On 31.12.2011 furniture purchased on 1.1.2010 was sold for Rs.15,000. Prepare the furniture account up to 31.12.2012 charging depreciation @12% p.a. as per diminishing balance method.

(Ans. Loss Rs.488, Balance Rs.8008)

Ψ

UNIT 2

ACCOUNTS OF NON – TRADING CONCERNS

Accounts of Non Trading Concerns – Distinction between capital and revenue expenditure – Receipts and payments account – Income and expenditure account - including problems.

Learning Objectives

After completing this unit, the student will be able to

- Understands the meaning and characteristics of accounting of non profit organizations.
- Identity the need for, and nature of accounting records relating to not-for-profit organizations.
- List the principal financial statements prepared by non profit organisations and explain their nature.
- Prepare the Receipt and Payment Account from a given date.
- Explain the procedure of preparing the Income and Expenditure Account from a given Receipt and Payment Account and some additional information.·
- Distinguish between the Receipt and Payment Account and the Income and Expenditure Account.
- Prepare Income and Expenditure Account and Balance Sheet from a given Receipt and Payment Account and the relevant additional information.
- Explain treatment of certain peculiar items of receipts and payments such as subscriptions from members. Special Funds. legacies. sale of old .fixed assets. etc.
- Understand the meaning and purpose of Accounts of Non – Trading concerns.

1.0 Introduction:

There are certain organisations which are set up for providing service to its members and the public in general. Such organisations include clubs, charitable institutions, schools, religious organisations, trade unions, welfare societies and societies for the promotion of art and culture. These organisations have service as the main objective and not the profit as is the case of organisations in business. Normally, these organisations do not undertake any business activity, and are managed by trustees who are fully accountable to their members and the society for the utilization of the funds raised for meeting the objectives of the organisation. Hence, they also have to maintain proper accounts and prepare the financial statement which take the form of Receipt and Payment Account; Income and Expenditure Account; and Balance Sheet at the end of for every accounting period (normally a financial year).

This is also a legal requirement and helps them to keep track oftheir income and expenditure, the nature of which is different from those of the business organisations. In this chapter we shall learn about the accounting aspects relating to not-for-profit organisation.

1.1 Meaning:

Not-for-Profit Organisations refer to the organisations that are for used for the welfare of the society and are set up as charitable institutionswhich function without any profit motive. Their main aim is to provide service to a specific group or the public at large. Normally, they do not manufacture, purchase or sell goods and may not have credit transactions. Hence they need not maintain many books of account (as the trading concerns do) and Trading and Profit and Loss Account.

The funds raised by such organisations are credited to capital fund or generalfund. The major sources of their income usually are subscriptions from their member's donations, grants-in-aid, income from investments, etc. The main objective ofkeeping records in such organisations is to meet the statutory requirement and help them in exercising control over utilisation of their funds. They also have to prepare the financial statements at the end of each accounting period (usually a financial year) and ascertain their income and expenditure and the financial position, and submit them to the statutory authority called Registrar of Societies.

1.2 Accounting Records of Not-for-Profit Organisations:

The final accounts of a 'not-for-profit organisation' consist of the following:

a. Receipt and Payment Account
b. Income and Expenditure Account, and
c. Balance Sheet

1.3 Capital and Revenue

One of the objects of accounting is to determine whether the business has earned profit or not. For this purpose a proper distinction has to made between capital and revenue as regards expenditure, receipts and losses are required. Failure to distinguish capital from revenue will effect the whole results. For example, plant purchased may be charged to the purchase account, proceeds from the sale of fixed assets may be treated as income. In each case both the profit and loss account and balance sheet will be affected. While preparing the final accounts all revenue items are included in the revenue account i.e., Income and expenditure account and balance sheet. Any more committed in distinguishing between "Capital" and "Revenue" will effect the ascertainment of correct profit.

It is very difficult to give clear cut rules as to make a distinction between the capital and revenue expenditure. However the following rules may serve as guide for making distinction between capital and revenue expenditure.

Capital Expenditure

Capital expenditure is such an expenditure which benefits the business over a long period it include assets acquired for the purpose of earning and not for resale, improving extending fixed assets, increasing the earning capacity of the business and rising capital for the business. Purchase of new plant, additions to the buildings, brokerage and commission paid for procuring long term loans are a few examples of such expenditure. All items of capital expenditure appear on the assets side of the balance sheet.

Revenue Expenditure

Revenue expenditure is the expenditure incurred in one accounting period and the full benefit it enjoyed in the same period. Therefore, it is normally of recurring nature. Such an expenditure does not increased the earning capacity of the business and is done not bring into existence and assets. It includes expenses incurred for acquiring assets for resale at a profit or for conversion into finished product, for maintaining fixed assets in good working order e.g., normal repairs and renewal of plant, White washing of building replacement of machinery etc., for keeping the organization going e.g., rent, rates and taxes wages and salaries, insurance and other trade charges. All items of revenue expenditure appear in the trading and profit and loss account.

Revenue expenditure becoming capital expenditure.

An expenditure which is primarily of revenue nature but incurred for the purpose of acquiring any asset or adding to its value, is termed as 'capitalized expenditure'. The following are some of the examples of revenue expenditure becoming capital expenditure.

1. **Repairs:**Repairs are usually revenue expenditure but, if we purchase a second hand machinery and pay for repairs necessary as 'capitalized expenditure.
2. **Wages:**Wages are usually based as a revenue charge but if paid to the employees for the construction or erection or installation of fixed assets of the business, them these will become capital expenditure and should be added to the cost of the fixed asset concerned.
3. **Legal Expenses:**These are usually a revenue charge but, if incurred on acquiring a property, should be added to the cost of the asset acquired cost of the asset.
4. **Freight And Carriage:** These are usually a revenue item, but payments made for transporting newly acquired asset will be treated as a capital expenditure and will from additional cost of the asset.
5. **Interest:**Interest on borrowing and capital are generally a revenue item and is allowed to be treated as capital item if paid during the period of construction.
6. **Preliminary expenses:**Initial expenses, connected with the formation of a company through revenue in nature are allowed to be capitalized and can be shown as an asset in the balance sheet.
7. **Brokerage and stamp duty:**Normally these are revenue items, but brokerage and stamp duty paid on the purchase of a property may be treated as capital expenditure.
8. **Development expenditure:**In concerns like mines, tea plantations, collieries, horticulture rubber plantation etc. a sizeable is spent during the period of development and such expenses incurred upto the time they begin to earn, must to be treated as capital expenditure.
9. **Advertising:**A huge sum spent on advertising in a year, the benefit of which shall accrue in future years, also may have the affect of creating a future goodwill, therefore such sums may be capitalized. For example, lakhs of rupees spent in changing the name from Binaca to Cibaca.
10. **Raw materials and stores:**They are usually a revenue charge, but if consumed to make a fixed asset, they must be treated as part of the cost of the asset.

Deferred Revenue Expenditure

It is the expenditure which would normally be treated as revenue expenditure, but it is not written off in one year as a benefit is not completely exhausted in the year during which it is incurred at it may as it may be spread over a number of year. Therefore, a proportionate amount will be charged to the profit and is account of each year and the balance is carried forward to subsequent years as deferred revenue expenditure and is shown as an asset in the balance sheet. Sometimes extra ordinary losses are also treated as deferred revenue expenditure and charged to profit and loss account for four to five years.

Usual items of capital Expenditure

The following items usually represent capital expenditure:

1. Cost of acquisition of fixed assets like goodwill, land building, leasehold premises, tools and equipment, furniture, trademarks etc.
2. Expenses of putting a new asset in working condition like installation and erection expenses of any fixed asset.
3. Additions or extensions or structural improvement to the existing assets leading to increase in their working efficiency or revenue earning capacity or cost reduction e.g., refurnishing of the seating accommodation of a cinema hall etc,.
4. Expenses incurred for the development of mines and plantation.
5. Formation expenditure of a business i.e. preliminary expenses like preparing and filling the legal documents required for starting a business etc.

Usual items of Revenue Expenditure

The following are usual items of revenue expenditure

1. Expenses incurred in the ordinary conduct and administration of the business e.g. rents, salaries, wages, advertisement etc.
2. Expenses incurred in purchasing raw material or stock finished goods for resale store and supplies like grease, cotton, oil for machines etc,.
3. Expenses incurred to maintain assets in working order like ordinary repairs, renewals or alterations etc,.
4. Expenses incurred in maintaining or pushing sales like carriage of finished goods commissions travelling expenses, free samples and gifts etc.
5. Loss arising from sale of fixed assets.
6. Loss arising from damage, destruction, theft of stock, trade cash etc.
7. Loss arising from depreciation in the values of fixed assets or book value of asset discarded.
8. Annual renewal fees of patents etc.

1.4 Capital and Revenue Receipts

Capital receipts if business comprise capital contributed by partners or by the share holders, loans, raised, sale proceeds of any fixed assets, etc,. In case of clubs and associations receipts on account of life subscriptions, entry fee, government grants, legacies and endowments are capital receipts. Revenue receipts of a business are cash from sale, discount received, commission, interest on investment etc. In case of clubs and association, annual subscription, sale or games articles, receipts, arising when the premises are given to others for use, are revenue receipts. Revenue receipts are shown in the revenue account i.e,. Income and Expenditure account will the capital receipts are taken to the balance sheet.

To decide of a particular receipts is of capital nature the following guide lines may be followed.

1. Nature of receipts is to be determined by its character in the hands of the person receiving it and not by the source from which payments was made e.g. pay of interest out of capital by a company still under construction is capital expenditure for the company but revenue receipts in the hands of the persons receiving it.
2. In case of a single transaction of purchase and sale of property the motive of the owner will decide whether the receipt is capital or receipts but if A sells the share with speculations motive it will be revenue receipts.
3. A receipts on account of sale of a fixed asset is a capital receipt while a receipt on account of a sale of current asset is a revenue receipt for e.g. sale proceeds of building plant etc. Constitute receipt while sale if stock-in-trade is revenue receipts.
4. If the receipts is in substitution of a source of income then it is capital receipts but, it is in substitution of income alone it is revenue receipt. For e.g. if a railway passenger meets with an accident and dies, or is permanently disables, the compensation received from the railway department is capital receipt because this receipts is in substitution of source of income i.e. his life but if he temporarily disabled the receipts will be revenue as it is in substitution of income i.e. loss of earning as during the period of disablement.
5. If a sum is received for the surrender of certain right, it is capital receipts but if the sum is received is a compensation for loss of future profits then it is a revenue goods for e.g. A, the railway company for working on the field adjacent to the railway lines, amount paid by the railway company to A is a revenue receipt because the receipts is in lieu if his right to work upon the clay field.

Example of Capital Receipts

1. Compensation received for the loss of right of future remunerations.
2. Compensation received for suspension of export license.
3. Compensation received by a partner of a partnership firm from another partner for relinquishing all his rights in the partners firm.

Example of Revenue Receipts

1. Receipts of annuity for transfer of a capital asset.
2. Lump-sum received in consideration of reduction of remuneration.
3. Compensation received for premature termination of contract.
4. Consideration received for transfer of permits etc.

Capital and Revenue Losses

Revenue loss is of some revenue receipts in the course of the business and in incidental to it. Any loss which is termed as revenue loss is a capital loss for e.g. loss of stock-in-trade by fire of white ants by theft is a revenue loss whereas loss of fixed asset like building, plant etc by fire or earth quake is a capital loss.

Loss caused to the business by reason of cash being misappropriated by employees is a revenue loss. If the funds reach home of the owner and lost after then the loss it outside the trade and not incidental to the business, therefore it is capital loss (expectations are banks or lending houses).

1.5 Receipts and Payments Account

It is summary of cash transaction at the end of particular period showing the receipts and payments of cash during the period under different heads.

The features of this account are:

1. It is prepared by non-trading concerns in lieu of cash book.
2. It is real account.
3. Its start with the opening balance of cash in hand and at the bank.
4. All receipts and payments of cash are entered on the debit and credit side respectively.
5. No distinction is made between the capital and revenue items while entering transactions in the receipts and payments account.
6. All receipts and payments whether they are relating to the current, proceeding or succeeding period are written in this account.
7. Opening balance of this account cash in hand at the beginning of the accounting period and closing balance shows cash in hand at the end of accounting period.
8. All types of accounts i.e., real and nominal are written in this account.
9. No adjustment for outstanding, prepaid expenses provisions for doubtful debts or depreciations are made in this account it is prepared in cash system of accounting.
10. It does not reveal the financial results or the financial position of the association or clubs because accrued incomes and outstanding expenses are not taken into account.

A specimen of the receipt and payments account of a club for a particular year is given below.

Receipts and Payments Account of……for the year ending 31.03.2019

Dr. Receipts	Rs.	Payments	Cr.
To Balance b/d	xxx	By Rent	xxx
To Subscriptions	xxx	By Fixed Assets	xxx
To Entrance fee	xxx	By Sports material purchased	xxx
To Legacy	xxx	By Building	xxx
To Donations for building	xxx	By Ground maintenance	xxx
To Interest received	xxx	By Salaries	xxx
To Sale of furniture	xxx	By Honorarium	xxx
To Sale of old Sports materials	xxx	By Stationary	xxx
To Match fund	xxx	By Investments	xxx
To Life membership fees	xxx	By Balance c/d	xxx
	xxx		xxx
To Balance b/d	xxx		

Illustration 1

Stadium club kept its account on cash basis and the figures for the year 2018 are given below. You are required to prepare Receipts and Payments Account.

	Rs.		Rs.
Subscription Received			
2017	800	Salaries	4,800
2018	7,200	Postage	480
Receipt from		Stationary	1,200
Common Room	5,000	Rent	2,000
Hiring Rooms	400	Cash in hand	xxx
Billiards Rooms	2,400	01-01-2018	720
Supplies from		Electricity	1,600
Entertainment room	3,400		
Wages to Watchman's	2,720		

Receipts and Payments Account of stadium club for---------------- in the year Ending on 31st Dec 2018

Dr. **Cr.**

Receipts	Rs.	Payments	Rs.
To Balance b/d	720	By Supplies for entertainment	3,400
To Subscriptions			
2017	800	By Watchman's wages	2,720
2018	7,200	By Salaries	4,000
To Receipt from c. room	5,000	By Postage	480
To Hiring of rooms	400	By Stationary	1,200
To Billiards rooms	2,400	By Rent	2,000
		By Electricity	1,600
		By Balance c/d	1,120
	16,520		16,520
To Balance b/d	1,120		

1.6 Income and expenditure Account

It is prepared by Non-trading concerns of profit and loss account to know whether during a particular period the income of the concerns or organization has exceeded or fallen short of the expenses, this account is prepared. In this account current expenses are compared with current incomes. The feature of this account are.

1. It is not start with any opening balance.
2. It is a nominal account. Expenses are shown in the debt side and incomes in the credit side.
3. Only revenue items are recorded in it. Capital items are totally excluded.
4. Only incomes and expenses of the concerned year are recorded in it and income and expenditure relating to the proceeding or succeeding periods are included while preparing this account.
5. This account is prepared on mercantile system of accountancy. Therefore all adjustment relating to the preceding or succeeding periods are excluded while depreciations and doubtful debts will be made.
6. Only adjustment accounts are taken into consideration for the preparations of this account. For personal and real accounts a balance sheet must be prepared along with this account.
7. The balance in the account shows either surplus i.e., excess of income over expenditure or deficit i.e. the excess of expenditure over income.

1.7 Difference between receipts and payments A/c and Income and Expenditure A/c

Receipts and Payments Account	Income and Expenditure Account
1.It is a real account	1. It is a nominal account
2. It is like cash book prepared by trading Concerns.	2. It is like profit and loss account Prepared by trading concerns.
3. It starts with a balance being cash at the beginning of the year	3.It does not start with any opening balance.
4. Receipts are shown on the debit side and Payments on credit side.	4. Income are shown on the credit side and expenditure on the debit side.
5. All times whether of capital or revenue nature are shown in this account.	5. Only revenue items are shown in this account.
6. All receipts and payments whether they are of preceding current or succeeding period are entered in it.	6. Income and expenditure of the current year are shown in it.
7. Outstanding receipts and payments are not shown in it as it is prepared on cash basis.	7. Income and expenses are shown after including outstanding income and expenses on accrual basis.
8. The closing balance represents cash in hand on that date.	8. The closing balance represents surplus or deficit for the period.
9. It is not necessary to prepare balance sheet along with this account.	9. In addition to this account balance sheet must be prepared in order to accommodate real and personal account.

Income and Expenditure Account for the year ended…………

Dr. **Cr.**

Expenditure	**Rs.**	**Income**	**Rs.**
To Salaries	xxx	By Subscriptions	xxx
To Honorarium	xxx	By Interest on Securities	xxx
To Wages of Groundsmen	xxx	By Proceeds of entertainment and lectures	xxx
To Upkeep of Ground	xxx		
To Printing and Stationary	xxx	By Rent of Hall	xxx
To Postage	xxx	By Grant from Government, Local authorities	xxx
To Telephone charges	xxx	By Interest on Deposits	xxx
To Lighting	xxx	By General Donations (Small amount)	xxx
To Bank Charges	xxx		
To General Expenses	xxx	By Entrance Fees (if not capitalized)	xxx
To Rent, Rates and taxes	xxx		
To Insurance	xxx	By Advertisement in Year Book	xxx
To Audit Fees	xxx	By Locker Rent	xxx
To Cost of entertainment	xxx	By Sale of grass	xxx
To Subscription to periodicals	xxx	By Profit on sale of asset	xxx
To Sports materials used	xxx	By Miscellaneous Receipts	xxx
To Depreciation	xxx	By Excess of Expenditure over Income (Deficit)	xxx
To Repairs	xxx		
To Loss on sale of assets	xxx		
To Excess of Income over Expenditure	xxx		
	xxx		xxx

1.8 Preparation of Income and Expenditure account from Receipts and Payments Account

The following steps are to be taken to convert a Receipt and Payments account into an Income and Expenditure account.

1. Leave the opening and closing balance of cash given in the receipts and payments account.
2. Only revenue items income and expenditure should be taken leaving all those items which are of capital nature.
3. Make all adjustment for outstanding and prepaid incomes and expenses, provision for depreciations or bad debts etc.
4. Take items of the current period only i.e. items relating to the proceeding and succeeding periods are to be ignored.
5. In the Incomes and Expenditure account, expenditure is recorded in the debit side and income is recorded on the credit side.
6. Once income and expenditure account is balanced it shows either surplus or deficit If credit balance is more than debit balance it is called 'Surplus' and if the debit balance is more than credit balance it is called as 'Deficit'.

Illustrations 2

For the following particulars, prepare income and expenditure account of Hyderabad Golf Club for the year ending 31 March, 2019.

	Rs.
Subscriptions received for 2018-2019	11,000
Entrance fees received for 2018-2019	1,500
Subscriptions and entrance fee for 2017-2019 realized	560
Subscriptions and entrance fees for 2020	3,100
Miscellaneous fees	4,200
Expenses for 2018-2019	14,200
Expenses unpaid	460
Audit fees for 2018-2019 not paid	400
Interest on Loan Paid	640
Capital expenditure in 2018-2019	4,120

Provide for depreciations for this year	340
Cash in hand	3,600

Solution:

Hyderabad Golf Club Income and Expenditure Account
for the year ended 31st March, 2019

Dr. **Cr.**

Expenditure	Rs.	Income	Rs.
To Expenses 14,000		By Subscriptions	11,000
Add : Unpaid 460	14,460	By Entrance Fee	1,500
To Audit fees	400	By Miscellaneous fees	4,200
To Interest loan	640		
To Depreciation	340		
To Surplus	860		
	16,700		16,700

Balance Sheet

The Income and Expenditure Account is accompanied by the balance sheet. In trading concerns, a balance sheet is to be prepared even by non-trading concerns to complete the double entry. The balance sheet covers all those items such as Assets, Liabilities and Capital fund.

Capital Fund

Capital fund is similar to capital account of trading concerns, Non-trading concerns do not have formal capital like that of trading concerns. Hence, excess of income over expenditure, capital receipts that are capitalized are accumulated under the heading “Capital Fund” and shows as liability in the Balance Sheet.

Some special terms pertaining to non-trading organization

While preparing final accounts of non-profit organizations the following items are often used.

1. **Legacy:**When an account is received as per will of some person, it is called ‘Legacy’. As it non-recurring and capital in nature it is to be capitalized. But if the amount is small it can be taken as an income.
2. **Donations:**Donations are often received by these organizations from both individuals and institutions. Donations is the amount received as a gift. Donations may be broadly classified into two categories viz; specific donations and general donations.

a. **Specific Donations:**A donations received for a specific purpose, whether big or small is capitalized an is taken to the liabilities side of the balance sheet. For example, a donations for the construction of a building. This amount should be utilized only for the purpose for which it is received i.e., construction for building.

b. **General Donations:** A general donation is the amount given by parties without specifically mentioning the purpose for which it should be utilized. This amount can be spent for any purpose. However, normally general donation of big amounts are capitalized and small amounts are treated as revenue income.

3. **Endowment Fund:**'Endowment' is the money or property given by parties so as to provide a permanent source of income to support the institution. For ex. The corpus fund of university. Since the fund provides a permanent means of support any amount received on account of this is capitalized and shown as a Liability. But the in interest or divided received on account of this fund is treated as revenue.
4. **General Fund:** Amount which are received for no Specific purpose and which are capitalized are shown under this head on the liabilities side of the balance sheet But the income obtained on account of this fund is taken to the credit side of income and expenditure account.
5. **Specific Funds:**Amount which are received for no Specific purpose are capitalized are shown in the balance sheet on its liabilities side e.g., prize fund, buildings fund. Receipts and income on account of these specific fund should beadded to the fund account and should not be taken to income and expenditure account. All expenses on account of these funds should be deducted from the particular fund in the balance sheet only. In case the expenses exceed the fund amount the excess expenses should be charged to the debit side of the income and expenditure amount.
6. **Subscription:**Amount agreed to the paid by the member or subscribers regularly at periodical interval are called 'Subscription'. They are a regular source of income to the organization. Hence subscription are shown as income.

Balance Sheet Proforma
Balance Sheet as on….

Liabilities	Rs.	Assets	Rs.
Outstanding Expenses	xxx	Cash in Hand	xxx
Income Received in advance	xxx	Cash at Bank	xxx
Bank Loan or Overdraft	xxx	Investments	xxx
Special Fund xxx		Outstanding subscriptions	xxx
Less : Expenses xxx	xxx	Interest Receivable	xxx
Specific Donations	xxx	Rent Receivable	xxx
Capital Fund xxx		Prepaid Expenses	xxx
Add Surplus xxx	xxx	Stock of stamps and stationary	xxx
Less Deficit (if any) xxx	xxx	Stock of sports material	xxx
		Library books	xxx
		Furniture and fixtures	xxx
		Land and Buildings	xxx
		Club ground and pavilion	xxx
	xxx		xxx

7. **Admission or Entrance Fees :**This is the amount received from a member at the time of his initial admission or readmission into the organization. There is a different of opinion about the treatment of this items in account. Some people argue that is should be capitalized. Since it is not a recurring items as each member pay it once only. However, there are others who argue that, though it is paid by each member only once the club or association received it regularly therefore it should be treated as income. Leaving the arguments a side, in the absence of specific instructions to capital entrance of admission fee must be treated as revenue income i.e. shown in the credit side of income and expenditure account.
8. **Honorarium :** It is taken payment made to certain people for their services. It is regularly treated as revenue expenditure and charged to the Income and Expenditure account. But if the amount is paid on account of a specific programme conducted in connection with a specific fund, the amount should be deducted from the specific fund in the balance sheet.
9. **Sale of Old Asset :** Any receipt from the sale of old asset such as furniture is a capital receipt and as such it should not be taken income and expenditure account. It should be

deducted for the concerned asset in the Balance sheet. However, any loss on the sale of asset in charged to income and expenditure amount. In case of gain on the sale of an asset, if the amount is small, it is taken to the income and expenditure account, but if it is a big, it is treated as a capital gain and shown in the Balance Sheet.

10. **Sale of Old Newspapers :**The amount received of in account of selling old news papers or old sport materials etc, is treated as revenue income.

SHORT ANSWER QUESTIONS (2 Marks)

1. What is non – trading business concerns?
2. How many types of final accounts prepared by non – trading concerns? What are they?
3. What is Revenue Expenditure?
4. What is Deferred Revenue Expenditure?
5. What is Capital Expenditure?
6. What is meant by Donations?
7. What is meant by Legacy?
8. What is meant by Entrance Fees?

ESSAY ANSWER QUESTIONS (6 Marks)

1. What are the differences between receipts & payments account and income and expenditure account?

EXERCISES

1. From the following particulars prepare Receipts and Payments account.

	Rs.
Cash in hand	1,000
Cash at Bank	5,000
Subscription received	33,000
Donations received	2,600
Investments purchased	10,000
Rent Paid	4,000
General expenses	2,000
Postage & Stationary	700
Sundry expenses	300
Cash balance at cost	200

(Ans : Closing Bank balance Rs.24,300)

2. Prepare Receipts and Payments account from the following particulars

		Rs.
Opening balance of cash in hand		1,800
Rent Paid		450
Stationary purchased		540
Subscription received		2,600
Previous year	1,800	
Current year	4,500	5,580
Honorarium Paid		810
Sale of old furniture		1,890
Flood relief expenses		684
Repairs		756

(Ans : Cash balance Rs.6,300)

3. From the following particulars prepare Income and Expenditure account

	Rs.
Fee collected (including Rs.24,000on account of last year)	2,24,000
Fee outstanding for current year	40,000
Advertisement	3,200
Salary Paid (including Rs.2,400 onAccount of last year)	19,200
Salary outstanding (current year)	4,000
Tournament expenses	8,000
Meeting expenses	16,000
Travelling & Conveyance	6,000
Purchase of books	16,000
Periodicals	8,000
Rent	9,600
Postage, Telephone and Telegrams	13,600
Printing & Stationary	4,000
Donations received	6,400

(Ans: Surplus Rs.1,56,800)

4. Following is the Receipts and Payments account of Vishakhapatnam cultural club for the year ended 31.12.2018.

Receipts	Dr. Rs.	Payments	Cr. (Rs.)
To Donation	25,000	By Salaries	900
To Life membership	2,000	By Cricket	300
To Sports competition fund	5,000	By Tennis	270
To Subscription	1,600	By Insurance	180
(Including Rs.50 for 2018)		By Billiards	85
To Locker rent	50	By Printing	15
To Interest on securities	200	By Telephone	125
To Cricket	150	By Investments	9,000
To Billiards	100	By Balance c/d	23,325
To Tennis	100		
	34,200		34,200

Subscription received for 2018 Rs.150, outstanding salaries, Rs.100. Half of the donations are to be capitalized, accrued interest Rs.300. Prepaid Insurance Rs.30. Prepare Income and Expenditure account for the year ended 31.12.2018.

(Ans : Surplus Rs.13,155)

5. From the following Receipts and Payments accounts of Youth Society prepare an Income and Expenditure account for the year ended 31.3.2019.

Receipts and Payments Account for the year ended 31.3.2019

Receipts	Dr. Rs.	Payments	Cr. (Rs.)
To Balance b/d	3,485	By Books	6,150
To Entrance fee	650	By Printing & Stationary	465
To Donations	6,000	By News Papers	1,110
To Subscriptions	6,865	By Sports Material	5,000
To Interest on Investment	1,900	By Repairs	650
To Sale lf furniture	685	By Investments	2,000
To Sale of old news paper	465	By furniture	1,000
To Preceeds from entertain-Ment	865	By Salaries	1,500

To Miscellaneous receipts	125	By Balance c/d	3,165
	21,040		21,040

The Entrance fees and Donations are to be capitalized. Sports materials are valued at Rs.4,000 on 31.3.2019.

(Ans : Surplus Rs.5,495)

6. From the following Receipts and Payments account for the year ending 31.3.2019. Prepare an income and expenditure account for the period ending 31.3.2019 and Balance Sheet as on that date.

Dr. **Cr.**

Receipts	Rs.	Payments	(Rs.)
To Donation received	35,000	By Salaries	37,500
To Subscriptions	1,15,000	By Help to poor students	37,000
To Life membership fee	50,000	By Expenses on fee dispensary	34,500
To Legacy	75,000	By Postage and Stationary	3,500
		By Furniture	50,000
		By Investments	75,000
		By Cash in hand	41,500
	2,79,000		2,79,000

Additional Information:

1. Subscription outstanding for the year Rs.5,000.
2. Salaries unpaid Rs.5,000.
3. Help to poor students promised but unpaid Rs.16,000.
4. Expenses of dispensary outstanding Rs.3,000.
5. Postage and Stationary expenses yet to be paid Rs.4,000.

(Ans: Surplus : Rs.18,500, B/S Total: Rs.171,500)

7. Vijayawada sports club was started on 1.4.2018. Their Receipts and Payments a/c for the year 2018-2019 is given below.

The following Adjustments

1. Subscription receivable for the year Rs.300/-
2. Salaries UnpaidRs.170/-

3. Entrance fee is to be capitalized.
4. Insurance is for one year and is premium paid upto 31st Dec 2019. Prepare the income and Expenditure account for 2018-2019.

Receipts and Payments account as on 31.03.2019

Dr. Cr.

Receipts	Rs.	Payments	(Rs.)
To Donation received	50,000	By Buildings	40,000
To Entrance fee	4,000	By Tournament expenses	900
To Tournament fund	10,000	By Furniture	2,100
Revenue Receipts		**Revenue Payments**	
To Subscriptions (Incl. Rs.100/- for 2012.13)	3,200	By Salaries	1,800
To Rent	100	By Cricket expenses	1,140
To Other Receipts	700	By Insurance	360
To Cricket fee	400	By Gardener salary	600
		By Investments	18,000
		By Balance c/d	3,500
	68,400		68,400

(Ans: Excess of income over expenditure Rs.800)

8. The Receipts and Payments account of the Hyderabad Friends Club for the period ending 31.3.2018 is given below.

Subscription fee outstanding for the year 2017-2018 Rs.150.Salaries unpaid for the year Rs.85. From the above particulars prepare an income and Expenditure account of the club for the year ended 31.3.2018 and the balance sheet in that date.

Dr. Cr.

Receipts	Rs.	Payments	(Rs.)
To Donation received	25,000	By Buildings	20,000
To Reserve Fund	2,000	By Furniture	1,050
(Being life membership fee received)		By Tournament expenses from match fund	450
To Match fund	5000		
Revenue Receipts		**Revenue Payments**	
To Subscriptions (Incl. Rs.50 for 2011.12)	3,200	By Salaries	900
To Lockers Rent	50	By Cricket	300
To Interest on securities	50	By Tennis	270

To Cricket	200	By Insurance (paid upto 31st Dec, 2011)	180
To Sundries	25	By Gardening	85
To Tennis	175	By Printing	15
To Billiards	100	By Telephone	125
		By Sundies	75
		By Investments (at cost)	9,000
		By Balance c/d	1,750
	34,200		34,200

(Ans: Excess of Income over expenditure Rs.400/- Balance Sheet Total : Rs.32,085)

9. Tarnaka Sports Club's Receipts and Payments account for the year ending 31.3.2019 is given here under.

Additional Information:

1. Subscription receivable for 2017-2018 were Rs.1000/- and for 2018-2019 Rs.1,050.
2. Games equipment in the beginning was Rs.1,000/- and at the end Rs.1,250/-
3. Provide depreciations at 10% on grass cutting machine.

Prepare Income and Expenditure for the year ending 31.302019 and opening and closing balance sheet.

Dr. **Cr.**

Receipts	Rs.	Payments	Rs.
To Cash in hand	250	By Salary to workmen	2,000
To Cash in Bank	2,250	By Grass cutting machine	1,000
To Subscription	6,750	By Rent	450
To Tournament fund	2,500	By Games expenditure	3,500
To Life membership fee	1,500	By Tournament expenditure	1,000
To Entrance fee	250	By Office expenditure	2,250
To Donation for pavilion	4,000	By Games equipment	1,500
To Sale of grass	200	By Balance c/d	
		Cash in Hand	750
		Cash at Bank	5,250
	17,700		17,700

(Ans: Deficit Rs.2,300. Balance Sheet total Rs.9,200)

10. Prepare Income and Expenditure account and balance sheet of Hyderabad Club from the particulars is given below for the year ending 31.3.2019.

Receipts and Payments account as on 31.3.2019

Dr. **Cr.**

Receipts	Rs.	Payments	Rs.
To Balance b/d	1,200	By Salaries	6,500
To Subscriptions	6,400	By Rent	1,200
(Including Rs.400 2012-13)			
To Interest on investment	2,500	By Printing & Stationary	180
(Investment cost Rs.40,000)			
To Bank Interest	50	By Postage	50
To Sale of furniture	500	By Cycle purchased	800
		By Govt.Bonds	1,000
		By Balance c/d	920
	10,650		10,650

Additional Information

1. Subscription received included Rs.200 of 2017-2018.
2. Rent paid included Rs.100 for March 2019 monthly rent is Rs.100.
3. Subscription due for 2017-2018 Rs.300.
4. Salaries Payable sold was Rs.600.
5. Cost of furniture sold was Rs.640.

(Ans: Deficit : Rs.20 Capital fund 41,940 Balance Sheet total Rs.43,020)

Ψ

UNIT 3

PARTNERSHIPACCOUNTS-I

Partnership Accounts-I – Meaning of Goodwill –objectives – methods of Goodwill calculation –Simple average and weighted average –Profit/loss sharing ratios - New, Sacrificing, Gaining ratios - Problems on Profit and Loss appropriation account.

Learning Objectives:

After studying this Chapter, you will be able to

- Prepare the capital accounts of partners under fixed and fluctuating capital methods.
- Understand the distribution of profits among the partners.
- Prepare the Profit and Loss appropriation account.
- Able to know the meaning, nature and methods of valuation of goodwill.

2.0 Meaning: A business may be organised in the form of a sole proprietorship, a partnership firm or a company. The sole proprietorship has its limitations such as limited capital, limited managerial ability and limited risk - bearing capacity. Hence, when a business expands, it needs more capital and involves more risk. Then two or more persons join hands to run it. They agree to share the capital, the management, the risk and the Profit or Loss of the business. Such mutual relationship based on agreement among these persons is termed as "Partnership". The persons who have entered into partnership are individually known as 'Partners' and collectively as 'Firm'.

2.1 Definition: The Indian Partnership Act 1932, Section 4, defines partnership as "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

2.2 Partnership Deed: Agreement to carry on a business between the partners, partnership comes into existence. The partnership agreement can be either oral or written. The Partnership Act does not require that the agreement must be in writing. But when the agreement is in written form, it is called 'Partnership Deed'. Partnership deed should be duly signed by the partners, stamped & registered.

Partnership deed generally contains the following details:

- Names and Addresses of the firm and its main business;
- Names and Addresses of all partners;
- A contribution of the amount of capital by each partner;
- The accounting period of the firm;
- The date of commencement of partnership;
- Rules regarding an operation of Bank Accounts;
- Profit and loss sharing ratio;
- The rate of interest on capital, loan, drawings, etc;
- Mode of auditor's appointment, if any;
- Salaries, commission, etc, if payable to any partner;

- The rights, duties, and liabilities of each partner;
- Treatment of loss arising out of insolvency of one or more partners;
- Settlement of accounts on the dissolution of the firm;
- Method of a settlement of disputes among the partners;
- Rules to be followed in case of admission, retirement, a death of a partner; and
- Any other matter relating to the conduct of business. Normally, all the matters affecting the relationship of partners amongst themselves are covered in partnership deed.

2.3 Accounting rules applicable in the absence of Partnership deed: Normally, a partnership deed covers all matters relating to mutual relationship among the partners. But, in the absence of agreement, the following provisions of the Indian Partnership Act, 1932 shall apply for accounting purposes.

1. **Interest on Capital:** No interest is allowed on Capitals of the Partners. If as per the partnership deed, interest is allowed, it will be paid only when there is profit. If loss, no interest will be paid.
2. **Interest on Drawings:** No interest will be charged on drawings made by the partners.
3. **Salary/Commission to partner:** No partner is entitled to salary/ commission from the firm, unless the partnership deed provides for it.
4. **Interest on loan:** If any partner, apart from his share capital, advances money to the firm as loan, he is entitled to interest on such amount at the rate of six percent per annum.
5. **Profit sharing ratio:** The partners shall share the profits of the firm equally irrespective of their capital contribution.

2.4 Special Aspects of Partnership Accounts and its Maintenance: Accounting Treatment for partnership firm is similar to that of a sole proprietorship business with the exception of the following aspects:

1. Distribution of Profit/Loss among partners
2. Maintenance of Partner's Capital Accounts
3. Reconstitution of the Partnership Firm
4. Dissolution of Partnership Firm

2.5 Distribution of Profit among Partners: In accordance with the provisions of the Partnership deed, the profits and losses made by the firm are distributed among the partners. However, sharing of profit and losses is equal among the partners, if the partnership deed is silent.

However, certain adjustments such as interest on drawings & capital, salary & commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm. The final figure of profit and loss to be distributed among the partners is ascertained by Profit and LossAppropriation Account.

Profit and Loss Appropriation Account:

After the Profit and Loss Account, Profit and Loss Account Appropriation is prepared for the firm. In this account how the profit or loss among the partners of the firm is distributed is shown.

Through this account, all adjustments in respect of partner's salary, partner's commission, interest on capital, interest on drawings, etc. are made.

It starts with the net profit/net loss as per Profit and Loss Account is transferred to this account.

The Performa of Profit and Loss Appropriation Account is given as follows:

Profit and Loss Appropriation Account

Dr. **Cr.**

Particulars	**Amount (Rs.)**	**Particulars**	**Amount (Rs.)**
To Profit and Loss (if there is a loss)	Xxx	By Profit and Loss (if there is profit)	xxx
To Interest on capital	Xxx	By Interest on drawings	xxx
To Salary to Partner	Xxx	By Partners' Capital a/c (distribution of loss)	xxx
To Commission to Partner	Xxx		
To Interest on Partner's Loan	Xxx		
To Partners'Capitala/c (distribution of profit)	Xxx		
Total	**Xxx**	**Total**	**xxx**

Solved Example for You

Illustration 1:

Avinash, Balaji, and Chandrika set up a partnership firm on April 1, 2018. They contributed Rs. 50,000, Rs. 30,000 and Rs. 20,000, respectively as their capitals and agreed to share profits and losses in the ratio of 5:3:2. Salary ofAvinash is Rs. 1,000 per month and Balaji, a Commission of Rs. 10,000. Interest on capital at 10% p.a.

The drawings for the year were Avinash Rs. 10,000, Bob Rs. 5,000 and Chandrika Rs. 2,000. Interest on drawings of Rs. 1000 was charged on Avinash drawings, Rs. 500 on Balaji drawings and Rs. 200, on Chandrika drawings. The net profit as per Profit and Loss Account for the year ending March 31, 2018, was Rs. 36300.

Prepare the Profit and Loss Appropriation Account to show the distribution of profit among the partners.

Solution:

Profit and Loss Appropriation Account

Dr. **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Salary to Avinash	12000	By Profit and Loss a/c	36300
To Interest on capital:		By Interestondrawings:	
Avinash	5000	Avinash	1000
Balaji	3000	Balaji	500
Chandrika	2000	Chandrika	200
To Commission to Balaji	10000		
To The share of profit transferred to Capital accounts :			
Avinash	3000		
Balaji	1800		
Chandrika	1200		
	38000		**38000**

2.6 Maintenance of Partner's Capital Accounts: Most of the transactions relating to the partners of the firm are recorded in the books of the firm through their capital accounts. This includes various transactions like money brought in by the partner, withdrawal of the capital, the share of profit, interest on drawings, interest on capital, etc.

There are 2 methods by which the capital of the partners is maintained. These special aspects accounts are:

a. Fixed Capital Method and
b. Fluctuating Capital Method.

a. **Fixed Capital Method:** Under this method, a firm maintains two capital accounts in order to keep the capital account balance stable from regular capital related transactions. These accounts are as follows:

a. Capital Account and
b. Current Account.

Capital Account only includes transactions like Initial investment, an addition of capital and permanent withdrawal of capital.

b. **Fluctuating Capital Method:** Under this method, a firm records all the capital related transaction (Permanent as well as Non-Permanent) under a single account and that is Capital Account.

Format: (Fixed Capital Method):

Capital Accounts

Particulars	x	y	z	Particulars	x	y	z
To balance c/d	xxx	xxx	xxx	By balance b/d	xxx	xxx	xxx
				By balance b/d			
	xxx	xxx	xxx		xxx	xxx	xxx
					xxx	xxx	xxx

Current Accounts

Particulars	x	y	z	Particulars	x	y	z
To drawings	xx	xx	xx	By balance b/d	xx	xx	xx
To interest on drawings	xx	xx	xx	By interest on capital	xx	xx	xx
To revaluation a/c (if loss)	xx	xx	xx	By commission	xx	xx	xx
To balance c/d	xx	xx	xx	By salary	xx	xx	xx
				By revaluation a/c	xx	xx	xx
	xxx	xxx	xxx		xxx	xxx	xxx

Format: (Fluctuating Capital Method)

Capital Accounts

Particulars	x	y	z	Particulars	x	y	z
To drawings	xx	xx	xx	By balance b/d	xx	xx	xx
To interest on drawings	xx	xx	xx	By interest on capital	xx	xx	xx
To revaluation a/c (if loss)	xx	xx	xx	By commission	xx	xx	xx
To balance c/d	xx	xx	xx	By salary	xx	xx	xx
				By revaluation a/c	xx	xx	xx
	xxx	xxx	xxx		xxx	xxx	xxx

Preparation of Capital Accounts

Illustration 2: Show how the following items will appear in the capital accounts of the partners, Anand and Baalu.

	Anand Rs.	Baalu Rs.
Capital on 1.4.2004	90,000	70,000
Drawings during 2004 – 2005	12,000	9,000
Interest on drawings	360	270
Interest on capital	5,400	4,200
Partners Salary	12,000	-
Commission	-	6,000
Share of profit for 2004 – 05	6,000	4,000

Solution:

a) When capital accounts are fixed:

Capital Accounts

Particulars	Anand	Baalu	Particulars	Anand	Baalu
To balance c/d	90000	70000	By balance b/d	90000	70000
	90000	70000	By balance b/d	90000	70000
				90000	70000

Current Accounts

Particulars	Anand	Baalu	Particulars	Anand	Baalu
To drawings To interest on drawings To balance c/d	12000 360 11040	9000 270 4930	By interest on capital By commission By salary By profit & loss a/c	5400 12000 6000	4200 6000 4000
	23400	14200		23400	14200
			By balance b/d	11040	4930

b) When capital accounts are fluctuating:

Capital Accounts

Particulars	Anand	Baalu	Particulars	Anand	Baalu
To drawings To interest on drawings To balance c/d	12000 360 101040	9000 270 74930	By balance b/d By interest on capital By commission By salary By profit & loss a/c	90000 5400 12000 6000	70000 4200 6000 4000
	113400	84200		113400	84200
				101040	74930

Illustration 3: Write up the capital and current accounts of the partners, Kamal and Mahesh from the following:

	Kamal Rs.	Mahesh Rs.
Capital on 1.1.2014	1,50,000	1,00,000
Current accounts on 1.1.2014 (Cr.)	20,000	15,000
Drawings during 2014	30,000	40,000
Interest on drawings	900	1,000
Share of profit for 2014	10,000	8,000
Interest on Capital	6%	6%

Capital Accounts

Particulars	Kamal	Mahesh	Particulars	Kamal	Mahesh
To balance c/d	150000	100000	By balance b/d	150000	100000
	150000	100000		150000	100000
			By balance b/d	150000	100000

Current Accounts

Particulars	Kamal	Mahesh	Particulars	Kamal	Mahesh
To drawings To interest on drawings To balance c/d	30000 900 8100	40000 1000	By balance b/d By interest on capital By profit & loss a/c By balance c/d	20000 9000 10000	15000 6000 8000 12000
	39000	41000		39000	41000
To balance b/d		12000	By balance b/d	8100	

2.7 Goodwill: When a firm is reconstituted, goodwill is valued and shared by the existing partners. Goodwill is the present value of a firm's anticipated excess earnings in future and the efforts had already made in the past. Goodwill really arises only if firm is able to earn higher profit than normal.

Meaning and Nature Goodwill is the value of the reputation of the firm which the business builds up due to its efficient service to its customers and quality of its products. It is a value of all favourable attributes relating to a business enterprise. It is not merely the past reputation but its continued existence in future that makes goodwill a valuable asset. It cannot be seen or touched. It is an intangible asset but not a fictitious asset.

Methods of valuation of goodwill: There are three methods of valuation of goodwill. They are:

1. Average Profit method
2. Super Profit method
3. Capitalisation method

1. Average profit method: In this method, past profits of a number of years are taken into account. Such profits are added and the average profit is found out. The average profit is multiplied by a certain number of years to arrive at the value of goodwill. The steps involved under this method are:

Step 1 → Calculate total profits by adding each years profit and deducting loss, if any.
Step 2 → Calculate the average profit by applying the following formula.
Average Profit =Total Profits / No of years .
Step 3 → Calculate the Goodwill by applying the following formula.
Goodwill = Average Profit X No. of years' purchase

Illustration 4:
The Goodwill is to be valued at two years' purchase of last four years average profit. The profits were Rs.40,000, Rs.32,000, Rs.15,000 and Rs.13,000 respectively. Find out the value of goodwill.

Solution:

a) Calculation of average profit:

I year	40,000
II year	32,000
III year	15,000
IV year	13,000
Total Profit	1,00,000

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No of years}}$$

$$= \frac{1,00,000}{4}$$

$$=25000$$

Calculation of Goodwill:

Goodwill = Average Profit X two years' purchase

= 25,000 X 2 = Rs. 50,000.

2. **Super Profit method:** The excess of average profit over normal profit is called super profit. The goodwill under the Super profits method is calculated by multiplying the super profits by certain number of years purchase. The steps involved under this method are:

Step 1 → Calculate the average profit – it may be adjusted for partners remuneration.
Step 2→ Calculate the normal profit on capital employed by applying the following formula.

Normal Profit = Capital employed X Normal rate of return

Step 3 → Calculate the super profit.by applying the following formula.

Super profit = Average Profit – Normalprofit

Step 4 → Calculate the value of goodwill by multiplying the amount of super profit by the given number of years' purchase

Goodwill = Super Profit X No. of years of purchase

3. **Capitalisation Method:** of Average Profits: Under this method, the value of goodwill is ascertained by deducting the actual capital employed (net assets) in the business from the capitalized value of the average profits on the basis of normal rate of return.

Goodwill = capitalised Value – Capital Employed
Capital Employed = Total Assets – Outside Liabilities

Illustration 5 :
A firm's net profits during the last three years were Rs.90,000 Rs.1,00,000 and Rs.1,10,000. The capital employed in the firm is Rs.3,00,000. A normal return on the capital is 10%. Calculate the value of goodwill on the basis of two years' purchase of super profit.

Solution:

a. Calculation of average profit:

I year	90,000
II year	1,00,000
III year	1,10,000
	3,00,000

$$\text{Average Profit} = \frac{\text{Total Profits}}{\text{No of years}}$$

$$= \frac{3,00,000}{3}$$

$$=1,00,000$$

b. Calculation of Normal Profit:

Normal Profit = Capital employed X Normal rate of return

$$3,00,000 \times \frac{10}{100}$$

$$=30,000$$

c. Calculation of Super Profit:

Average Profit – Normal Profit = 1,00,000 – 30,000 = Rs. 70,000.

Goodwill at two years' purchase of super profit: Goodwill =

Super Profit X No. of years of purchase = 70,000 X 2 = Rs. 1,40,000

3.8 New Profit Sharing Ratio: There are different cases when partnership can have new profit sharing ratio:

- Sometimes the partners may decide to change their existing profit sharing ratio, without any admission or retirement of partner,
- At the time of admission of the new partner
- At the time of retirement or death of an old partner

This may result in a gain to a few partners and loss to others. The partners who are in profit due to this change in the profit sharing ratio should compensate the sacrificing partner/partners.

- **New profit sharing ratio:** Ratio in which the partners decide to share profits/losses in future.
- **Gaining ratio:** Ratio in which the partners have agreed to gain their share of profit from other partners.
- **Sacrificing ratio:** Ratio in which the partners have agreed to sacrifice their share of profit in favour of other partners. Sacrificing ratio= Old Ratio – New Ratio

1. **New profit sharing ratio:** When a new partner is admitted, he should be given a portion of the profit of the firm. As the incoming partner is entitled to get a profit share, the profit share of all or some of the old partners will be reduced.

The profit shares of all the old partners will be reduced, if all of them make a sacrifice. What the old partners sacrifice, is in favour of the new partner. Thus, Profit Sharing Ratio should necessarily be changed when a new partner is admitted.

The ratio at which the profits should be divided among the old partners and the new partners is called the New Profit Sharing Ratio. After the admission of a new partner into the firm, New Profit Sharing Ratio should be found out, without which the profit cannot be divided among partners, including the new partner.

The following cases may arise while calculating the new Profit and Loss sharing ratio:

a. When the share of the new partner is given, then it should assume that the remaining profit should be shared by the old partners in their old profit sharing ratio.
b. When the share of the new partner is purchased out of the share of profit of one of the old partners, then the old partner forgoes a portion of the profit, which goes to the new partner.
c. The old partners may sacrifice their share of profits for the new partner in their existing profit sharing ratio.
d. New partner's share of profit is out of the profit of all partners in the equal ratio.

In all the cases, profit and loss sharing ratio is completely changed. All the types of cases are discussed below:

NEW PROFIT SHARING RATIO

When a new partner is admitted then the calculation of new profit sharing ratio becomes necessary. The reason behind that is the new partner acquires his share of profit from the old partners. Hence, old partners' shares reduce.

1. **When only the ratio of new partner is given**: In this case in the absence of any other agreement, it is presumed that the old partners will continue to share the remaining profits in the same ratio in which they were sharing before the admission of the new partner.

Example: X, Y and Z are partners in proportion of 3/6, 2/6 and 1/6 respectively. P was admitted in the firm as a new partner with $1/6^{th}$share. Calculate the new profit sharing ratios of the partners.

Solution:

Let total profit be = 1

Share given to P = 1/6

Remaining Share = 1 – 1/6 = 5/6

Now the old partners will share this remaining profit in their old profit sharing ratios. Hence,

X's share = 3/6 of 5/6 = 5/12

Y's share = 2/6 of 5/6 = 5/18

Z's share = 1/6 of 5/6 = 5/36

Thus, the new profit sharing ratio will be

X : Y : Z : P

5/12 : 5/18 : 5/36 : 1/6 =15 : 10 : 5 : 6

2. **When the new partner purchases his share of profit from the old partners equally:** In such cases, the new profit sharing ratio of the old partners can be calculated by deducting the sacrifice made by them from their existing share of profit.

Example: A and B are partners sharing profits and losses in the ratio of 7/12 : 5/12. They admit C as a new partner for $1/6^{th}$ share, which he acquires equally from A and B. Calculate the new profit sharing ratios of the partners

Solution:

Share of profits given to C = 1/6

Share acquired by C from A = ½ of 1/6 = 1/12

Share acquired by C from B = ½ of 1/6 = 1/12

Therefore,

A's new share = 7/12 – 1/12 = 6/12

B's new share = 5/12 – 1/12 = 4/12

C's share = 1/6

Hence, new profit sharing ratio will be

A : B : C

6/12 : 4/12 : 1/6 =3 : 2 : 1

3. **When new partner purchases his share from the old partners in a particular ratio:** In this case, the new profit sharing ratio of the old partners will be ascertained after deducting the sacrifice made by them from their existing share of profit.

Example: X and Y are partners in a firm sharing profits in the ratio of 7 : 5. Z is admitted on $1/6^{th}$ share which he takes $1/24^{th}$ from X and $1/8^{th}$from Y. Calculate the new profit sharing of the partners.

Solution:
X's old share = 7/12, out of which he surrenders 1/24th in favour of Z.

Therefore, X's new share = 7/12 – 1/24 = 13/24

Y's old share = 5/12, out of which he surrenders 1/8th in favour of Z.

Therefore, Y's new share = 5/12 – 1/8 = 7/24

Z's share = 1/6

Hence, new profit sharing ratio will be

X : Y : Z

13/24 : 7/24 : 1/6 =13 : 7 : 4

4. **When old partners surrender a particular fraction of their share in favour of the new partner:** in such case, the new partner's share is calculated by adding the surrendered portion of share by the old partners.

Example: P and Q are partners in a firm sharing profits and losses in the ratio of 3:2. A new partner R is admitted. P surrenders 1/5th share of his profit in favour of R and Q 2/5th share of his profit in favour of R. Calculate the new ratio of the partners.
Solution:
P's old share = 3/5

P surrenders 1/5th of 3/5 in favour of R i.e. 1/5 X 3/5 = 3/25

Q's old share = 2/5

Q surrenders 2/5th of 2/5 in favour of R i.e. 2/5 X 2/5 = 4/25

P's new share after surrendering 3/25 in favour of R = 3/5 – 3/25 = 12/25

Q's new share after surrendering 4/25 in favour of R = 2/5 – 4/25 = 6/25

R's share is the total of 3/25 from P and 4/25 from Q = 3/25 + 4/25 = 7/25

Therefore, new ratio will be

P : Q : R

12/25 : 6/25 : 7/25 =12 : 6 : 7

3.9 **Gaining Ratio:** Gaining ratio is calculated at the time of retirement or death of a partner. It is the ratio in which the remaining partners acquire the outgoing partner's share of profit.

When the partner retires, the profit sharing ratio of the continuing partners gets changed. Continuing partners distribute the share of retiring partner among them.

Gaining ratio= New Ratio – Old Ratio (if positive)

Examples:
Various cases of new ratio and gaining ratio are explained as follows:

Case 1:
When the share of retiring partner is acquired by old partners in an old ratio:

Amit, Summit, and Punit share profit and losses in the ratio of 3:2:1, respectively. Amit retires and the remaining partners decide to share to take Amit's share in the existing ratio i.e. 2:1. Calculate the new ratio and gaining ratio.

Solution:
The existing ratio between Summit and Punit= 2/6 and 1/6
Amit's ratio (retiring partner) = 3/6
Amit's share taken by Summit and Punit in the ratio of 2:1
Summit gets = 3/6 * 2/3 = 6/18
Punit gets = 3/6 * 1/3 = 3/18
New ratio between Summit and Punit is = 6:3 = 2:1

Gaining ratio= New Ratio – Old Ratio
Summit's gain = 2/3 – 2/6 = 2/6
Punit's gain = 1/3 – 1/6 = 1/6
Gaining ratio = 2:1

New Ratio = 2:1

Case 2:
When the share of retiring partner is acquired by old partners in old specified proportions:
Amit, Summit, and Punit share profit and losses in the ratio of 2:3:1, respectively. Amit retires and the remaining partners decide to share to take Amit's share equally. Calculate the new ratio and gaining ratio.

Solution:
The existing ratio between Summit and Punit= 3/6 and 1/6
Amit's ratio (retiring partner) = 2/6
Amit's share taken by Summit and Punit in the ratio of 1:1
Summit gets = 2/6 * 1/2 = 1/6
Summit's new share = 3/6 + 1/6 = 4/6
Punit gets = 2/6 * 1/2 = 1/6
Punit's new share = 1/6 + 1/6 = 2/6
New ratio between Summit and Punit is = 4:2 = 2:1
Gaining ratio is given the question i.e. 1:1
Gaining ratio = 1:1
New Ratio = 2:1

Case 3:
When the share of retiring partner is acquired fully by one of the continuing partners:
Amit, Summit, and Punit share profit and losses in the ratio of 4:5:2, respectively. Amit retires and Punit acquires Amit's share. Calculate the new ratio and gaining ratio.

Solution:
Punit's new share = 2/11 + 4/11 = 6/11
Summit share remains unchanged = 5/11

The new ratio between Summit and Punit is = 5:6
Gaining ratio in this case between Summit and Punit will be
Summit's gain = 5/11 – 5/11 = Nil
Punit's gain = 6/11 – 2/11 = 4/11
This shows that entire gain is taken by Punit.

Scarifying Ratio:
Illustration 6:
A and B are partners sharing profits and losses in the ratio of 5: 3. They admit C as a partner. C requires his share i.e. 4/20 from A and 2/20 from B. Find out the new profit sharing ratio and sacrificing ratio.
Solution:

A old ratio = 5/8
A sacrifices to C = 4/20
A new share = 5/8 - 4/20= 50-16/80 = 34/80

B old ratio = 3/8
B sacrifices to C = 2/20
B new share = 3/8 – 2/20 = 30-8/80 = 22/80

C's share = 4/20 + 2/20 = 6/20 or 24/80

New ratio of A, B and C = 34:22:24 or 17:11:12

Sacrificing Ratio = 2:1

Illustration 7:
A and B are partners sharing profit and loss in the ratio of 7:5. They take C into the partnership. C is given $1/6^{th}$ share which he acquires 1/24 from A and 1/8 from B. Calculate the future profit sharing ratio and also sacrificing ratio.
Solution:

Computation of profit sharing ratio:

Old Ratio – Sacrificing Ratio – New Ratio

Illustration 8:
A and B are partners sharing profit and loss in the ratio of 7:5. They take C into the partnership. C is given 1/6th share which he acquires 1/24 from A and 1/8 from B. Calculate the future profit sharing ratio and also sacrificing ratio.

Solution:

Computation of profit sharing ratio:

Old Ratio – Sacrificing Ratio – New Ratio (or) OR – SR – NR

A – 7/12 – 1/24 = 14 – 1 /24 = 13/24

B – 5/12 – 3/24 = 10 – 3 /24 = 7/24

C – 1/24 + 1/8 = 1 + 3/24 = 4/24

Future profit sharing ration of A, B and C = 13:7:4

Sacrificing Ratio (given) = 1:3

SHORT ANSWER QUESTIONS (2 Marks)

2. What is Partnership Business?
3. What is Goodwill?
4. Manjula and Kusuma started business on 1st April 2018 with capitals of Rs.60,000 and Rs. 50,000 respectively. On 1st July 2018 Manjula withdrew Rs.8,000 from his capital. Kusuma introduced additional capital Rs.10,000 on 30.9.2018. Calculate interest on capital at 5% for the year ending 31st March 2019.
   (Answer: Interest on capital; Manjula : Rs. 2,700; Kusuma : Rs. 2,750)
5. P, Q and R had capitals of Rs. 80,000, Rs.60,000 and Rs.40,000 respectively on 1.4.2017. Q withdrew Rs.8,000 from his capital on 30.9.2017, King introduced additional capital Rs. 12,000 on 31.12.2017. Calculate interest on capital at 6% for the year ending 31st March 2018.
   (Answer: Interest on capital; P : Rs. 4,800; Q : Rs. 3,360; R : Rs.2,580)
6. The profit for the five years of a firm are as follows: 2014 –Rs. 400000; 2015 –Rs. 398000; 2016 – Rs. 450000; 2017 –Rs. 445000; 2018 –Rs. 500000. Calculate goodwill of the firm on the basis of 4 years purchase of 5 years average profits.
   (Ans: Rs. 17,54,400)
7. A firm earns profit of Rs. 65000 on a capital of Rs. 480000 and the normal rate of return in similar business is 10%. 3 years purchase value of super profit will be treated as goodwill.
   (Ans:Rs. 51000)
8. Goodwill is to be valued at three years purchase of five year's average profits. The profits for the last five years of the firm were: 2012 - Rs. 4,200; 2013 - Rs. 4,500; 2014 - Rs. 4,700; 2015 - Rs. 4,600 and 2016 - Rs. 5,000.
   (Ans. : Goodwill Rs. 13,800)
9. Calculate the amount of goodwill on the basis of two year's purchase of the last four years average profits. The profits for the last four year's are: I Year Loss Rs. 10,000 II Year Profit Rs. 26,000 III Year Profit Rs. 34,000 IV Year Profit Rs. 50,000
   (Ans. : Goodwill Rs. 50,000)
10. Goodwill is to be valued at three years purchase of four years average profits. The profits for the last four years of the firm were: 2001 - Rs. 12,000; 2002 - Rs. 18,000; 2003 - Rs. 16,000; 2004 - Rs. 14,000. Calculate the amount of goodwill.
    (Ans. : Goodwill Rs. 45,000)

11. Calculate the amount of goodwill on the basis of two years' purchase of the last four years' average profits. The profits of the last four years are 2014 Profit Rs. 20,000;2015 Profit Rs. 30,000;2016 Loss Rs. 6,000;2017 Profit Rs. 16,000.

(Ans. : Goodwill Rs. 30,000)

12. A firm earned net profits during the last three years as follows: I Year Rs. 36,000 II Year Rs. 40,000 III Year Rs. 44,000 The Capital investment of the firm is Rs.1,20,000. A fair return on the capital having regard to the risk involved is 10%. Calculate the value of goodwill on the basis of three years purchase of Super profits.
(Ans. : Goodwill Rs. 84,000)
13. A firm earned average profit during the last few years is Rs. 40000 and the normal rate of return in similar business is 10%. The total assets is Rs. 360000 and outside liabilities is Rs. 50000. Calculate the value of goodwill with the help of Capitalisation of Average Profit Method.
(Ans: Rs. 90000)
14. A business has earned average profits of Rs. 1,00,000 during the last few years and the normal rate of return in a similar business is 10%. Ascertain the value of goodwill by capitalisation average profits method, given that the value of net assets of the business is Rs. 8,20,000.
(Ans: Rs. 180000)
15. Mani and Nani are partners sharing profit and losses in the 1:2 ratio. They have decided to admit 'Omkar' by giving him 1/4th share in future profits. Calculate the New Profit Sharing Ratio.
(Ans: 1:2:1)
16. Padma and Rani are partners sharing the ratio of 2:3. They admit Ratna for 1/4h share and she gets this share equally from Padma and Rani. Calculate new ratio.
(Ans: 11:19:15)
17. James and Roi are partners sharing in the ratio of 4:3. They admit Jhansi with 3/7th share; which he gets 2/7th from James and 1/7th from Roi. What is the new profit sharing ratio?
(Ans: 2:2:3)
18. Anitha and Bhanu are partners sharing in the ratio of 3:2. Chandu is admitted and he gets 3/20th from Anitha and 1/20th from Bhanu. Calculate new ratio.
(Ans: 9:7:4)
19. Srikanth and Gopi are partners share profits in the ratio of 5:3. Madhu the new partner gets 1/5th of Srikanth's share and 1/3rd of Gopi's share. Calculate new ratio.
(Ans: 4:2:2)
20. If Satya and Siri are partners sharing profits in the ratio of 5:3. What will be their sacrificing ratio , if Revathi is admitted for 1/8th share of profit in the firm?
(Ans: 5:3)
21. Krishna and Balram are partners in a firm sharing profits in the ratio of 5:2. They admitted Arjun as a new partner for 1/4th share. The new profit sharing ratio of the partners will be 2:1:1. Calculate their sacrificing ratio.
(Ans: 6:1)

Questions (6 Marks)

1. Tripathi and Chauhan are partners in a firm sharing profits and losses in the ratio of 3:2. Their capitals were Rs.60,000 and Rs.40,000 as on January 01, 2005. During the year they earned a profit of Rs. 30,000. According to the partnership deed both the partners are entitled to Rs. 1,000 per month as Salary and 5% interest on their capital. They are also to be charged an interest of 5% on their drawings, irrespective of the period, which is Rs. 12,000 for Tripathi, Rs. 8,000 for Chauhan. Prepare Partner's Accounts when, capitals are fixed.
   (Ans : Tripathi's Current account Balance Rs. 20,400,Chauhan's Current account Balance Rs.17,600).

2. Anushka and Kajal are partners of afirm sharing profits and losses in the ratio of 2:1. Their capital, were Rs.90,000 and Rs.60,000. The profit during the year were Rs. 45,000. According to partnership deed, both partners are allowed salary, Rs. 700 per month to Anushka and Rs. 500 per month to Kajal. Interest allowed on capital @ 5%p.a. The drawings at the end of the period were Rs. 8,500 for Anushka and Rs. 6,500 for Kajal. Interest is to be charged @ 5% p.a. on drawings. Prepare partners' capital accounts, assuming that the capital account are fluctuating.
   (Ans : Anushka's Capital Account Balance Rs.1 ,23,975, Kajal's Capital Account Balance Rs. 77, 175).

3. Rakhi and Shikha are partners in a firm, with capitals of Rs. 2,00,000 and Rs, 3,00,000 respectively. The profit of the firm, for the year ended 2016-17 is Rs. 23,200. As per the Partnership agreement, they share the profit in their capital ratio, after allowing a salary of Rs. 5,000 per month to Shikha and interest on Partner's capital at the rate of 10% p.a. During the year Rakhi withdrew Rs. 7,000 and Shikha Rs. 10,000 for their personal use. You are required to prepare Profit and Loss Appropriation Account and Partner's Capital Accounts.
   (Ans : Loss Transferred to Rakhi Capital Rs.34, 720 and Shikha Capital Rs.52,080)

4. Lokesh and Azad are partners sharing profits in the ratio 3:2, with capitals of Rs. 50,000 and 30,000, respectively. Interest on capital is agreed to be paid@ 6% p.a. Azad is allowed a salary of Rs. 2,500 p.a. During 2016, the profits prior to the calculation of interest on capital but after charging Azad's salary Rs. 12,500. A provision of 5% of profits is to be made in respect of manager's commission. Prepare accounts showing the allocation of profits and partner's capital accounts.
   (Ans: Profit transferred to Lokesh's Capital Rs. 4,170 and Azad's CapitalRs.2,780)

5. The partnership agreement between Maneesh and Girish provides that:
   a. Profits will be shared equally;
   b. Maneesh will be allowed a salary of Rs. 400 p.m;
   c. Girish who manages the sales department will be allowed a commission equal to 10% of the net profits, after allowing Maneesh's salary;
   d. 7% interest will be allowed on partner's fixed capital;
   e. 5% interest will be charged on partner's annual drawings;
   f. The fixed capitals of Maneesh and Girish are Rs. 1,00,000 and Rs. 80,000, respectively. Their annual drawings were Rs. 16,000 and 14,000, respectively. The net profit for the

year ending March 31 , 2018 amounted to Rs. 40,000; Prepare firm's Profit and Loss Appropriation Account.

(Ans : Profit transferred to the Capital accounts of Maneesh and Girish, Rs.1 0,290)

6. Ram, Raj and George are partners sharing profits in the ratio 5 : 3: 2. According to the partnership agreement George is to get a minimum amount of Rs. 10,000 as his share of profits every year. The net profit for the year 2018 amounted to Rs, 40,000. Prepare the Profit and Loss Appropriation Account.

   (Ans :Profit transferred to Ram's Capital Rs.18,750 Raj's Capital Rs.11,250 and George'Capital Rs.1 0 ,000)

7. Anwar, Bhatia and Suresh are partners in a firm. Their profit sharing ratio is 2:2:1. Suresh is guaranteed a minimum amount of Rs. 10,000 as share of profit, every year. Any deficiency on that account shall be met by Bhatia. The profits for two years ending December 31, 2017 and December 31, 2018 were Rs. 40,000 and Rs. 60,000, respectively. Prepare the Profit and Loss Appropriation Account for the two years.

   (Ans : For the year 2017, Profits transferred to Anwar's Capital, Rs.16,000; Bhatia's Capital Rs.14,000; Suresh's capital Rs.10,000 and for the year 2018, Profit transferred to Anwar's Capital Rs.24,000, Bhatia's Capital Rs.24,000, Suresh's capital, Rs.12,000)

8. Ramesh and Suresh were partners in a firm sharing profits in the ratio of their capitals contributed on commencement of business which were Rs. 80,000 and Rs. 60,000 respectively. The firm started business on April 1, 2018. According to the partnership agreement, interest on capital and drawings are 12% and 10% p.a., respectively. Ramesh and Suresh are to get a monthly salary of Rs. 2,000 and Rs. 3,000, respectively. The profits for year ended March 31, 2019 before making above appropriations was Rs. 1,00,300. The drawings of Ramesh and Suresh were Rs. 40,000 and Rs. 50,000, respectively. Interest on drawings amounted to Rs. 2,000 for Ramesh and Rs. 2,500 for Suresh. Prepare Profit and Loss Appropriation Account and partners' capital accounts, assuming that their capitals are fluctuating.

   (Ans : Profit transferred to Ramesh's Capital Rs.16,000 and Suresh's Capital, Rs.12,000)

Ψ

UNIIT 4

PARTNERSHIP ACCOUNTS - II

Partnership Accounts-II- Admission of partner - Retirement of partner - including problems.

Learning Objectives:

After studying this Chapter, you will be able to

- Understand the need for admission of a partner.
- Calculate the new profit sharing ratio and the sacrificing ratio.
- Understand how the revaluation of assets and liabilities is taken into account.
- Understand the need for distribution of accumulated reserves, profits or losses.
- Learn the accounting treatment of goodwill.
- Prepare revaluation account, capital accounts and balance sheet of a new firm.

3.0 Introduction: A Partnership firm suffering from shortage of funds or administrative in capabilities may decide to admit a partner. Admission of a partner is one of the modes of reconstituting the firm. According to Section 31 (1) of the Indian Partnership Act 1932, a person can be admitted only with the consent of all the existing partners. A person who is admitted to the firm is known as an incoming or a new partner. On admission of a new partner, the existing partnership comes to an end and a new partnership comes into effect. In other words, a new firm is reconstituted under a fresh agreement.

Whenever a partner is admitted into the partnership firm, he acquires two rights.

a. Right to share the assets of the partnership firm.
b. Right to share the future profits of the partnership firm.

The amount that the new partner brings in for the right to share in the partnership assets is called his capital and is credited to his Capital account. Whereas the consideration which he pays to the old partners for the right to participate in the division of future profits is called Goodwill.

3.1 Admission of a Partner – Accounting Treatment (Adjustments): While admitting a new partner, the following adjustments are necessary:

a. Recording the Capital of a new partner.
b. Calculation of New Profit Sharing ratio and Sacrificing ratio.
c. Revaluation of assets and liabilities.
d. Transfer of Undistributed Profit or loss.
e. Transfer of Accumulated reserves.
f. Treatment of Goodwill.

3.2 Revaluation Of Assets And Liabilities: Revaluation is the valuation of assets and liabilities at the time of reconstitution of the partnership firm. At the time of admission of a partner, the assets and liabilities are revalued so that the profit and loss arising on account of such revaluation may be adjusted in the old partners' capital accounts in their old profit sharing ratio and the incoming partner may not be affected by the profit or loss on account of revaluation of assets and liabilities. For the purpose a revaluation account is opened.

Revaluation Account is credited with the following profit items:

a. Increase in the value of assets,
b. Decrease in the amount of liabilities and
c. Unrecorded assets now recorded.

Revaluation account is debited with the following loss items:

a. Decrease in the value of assets,
b. Increase in the amount of liabilities,
c. Unrecorded liabilities now recorded and
d. Creation of a new liability.

The balance of Revaluation account shows the net effect on account of revaluation which is transferred to old partners' capital accounts in their old profit sharing ratio. The assets and liabilities appear in the Balance Sheet of the reconstituted firm at their revised values.

Format of Revaluation Account

Dr. **Revaluation Account** **Cr.**

Particulars	**Rs.**	**Particulars**	**Rs**
To Assets (Individually) - (Decrease in the value)	xxx	By Assets (Individually) (Increase in the value and unrecorded)	xxx
To Liabilities (Increasein the amount,unrecorded and newly created)	xxx	By Liabilities (Decrease in the amount)	xxx xxx
To Partners' capital A/c (Profit on revaluation)	xxx	By Partner's Capital A/c (Loss on revaluation)	
	xxx		xxx

Illustration 1:

Sankar and Saleem are partners in a firm sharing profits and losses in the ratio of 3:2 as on 31st March 2005. Their Balance Sheet was as under:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Creditors	90000	Cash	5000
Bills payable	25000	Bank	40000
Capital Accounts:		Stock	60000
Sankar : 1,50,000		Furniture	20000
Saleem : 1,20,000	270000	Land and Building	
		Debtors 62,000	
		Less: Provision	

		for Bad debts 2,000	60000
	385000		385000

On 1st April 2005, they admit Solomon into partnership on the following condition:
1. Solomon has brought Rs.1,00,000 as capital.
2. The value of land and building was to be increased by Rs.20,000.
3. Stock and furniture were to be depreciated by Rs.10,000 and Rs.5,000 respectively.
4. Rs.15,000 to be written off from Sundry creditors as it is no longer liability.
5. Provision for doubtful debts is to be increased by Rs.1,000. Prepare Revaluation Account and the Balance Sheet.

Solution:

Dr **Revaluation Account** **Cr**

Particulars	Rs.	Particulars	Rs.
To Stock To Furniture To Provision for doubtful debts To Profit on revaluation transferred to Sankar's Capital A/c 12,000 Saleem's Capital A/c 8,000	10,000 4,000 1,000 20,000	By Land and Building By Sundry Creditors	20,000 15,000
	35,000		35000

Capital Accounts

Particulars	Sankar	Saleem	Solomon	Particulars	Sankar	Saleem	Solomon
To balance c/d	162000	128000	100000	By balance b/d By revaluation a/c	150000 12000	120000 8000	100000
				By balance b/d			
	162000	128000	100000		162000	128000	100000
					162000	128000	100000

Bank Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d To Solomon's Capital A/c	40,000 1,00,000	By Balance c/d	1,40,000
	1,40,000		1,40,000

Balance Sheet of Sankar, Saleem, Solomon

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	75,000	Cash	5,000
Bills payable	25,000	Bank	140,000
Capital Accounts		Stock	50000
Sankar : 1,62,000		Land and Building	220000
Saleem : 1,28,000		Sundry Debtors 62,000	
Solomon : 1,00,000	390,000	Less: Provision	
		for doubtful debts 3,000	59000
		Furniture	16000
	490000		49000

Illustration2:

Amar and Akbar are partners in a firm sharing profits and losses in the ratio of 2:1 as on 31st March 2019. Their Balance Sheet was as under:

Balance Sheet

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	80,000	Cash	10,000
Bills payable	40,000	Bank	70,000
Capital Accounts		Stock	80000
Amar : 270,000		Plant and Machinery	100000
Akbar : 210,000		Sundry Debtors	40000
	480,000	Land and Buildings	300000
	600000		600000

On 1st April 2019, they admit Antony into partnership on the following conditions:

1. Antony has bring in a capital of Rs.1,50,000 for 1/5th share of the future profits.
2. Stock and machinery were to be depreciated by Rs.6,000 and Rs.15,000 respectively.
3. Investments of Rs.15,000 not recorded in the books brought into accounts.
4. Provision for doubtful debts is to be created at 5% on debtors.
5. A liability of Rs.4,000 for outstanding repairs has been omitted to be recorded in the books.

Prepare Revaluation Account, Capital Account, Bank Account and the Balance Sheet.

Revaluation Account

Particulars	Rs.	Particulars	Rs.
To Stock To Machinery To Provision for doubtful debts To Provision for outstanding repairs	6,000 15,000 2,000 4,000	By Investments By Loss on revaluation transferred to Amar's Capital A/c8,000 Akbar's Capital A/c 4,000	15,000 12,000
	27,000		27,000

Bank Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d To Antony's Capital A/c	70,000 1,50,000	By Balance c/d	220,000
	220,000		220,000

Capital's Accounts

Particulars	Amar	Akbar	Antony	Particulars	Amar	Akbar	Antony
To revaluation a/c	8000	4000		By balance b/d	270000	210000	
To balance c/d	262000	206000	100000	By Bank a/c			150000
	270000	210000	100000		270000	210000	150000
				By balance b/d	262000	206000	150000

Balance Sheet of Amar, Akbar and Antony as on 1st April, 2019

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	80,000	Cash	10,000
Bills payable	40,000	Bank	2,20,000
Outstanding repairs	4,000	Investments	15,000
Capital Accounts:		Sundry Debtors 40,000	
Amar : 2,62,000		Less: Provision	
Akbar : 2,06,000		for doubtful debts 2,000	38,000
Antony : 1,50,000	6,18,000	Plant and Machinery	85,000
		Land and Building	3,00,000
	7,42,000		7,42,000

3.3 Accounting Treatment of Goodwill

The new partner acquires his/her share profit from the existing partners. This will result in the reduction of the share of existing partners. Therefore, he/she compensates the existing partners for the sacrifices. He/she compensates them by making payment in cash or in kind. The payment is equal to his/her share in the goodwill.

If, he/she does not pay for goodwill, then amount equal to his/her share of goodwill will be deducted from the capital. The amount brought in by him/ her as goodwill or amount of goodwill deducted from his/her capital anddivided between the existing partners in their sacrificing ratio. At the time of admission of a new partner any goodwill appearing in the books, will be written off in existing ratio among the existing partners.

There are different situations relating to treatment of goodwill at the time of admission of a new partner. These are discussed as under:

a. When the amount of goodwill is paid privately by the new partner.
b. When the new partner brings his/her share of goodwill in cash.
c. When the new partner does not bring his/her share of goodwill in cash.

a. The amount of goodwill is paid privately by the new partner:

If the amount of goodwill is paid by the new partner to the existing partner privately, no journal entries are made in the books of the firm.

b. The new partner brings his/her share of goodwill in cash and the amount of goodwill is retained in the Business:

When, the new partner brings his/her share of goodwill in cash. The amount brought in by the new partner is transferred to the existing partner in the sacrificing ratio. If there is any goodwill account in the balance sheet of existing partner, it will be written off immediately in existing ratio among the partners. The journal entries are as follows:

a. The existing goodwill in the books of the firm will be writtenoffin existing profit ratio as:

Existing Partners Capital A/c Dr. [individually]
To Goodwill A/c
(Existing goodwill written off)

b. For bringing cash for Capital and goodwill:

Cash/Bank A/c Dr.
To Goodwill A/c
To New partner's Capital A/c
(Cash brought in for capital and goodwill)

c. For amount of goodwill transferred to existing partner capitalaccount:

Goodwill A/c Dr.
To Existing Partner's Capital/current A/c [individually]

(The amount of goodwill credited to existing partner's capitals in sacrificing ratio)

d. **The amount of goodwill is withdrawn by the existing partners**:

Existing Partners Capital/current A/c Dr. [individually]
To Cash/Bank A/c
(The amount of goodwill withdrawn by the existing partners)

c. New partner does not bring his/her share of goodwill in cash:

When the goodwill of the firm is calculated and the new partner is not able to bring his/her share of goodwill in cash, goodwill will be adjusted through new partner's capital accounts. In this case new partner's capital account is debited for his/her share of goodwill and the existing partner's capital accounts are credited in their sacrificing ratio. The journal entry is as under:

New Partner's Capital A/c Dr.
To Existing Partner's Capital A/c [individually in sacrificing ratio]
(New partner's share in goodwill credited to existing partner's in sacrificing ratio)

Goodwill appears in the books of the firm and new partner does not bring his/her share of goodwill in cash:

If the goodwill account appears in the books of the firm, and the new partner is not able to bring goodwill in cash. In this case, the amount of goodwill existing in the books is written off by debiting the capital account of existing partners in their existing profit sharing ratio.

New partner brings in only a part of his share of goodwill:

When new partner is not able to bring the full amount of his/her share of goodwill in cash and brings only a part of cash. In this case, the amountof goodwill brought by him is credited to goodwill account. At the time of goodwill transferred to capital account of existing partner's, new partner's capital account is debited with his unpaid share of goodwill besides debiting goodwill account with the amount of goodwill is paid by him.

The journal entries is as:

Bank A/c Dr.
To Goodwill A/c
(Part Amount of goodwill brought by new partner)

Goodwill A/c Dr.
New Partner's Capital A/c Dr.
To Existing Partner's Capital A/c [individually in sacrificing ratio]
(Credit given to sacrificing partner by new partner's in full share of goodwill)

Adjustment Of Partner's Capital:

Sometime, at the time of admission, the partners' agree that their capitals be adjusted in proportion to their profit sharing ratio. For this purpose, the capital accounts of the existing partners are prepared, making all adjustments, on account of goodwill, general-reserve, revaluation of assets and resettlement of liabilities. The actual capital so adjust will be compared with the amount of capital that should be kept in the business after the admission of the new partner. The excess if any, of adjusted actual capital over the proportionate capital will either be withdrawn or transferred to current account and vice versa. The partners may decide to calculate the capitals which are to be maintained in the new firm either on the basis of new Partner's Capital and his profit sharing ratio or on the basis of the existing partner's capital account balances.

Adjustment of existing partner's capital on the basis of the capital of the new partner: If the capital of the new partner is given, the entire capital of the new firm will be determined on the basis of the new partner's capital and his profit sharing ratio. Therefore the capital of other partners is ascertained by dividing the total capital as per his profit sharing ratio. If the existing capital of the partner after adjustment is in excess of his new capital, the excess amount is withdrawn by partner or transferred to the credit of his current account. If the existing capital of the partner is less than his new capital, the partner brings the short amount or makes transfer to the debit of his current account.

The journal entries are made as under:

a. When excess amount is withdrawn by the partner or transferred tocurrent account.

Existing Partner's Capital A/c Dr.

To Bank A/c or Partner Current A/c

(Excess amount is withdrawn by the partneror transferred to current account)

b. For bringing in the Deficit amount or Balance transferred to currentaccount.

Bank A/c or Partner Current A/c Dr.

To Existing Partner's Capital A/c

(Bringing the Deficit amount or Balancetransferred to current account)

Illustrations 1:

Govind and Gopal are sharing the profit in 3:2 ratio. The balance sheet of their partnership firm appears as under.

The partners propose to Admit Goverdhan with a share of 3/8 in the profit of the firm from 1.04.2019. The incoming partner will bring Rs.3,00,000 as capital besides Rs.85,000 as his share of Good will, in which will remain in business.

Balance Sheet of Govind and Gopal as on 31-03-2019

Liabilities	Amount (Rs.)	Assets	Amount(Rs.)
Capital		Cash	7,100
Govind 3,40,500		Bank	1,19,250
Gopal 3,40,500	6,81,000	Sundry Debtors	55,000
Sundry Creditors	1,24,350	Stock	1,80,000
		Furniture	44,000

		Buildings	4,00,000
	8,05,350		8,05,350

Govind and Gopal want to make the following adjustment in the books before admitting Goverdhan.

1. Stock and furniture should be depreciated by 12.5 percent respectively.
2. Buildings to be raised in value of Rs.75,000.
3. A provision for bad debts to be credited with 5 percent of Sundry debtors.
4. An investment not recorded earlier in the books worth Rs.21,500 should be brought into books.
5. A contingent liability worth Rs.6,000 became a certain liability. Write necessary journal entries, prepare important accounts and show the balance sheet of the firm after Goverdhan admission.

Solution:

Revaluation Account

Dr. **Cr.**

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Stock Account	22,500	By Building Account	75,000
To Furniture Account	2,200	By Investment Account	21,500
To Provision for bad debt.	2,750		
To Liability Account	6,000		
To Govind's Capital A/c.	37,830		
To Gopal's Capital A/c.	25,220		
	96,500		96,500

Govind's Capital Account

Dr. **Cr.**

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Balance c/d	4,29,330	By Balance b/d	3,78,330
		By Goodwill A/c	51,000
	4,29,330		4,29,330
		By Balance b/d	4,29,330

Gopal's Capital Account

Dr. **Cr.**

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**

To Balance c/d	3,99,720	By Balance b/d	3,65,720
		By Goodwill A/c	34,000
	3,99,720		3,99,720
		By Balance b/d	3,99,720

Goodwill Account

Dr. **Cr.**

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Govind A/c	51,000	By Cash Account	85,000
To Gopal's Capital A/c	34,000		
	85,000		85,000

Cash Account

Dr. **Cr.**

Particulars	**Amount Rs.**	**Particulars**	**Amount Rs.**
To Balance b/d	7,100	By Balance b/d	3,92,100
To Goodwil A/c	85,000		
To GoverdhanCapitalA/c	3,00,000		
	3,92,100	By Balance b/d	3,92,100

Balance Sheet of M/s. Govind, Gopal and Goverdhan as on 01-04-2019

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
Sundry Creditors	1,24,350	Cash	3,92,100
Contingency Liability	6,000	Bank	1,19,250
Capital Accounts:		Sundry Debtors 55,000	
Govind 4,29,330		Less: Res. for bad debt 2,750	52,250
Gopal 3,99,720		Stock(1,80,000-22,5000)	1,57,500
Goverdhan 3,00,000	11,29,050	Furniture(44,000-2,200)	41,800
		Investments	21,500
		Buildings(4,00,000+75,000)	4,75,000
	12,59,400		12,59,400

Illustration: 2

When the Goodwill is over valued in the books of the old firm: (When Goodwill is shown at value greater than its present value in the books.)

Land M were partners in a firm sharing profit and losses in the ratio of 3:2.The balance sheet of the firm as on 31-12-2018 was as follows

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	20,000	Cash in hand	1,00,000
Outstanding expenses	2,000	Stock	50,000
Bills payable	18,000	Sundry Debtors	25,000
Reserve fund	10,000	Bills receivable	1,00,000
Capitsls		Land & Buildings	1,00,000
L 3,00,000	11,29,050	Plant and Machinery	1,25,000
M 2,00,000	5,00,000	Good will	50,000
	5,50,000		5,50,000

On 1-1-2019 Mr. N is to be admitted on the following terms and conditions.

a. N is to bring Rs.2,00,000 for 1/4th sharing in the profits.
b. The firm's assets as to be revalued as follows.
   Land & Building is to be brought to Rs.1,80,000/-
   Plant & Machinery is to be reduced by 210%
   R.D.D. is to be created @ 10% on Sundry Debtors.
   Stock is to be reduced by 20%
   Goodwill is to be revalued at Rs.35,000/-.
c. The outstanding expenditure is need not be paid.

Show Revaluations Account, Partners Capital accounts, Goodwill Account and the Balance sheet after the admission of 'N'.

Solution:

Revaluation Account

Dr. **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Plant and Machinery A/c	12,500	By Land & Buildings	80,000
To Res. For D.Debt A/c	2,500	By Outstanding Expenses	2,000
To Stock A/c	10,000		

To L's Capital A/c 34,200 To M's Capital A/c 22,800 To (Profit on Revaluation transferred to Capital A/c in 3:2 ratio)	57,000		
	82,000		82,000

Goodwill Account

Dr. **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To balance b/d	50,000	By L's Capital A/c (3/5 X 15000) By M's Capital A/c (2/5 X 5000) By Balance c/d	9,000 6,000 35,000
	50,000		50,000

Note: Revaluation of Overvalued goodwill or undervalued goodwill of the old firm is concerned only to the old partners, hence to be debited or credited (as the case may be) only to old partners Capital Account in old ratio.

Capital Accounts

Particulars	L Rs.	M Rs.	N Rs.	Particulars	L Rs.	M Rs.	N Rs.
To Goodwill A/c	9000	6,000		By bank a/c By Bal b/d	300000	200000	200000
To Bal c/d	331200	220800	200000	By Res. Fund A/c	6,000	4,000	
				By Revaluation A/c	34200	22800	
	340200	226800	200000		340200	226800	200000
				By Balance b/d	331200	220800	200000

Balance sheet of L, M and N as on 1-1-2019

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	20,000	Cash in hand	3,00,000
Bills payable	18,000	(1,00,00+2,00,000)	
Capital A/c's;		Stock 50,000	
L's Capital 3,31,200		Less : Dep 10,000	40,000

M's Capital 2,20,800 N's Capital 2,00,000	7,52,000	Sundry Debtors25,000 Less : RBD 2,500	22,500
		Bills Receivables	1,00,000
		Land & Building 1,00,000 Add: Appr. 80,000	1,80,000
		Plant & Machinery 1,25,000 Less : Dep 12,500	1,12,500
		Goodwill	35,000
	7,90,000		7,90,000

Retirement of a Partner: According to section 32(1) of the Indian Partnership Act 1932, a partner may retire from the firm

a. With the consent of all the partners.
b. In accordance with an express agreement by the partners.
c. Where the partnership at will by giving notice in writing to all the other partners of his intention to retire.

Sometimes, a partner may decide to retire from the firm because of old age, ill health etc. Technically, on retirement, the old partnership comes to an end and a new one comes into existence with the remaining partners. However, the firm as such continues. A person who is retired from the firm is known as an outgoing partner or a retiring partner. A retiring partner will be held liable for the debts incurred by the firm before his retirement. But, he will not be responsible for the firms' acts after his retirement.

When a partner retires, his share in the properties of the firm has to be ascertained and paid off. Certain adjustments have to be made in the books to ascertain the amount due to him from the firm. These adjustments are very similar to those which we saw in connection with the admission of a partner.

Accounting Treatment (Adjustments)

When a partner retires, the following accounting adjustments are necessary:

1. Calculation of New profit sharing ratio and Gaining ratio.
2. Revaluation of assets and liabilities.
3. Transfer of Undistributed Profit or loss.
4. Transfer of Accumulated reserves.
5. Treatment of Goodwill.
6. Settlement of the retiring partner's claim.

1. Calculation of New Profit sharing ratio and Gaining ratio:

At the time of retirement of a partner, the remaining partners acquire some portion of the retiring partner's share of profit. This necessitates the calculation of new profit sharing ratio of the remaining partners.

New Profit Sharing Ratio:

The ratio in which the continuing partners decide to share the future profits and losses is known as new profit sharing ratio.

New Profit sharing ratio = Old ratio + Gaining ratio

New share = Old share + Acquired share (gain)

Gaining Ratio:

The ratio in which the continuing partners acquire the outgoing partner's share is called as gaining ratio. This ratio is calculated by taking out the difference between new profit sharing ratio and old profit sharing ratio.

Gaining ratio = New ratio – Old ratio

Gain = New share – Old share

The purpose of this ratio is to determine the amount of compensation to be paid by each of the remaining partners as the firm to the retiring partner.

Revalutaion of Assets and Liabilities:

At the time of retirement of a partner, it is necessary to revalue the assets and liabilities of the firm. It is necessary that the retiring partner is given a share of all profits that have arisen till his retirement. Further, he is made to bear his share of losses that had occurred till his retirement. A Revaluation account is opened and credited with all the profit items and debited with all the loss items. The profit or loss on revaluation will be transferred to partners' capital accounts including the retiring partner in the old profit sharing ratio.

Transfer of Undistributed Profit or Loss:

At the time of retirement of a partner, undistributed profit or loss of the old firm should be transferred to all partners' capital accounts in their old profit sharing ratio.

Transfer of Accumulated Reserve:

Any amount kept aside as Reserve, General reserve, Reserve fund, contingency reserve etc., at the time of retirement of a partner, should be transferred to the capital accounts of all partners including retiring partner in the old profit sharing ratio.

Treatment of Goodwill:

At the time of retirement of a partner, adjustment for goodwill of the firm, if any, has to be made as in admission. In retirement too, we confine to the Revaluation Method only.

a) **Goodwill is raised in the books of the firm:**

At the time of retirement, Goodwill is raised to its present value and brought into record. The entry is**:**

Goodwill A/c Dr	....	
To All partners' capital A/c		....

(Goodwill raised and adjusted to the all partners' capital account)

b) **Goodwill appears in the books -understated:**

If the goodwill appears in the balance sheet at a value less than the present value of goodwill, the difference in the goodwill account is transferred to all partners' capital accounts in the old ratio. The entry is:

Goodwill A/c Dr ....

To All Partners' capital A/c ....

(Increase in the value of goodwill transferred to all partners' capital accounts in the old ratio)

c) Goodwill appears in the books - overstated:

If the goodwill appears in the balance sheet at a value more than the present value of goodwill, the difference in the goodwill is transferred to all partners in the old ratio. The entry is:

All Partners' Capital A/c Dr ....

To Goodwill A/c ....

(Decrease in the value of goodwill transferred to all partners' capital accounts in the old ratio)

Settlement of Claim of the Retiring Partner:

The retiring partner is entitled for the amount due to him from the firm. The amount due to the retiring partner is ascertained by preparing his capital account incorporating all the adjustments like the share of goodwill, undistributed profits or losses, accumulated reserves, profit or loss on revaluation of assets and liabilities etc. The amount due is either paid off immediately or is paid in instalments. When it is not paid immediately, it will be transferred to his loan account.

Illustration 3:

Om, Jai and Jagdish are partners sharing profit in the ratio of 3 : 2 : l. Their balance sheet as on December 31st 2018 is as under:

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	32,000	Cash in hand	750
Bills payable	62,500	Cash at bank	2,04,500
Capital A/c's;		Sundry Debtors	89,000
Lalitha200000		Stock	1,11,500
Jyothi125000		Furniture	17,500
Kanaka150000	4,75,000	Plant and Machinery	48,750
Profit & Loss A/c	22000	Building	1,20,000
Outstanding expenses	500		
	5,92,000		5,92,000

Lalitha retired from the partnership on 1st Jan, 2019 on the following terms:

1. Goodwill of the firm was to be valued at Rs.30,000
2. The assets are to be valued as under: Stock Rs.1,00,000; Furniture Rs.15,000; Plant and Machinery Rs.45,000; Building Rs.1,00,000.
3. A provision for doubtful debts be created at Rs.4,250. 4. Lalitha was to be paid off immediately.

Prepare revaluation account, capital accounts, Bank account and balance sheet of the reconstituted partnership.

Revaluation Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Furniture A/c	2500	By loss transferred to Capital A/c's:	
To Plant & Machinery A/c	3750	Lalitha 15750	
To Stock A/c	11500	Jyothi 10500	
To Provision for bad debts A/c	4250	Kanaka 15750	42000
To Buildings	20000		
	42,000		42,000

Capital Accounts

Particulars	Lalitha	Jyothi	Kanaka	Particulars	Lalitha	Jyothi	Kanaka
To revaluation a/c	15750	10500	15750	By balance b/d	200000	125000	150000
To cash a/c	203750			By P & L a/c	8,250	5500	8250
To balance c/d		127500	153750	By goodwill a/c	11250	7500	11250
	219500	138000	169500		219500	138000	169500
				By balance b/d		127500	153750

Bank Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	204500	By Lalitha Capital A/c	203750
		By Balance c/d	750
	204500		204500

Balance Sheet of Jyothi, Kanaka as on 1st April, 2019

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	62,500	Cash	750
Bills payable	32,000	Bank	750

Outstanding expenses	500	Stock		1,00,000
Capital Accounts:		Sundry Debtors	89,000	
Jyothi : 127500		Less: Provision		
Kanaka : 153750	2,81,250	for doubtful debts	4250	84,750
		Plant and Machinery		45,000
		Furniture		15,000
		Land and Building		1,00,000
		Goodwill		30,000
	3,76,250			3,76,250

Illustration 4:

A, B and C were carrying a business in partnership sharing profits and losses in the ration of 3:2:1. On 31st December 2018, Balance Sheet of the firm stood as follows.

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	13,500	Cash	5,900
Capital Accounts		Debtors	8,000
A 15,000		Stock	11,690
B 10,000		Buildings	12,000
C 10,000	35,000	Plant and Machinery	10,000
General Reserve	12,000	Furniture	2,000
	60,590		60,590

B retired on the above mentioned date on the following terms.

i. Buildings be appreciated by Rs.7,000

ii. Provision for bad debts be made @ 5% on debtors

iii. Goodwill of the firm raised at Rs.9000 and immediately written off.

iv. Rs.5,000 be paid to B immediately and the balance due to him be treated as loan carrying interest %6% per annum.

Prepare revaluation account, Partners capital account and new Balance Sheet.

Revaluation Account

Dr. **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To P.D.D	400	By Building A/c	7,000
To Profit	6,600		
(Transfer to Partners)	7,000		7,000

A's Capital Account

Dr. **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Goodwill A/c	6,750	By Balance b/d	15,000
To Balance c/d	22,050	By Goodwill a/c	4,500
		By Revaluation a/c	3,300
		By General reserve a/c	6,000
	28,800		28,800
		By Balance b/d	22,050

B's Capital Account

Dr. **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Cash a/c	5,000	By Balance b/d	10,000
To Loan A/c	14,200	By Goodwill a/c	3,000
		By Revaluation a/c	2,200
		By General reserve a/c	4,000
	19,200		19,200

C's Capital Account

Dr. **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Goodwill A/c	2,250	By Balance b/d	10,000
To Balance c/d	12,350	By Goodwill a/c	1,500
		By Revaluation a/c	1,100
		By General reserve a/c	2,000
	14,600		14,600
		By Balance b/d	14,600

Balance Sheet of A & C as on 01-01-2019

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	13,590	Cash 5,900	
Capital Accounts		Less : B's Cap. 5,000	900
A 22,050		Debtors 8,000	
C 12,350	34,400	Less: P.D.D 400	7,600
B's Loan A/c	14,200	Stock	11,690
		Building 23,000	
		+ App. 7,000	30,000
		Plant & Machinery	10,000
		Furniture	2,000
	62,190		62,190

Exercises

Admission of a partner

1. A and B are carrying on business in a partnership, sharing profit & Losses in the ratio of 2:3. There Balance sheet as at 31-3-2019 was as under.

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	50,000	Cash in hand	30,000
Capital Accounts		Cash at Bank	20,000
A 2,80,000		Sundry Debtors	1,00,000
B 4,20,000	7,00,000	Stock	2,00,000
		Furniture	50,000
		Buildings	3,50,000
	7,50,000		7,50,000

On that date they admit 'C' in to partnership and given him 1/4th share in the future profit on the following terms:

(a) 'C' is to bring in Rs.3,00,000 as his Capital and Rs.1,00,000 as good will, which sum is to remain in the business.
(b) Stock and Furniture are to be reduced in value by 10%
(c) Buildings are to be appreciated by Rs.50,000
(d) A provision of 5% to be created on sundry Debtors for doubtful debts.

Prepare Revaluation Account and show the opening Balance Sheet of the new firm.

(Balance Sheet Rs.11,70,000, Revaluation profit Rs.20,000)

2. The Balance Sheet of Srinitha&Srihitha who are partners sharing profit & losses in the ratio 2:1, on 31-03-2018 was as under.

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	1,00,000	Cash	5,000
Bills payable	3,20,000	Sundry Debtors 4,00,000	
		Less:	
		Provision for D.D. 5,000	3,95,000
General Reserve	1,80,000	Stock	2,50,000
Capitals		Furniture	1.00.000
Srinitha 3,00,000		Buildings	3,00,000
Srihitha 1,50,000	4,50,000		
	10,50,000		10,50,000

On that date Srinidhi was admitted for 1/3 share of profit on the following terms

(a) That Srinidhi brings in Cash Rs.90,000 for Goodwill & Rs.1,50,000 as Capital.
(b) That half of the goodwill shall be withdrawn by the old partners.
(c) The provision for bad and doubtful debts is to be increased by Rs.10,000.
(d) That a liability for Rs.8,500 be created against outstanding salaries.
(e) That the stock & Furniture to reduced by 5%.
(f) That the value of Buildings be appreciated by 10%.

Prepare Revaluation a/c, Partners Capital Account & Balance Sheet of new firm.

(Balance Sheet Rs.12,47,500, Revaluation Loss Rs.6,000)

3. Naveen and Kiran are partners sharing their profits in the ratio of 3:2 on 31-12-2018. The Balance Sheet is as under:

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Creditors	16,000	Cash in hand	2,000
Bank O.D.	10,000	Cash in Bank	10,000
Bills Payable	12,000	Debtors	20,000
Capitals A/cs:		Stock	18,000
Naveen 48,000		Furniture	10,000
Iran 24,000	72,000	Buildings	30,000
		Machinery	20,000
	1,10,000		1,10,000

Adjustments:

1-1-2018 Rajesh was admitted as partner in the following conditions.

(a) Firm's Goodwill valued for Rs.10,000
(b) Depreciate stock, furniture, machinery @ 10%
(c) Appreciate Buildings @ 10%
(d) Provide Reserve for Bad Debts at 5% on the debtors.

(e) Rajesh has to brings Rs.16,000/- in cash for his share of Capital.

Prepare necessary accounts & the new balance sheet of the firm after Rajesh's entry.

(Ans: Revaluation loss Rs.2,800; Capital A/C Balance – Naveen Rs.52,320; Kiran Rs.26,880; Rajesh Rs.16,000 B/s Total Rs.1,33,200.

4. X, Y Share profit in the ratio of 1:1. Their Balance Sheet as on 31-12-2018 is given below.

Liabilities	Amount Rs.	Assets	Amount Rs.
Outstanding expenses	10,000	Cash in hand	4,000
Creditors	48,000	Cash at Bank	38,000
Overdrafts	40,000	Debtors	40,000
Bills payable	20,000	Furniture	12,000
Capital Accounts		Buildings	57,000
X 45,000		Machinery	42,000
Y 30,000			
	1,93,000		1,93,000

They admitted Z on the following conditions.

(a) Depreciations on Machinery, Buildings, Furniture by 5%

(b) Provision for bad debts 5% on debtors.

(c) Create Goodwill Rs.30,000

(d) She Should bring Rs.45,000/- as capital for 1/4th Share.

Prepare profit & loss Adjustment account & New Balance Sheet on 1.1.19

(Ans : Revaluations Loss Rs.7,550; Capital Balance X-Rs.56,225; Y-Rs.41,225; Z-Rs.45,000; B/s Total Rs.2,60,450)

5. Given below is the Balance Sheet of A and B who are carrying on a partnership business as on 31-12-2018. A and B share profit and Losses in the ratio of 2:1.

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Bills payable	10,000	Cash in hand	10,000
Creditors	58,000	Cash at Bank	40,000
Outstanding	2,000	Sundry Debtors	60,000
Capitals A/cs:		Stock	40,000
A 1,80,000		Plant and Machinery	1,00,000
B 1,50,000	3,30,000	Buildings	1,50,000
	4,00,000		4,00,000

'C' is admitted as a partner on the date if the Balance Sheet is on the following terms.

(a) 'C' will brings in Rs.1,00,000 as his capital & Rs.60,000 as his share of Goodwill for ¼ share of profit.

(b) Plant and Machinery is to be appreciate to Rs.20,000 & the value of Building is to be appreciated by 10%.

(c) Stock is found overvalued by Rs.4,000.

(d) A provision for bad & doubtful debts is to be created at 5% on debtors.
(e) Creditors were unrecorded to the extent of Rs.1,000/-.

Prepare the Profit & Loss adjustment account and show the Balance Sheet after the admission of 'C'.

(Ans: Revaluation profit Rs.27,000; Capital AccountBalances A- Rs.2,38,000; B- Rs.1,79,000; C- Rs.1,00,000;Balance Sheet Total Rs.5,88,000)

6. X and Y were sharing profits in the positions of 2/3 and 1/3 showed the following as their Balance Sheet on 31-12-2018.

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	29,950	Buildings	25,000
Bills Payable	3,000	Plant and Machinery	17,500
Capital Accounts		Stock	10,000
X 15,000		Sundry Debtors	4,850
Y 10,000	25,000	Cash in hand	600
	57,950		57,950

They agreed to admit Z into partnership on the following terms

(a) Z was to bring Rs.75,000 as his Capital & Rs.3,000 as goodwill for ¼ share in the future profits of the firm.
(b) That the Value of stock, Plant & Machinery were to be reduced by 5%
(c) That a reserved of Rs.375 was to be created in respect of sundry debtors.
(d) That the Building account was to be appreciated by 10%
(e) That the Good will was to be retained in the business.

Prepare profit & Loss Adjustment Account, the Capital Account, & the new balance sheet of the firm.

(Ans: Revaluation Profit Rs.750; Capital A/c Balance X-Rs.17,500; Y- Rs.11,250; Z – Rs.7,500; Balance sheet Total Rs.69,200)

7. On 31-12-18 the Balance Sheet of equal partner P, Q and R is given below:

Balance Sheet

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	29,950	Buildings	41,000
Bills Payable	3,000	Furniture	3,200
Capital Accounts		Stock	25,200
P 15,000		Sundry Debtors	32,000
Q 10,000		Cash in hand	4,200
R 18,000	82,000		
	1,05,600		1,05,600

They admitted Mr. 'S' on the following conditions.

(a) 'S' has to bring Rs.24,000 towards Good will and Rs.30,000 as Capital for his 1/4th Share.
(b) ½ (half) of the Goodwill be taken away by the old Partners from the business.
(c) Depreciation @ 5% to be Provided on Stock & Furniture.
(d) 5% provision for Bad debts Reserve on debtors required.
(e) Building is to be valued at Rs.59,000/-.

Prepare Profit and Loss adjustment account, Capital Account and Balance Sheet as on 1-1-2011.
(Ans: Revaluation Profit – Rs.14,980, Capital A/C Balance P-Rs.43,993; Q – Rs.37,993; R – Rs.26,994; S – Rs.30,000; Balance Sheet Total Rs.1,62,580.)

Retirement of a Partner:

Exercises

1) X,Y,Z were partners sharing profits in the ratio of ½, 1/6, 1/3, Their Balance Sheet on 31-12-2018 was as follows:

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	20,500	Buildings	50,000
Bills Payable	10,000	Plant and Machinery	25,000
Capital Accounts		Furniture	2,500
X 15,000		Stock	22,500
Y 10,000		Debtors 20,000	
Z 10,000	80,000	Reserve 1,000	19,000
Reserve fund	12,000	Cash	3,500
	1,22,500		1,22,500

Z retires, so the following adjustment were agreed upon for ascertainment of the payment be made to him.

(1) Appreciate the Buildings by 10% and Stock by 15%.

(2) Depreciate Plant by 10% and furniture by 7 ½ %.

(3) Reserve for Doubtful debts to be made up to Rs.1,500.

(4) Create Goodwill worth Rs.20,000.

(5) The amount payable should be transferred to Loan account.

(6) It is assumed that goodwill credited to retiring partner is being reduced from X and Y'sCapital Balance Sheet.

(Ans : Revaluation Profit – Rs.5,187; Z's Loan A/c – Rs.47,39, Balance Sheet Total – Rs.1,27,687)

2. A, B, C are sharing profits and losses in the ration of 5:3:2 on 31st December, 2018. The balance sheet was as follows:

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	21,000	Cash	50,500
Bills Payable	10,000	Debtors 31,000	
General Reserve	20,000	(-) Res.forb.debt 500	30,500
Capital Accounts		Stock	20,000
A 80,000		Machinery	40,000
B 60,000		Building	80,000
C 30,000	1,70,000		
	2,21,000		2,21,000

On 1st January, 2019C retired on the following terms

1. Value of buildings to be appreciated by 10%.
2. Bad debts reserve to be increased to Rs.1,200.
3. Goodwill is to be created Rs.40,000.
4. Amount due to C is to be transferred to 8% loan account in her name.

(Ans. Revaluation Profit – Rs.7,300; C's 8% Loan A/c – Rs.43,460 Balance Sheet Total Rs.2,68,300)

3. Gayatri, Chandrika andPadma are partners sharing profit and losses in the ratio of 5:3:2. Their Balance Sheet as on 31.12.2018 is given below.

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	1,21,000	Buildings	80,000
Bills Payable	10,000	Machinery	1,40,000
Capital Accounts		Stock	20,000
Gayatri 80,000		Debtors 31,000	
Chandrika 60,000		Reserve 500	19,000
Padma 30,000	1,70,000	Cash	50,500
Reserve fund	20,000		1,22,500
	3,21,000		3,21,000

Padma retires on the following adjustments.

(1) Appreciate Buildings by 10% and depreciate Machinery by 20% and stock revalued at Rs.15,000.

(2) Bad debts reserve is to be increased upto Rs.1,200

(3) Goodwill is to be created for Rs.49,000.

Prepare profit and loss adjustment account and new balance sheet.

(Ans :Revluations Loss – Rs.25,700 :Padma Loan A/c – Rs.39,660;Balance Sheet total – Rs.3,44,300).

4. Navaratna, Revathi and Konda are partners sharing profits and losses equally. Their Balance Sheet on 31st March 2019 is given below.

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	20,000	Cash & Bank	18,000
Reserve fund	18,000	Debtors	30,000
Capital Accounts		Stock	24,000
Navaratna 50,000		Machinery	40,000
Revathi40,000		Buildings	46,000
Konda 30,000	1,20,000		
	1,58,000		1,58,000

On the above date, Konda decided to retire from the firm on the following conditions.

(i) Goodwill of the firm be valued at Rs.24,000.

(ii) Depreciate stock & Machinery by 10%

(iii) Buildings will be appreciated to Rs.56,000.

(iv) Provide 5% on the debtors towards reserve for doubtful debts.

Write Revaluations Account, Capital Account and Balance Sheet after due amount is to be paid in cash to Konda to the extent possible and Balance transferred to a Loan A/C.

(Ans : Revaluations profit – Rs.2,100; Konda Loan A/c – Rs.26,700; Balance sheet – Rs.1,66,100)

5. Shanti, Indu and Lakshmi are partners sharing profit and losses equally. Their Balance Sheet as on 31st March, 2018 is given below.

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	1,00,000	Cash & Bank	90,000
Profit & Loss A/c	90,000	Debtors	1,50,000
Capital Accounts		Stock	1,20,000
Shanti 2,50,000		Machinery	2,00,000
Indu 2,00,000		Buildings	2,30000
Lakshmi 1,50,000	6,00,000		
	7,90,000		7,90,000

On above date Lakshmi, decided to retire from the firm on the following conditions:

(a) Goodwill of the firm to be valued at Rs.1,20,000.
(b) Depreciate stock and Machinery by 10%
(c) Buildings to be appreciated up to Rs.2,80,000.
(d) Provide 5% on debtors towards reserve for doubtful debts.

Prepare ledger accounts and new balance sheet of the firm as on 1.4.2018.

(Balance sheet Total Rs.9,20,500, Revaluation profit Rs.10,500)

Ψ

UNIT 5

COMPANY ACCOUNTS - I

Company Accounts – I –(As per Companies act 2013) Meaning of company – Meaning of Share capital – Classification of share capital – Types of shares – Issue of shares at par, premium, discount (Including problems).

Learning Objectives

After studying this unit, the student will be able to

- Understand the meaning of company and share capital
- Understand about classification of share capital
- Learn about classification of shares
- Issue of shares.

5.0 Definition of Company: According to Justice Marshall a company is 'an artificial being invisible, intangible and existing only in the contemplation of Law. "According to Sec. 3(1) of the Companies Act defines a company as 'company formed and registered under this Act, or an existing company'. An existing company means a company formed and registered under any of the former companies Acts.

5.1 Meaning of Share Capital:A company, being an artificial person, cannot generate its own capital which has necessarily to be collected from several persons. These persons are known as shareholders and the amount contributed by them is called share capital. Since the number of shareholders is very large, a separate capital account cannot be opened for each one of them. Hence, innumerable streams of capital contribution merge their identities in a common capital account called as 'Share Capital Account'.

5.2 CATEGORIES OF SHARE CAPITAL: From accounting point of view the share capital of the company can be classified as follows:

1. **Authorized Capital:** Authorised capital is the amount of share capital which a company is authorised to issue by its Memorandum of Association. The company cannot raise more than the amount of capital as specified in the Memorandum of Association. It is also called Nominal or Registered capital. The authorised capital can be increased or decreased as per the procedure laid down in the Companies Act. It should be noted that the company need not issue the entire authorised capital for public subscription at a time. Depending upon its requirement, it may issue share capital but in any case, it should not be more than the amount of authorised capital.
2. **Issued Capital:** It is that part of the authorised capital which is actually issued to the public for subscription including the shares allotted to vendors and the signatories to the company's memorandum. The authorised capital which is not offered for public subscription is known as 'unissued capital'. Unissued capital may be offered for public subscription at a later date.

3. **Subscribed Capital:** It is that part of the issued capital which has been actually subscribed by the public. When the shares offered for public subscription are subscribed fully by the public the issued capital and subscribed capital would be the same. It may be noted that ultimately, the subscribed capital and issued capital are the same because if the number of share, subscribed is less than what is offered, the company allot only the number of shares for which subscription has been received. In case it is higher than what is offered, the allotment will be equal to the offer. In other words, the fact of over subscription is not reflected in the books.
4. **Called-up Capital:** It is that part of the subscribed capital which has been called up on the shares. The company may decide to call the entire amount or part of the face value of the shares. For example, if the face value (also called nominal value) of a share allotted is Rs. 10 and the company has called up only Rs. 7 per share, in that scenario, the called up capital is Rs. 7 per share. The remaining Rs. 3 may be collected from its shareholders as and when needed.
5. **Paid-up Capital:** It is that portion of the called up capital which has been actually received from the shareholders. When the shareholders have paid all the call amount, the called-up capital is the same to the paid-up capital. If any of the shareholders has not paid amount on calls, such an amount may be called as ‘calls in arrears’. Therefore, paid-up capital is equal to the called-up capital minus call-in-arrears.
6. **Uncalled Capital:** That portion of the subscribed capital which has not yet been called-up. As stated earlier, the company may collect this amount any time when it needs further funds.
7. **Reserve Capital:** A company may reserve a portion of its uncalled capital to be called only in the event of winding up of the company. Such uncalled amount is called ‘Reserve Capital’ of the company. It is available only for the creditors on winding up of the company.

5.3 NATURE AND CLASSES OF SHARES:

Shares, as applied to the capital of a company, refer to the units into which the total share capital of a company is divided. Thus, a share is a fractional part of the share capital and forms the basis of ownership interest in a company. The persons who contribute money through shares are called shareholders.

The amount of authorised capital, together with the number of shares in which it is divided, is stated in the Memorandum of Association but the classes of shares in which the company’s capital is to be divided, along with their respective rights and obligations, are prescribed by the Articles of Association of the company. As per Section 86 of The Companies Act, a company can issue two types of shares. They are:

a. **Preference shares, and**
b. **Equity shares (also called ordinary shares).**

a. Preference Shares: According to Section 85 of The Companies Act, 1956, a preference share is one, which fulfils the following conditions:

a. That it carries a preferential right to dividend to be paid either as a fixed amount payable to preference shareholders or an amount calculated by a fixed rate of the nominal value of each share before any dividend is paid to the equity shareholders.

b. That with respect to capital it carries or will carry, on the winding-up of the company, the preferential right to the repayment of capital before anything is paid to equity shareholders.

However, notwithstanding the above two conditions, a holder of the preference share may have a right to participate fully or to a limited extent in the surpluses of the company as specified in the Memorandum or Articles of the company. Thus, the preference shares can be participating and non-participating. Similarly, these shares can be cumulative or non-cumulative, and redeemable or irredeemable.

b. Equity Shares: According to Section 85 of The Companies Act, 1956, an equity share is a share which is not a preference share. In other words, shares which do not enjoy any preferential right in the payment of dividend or repayment of capital, are termed as equity shares. The equity shareholders are entitled to share the distributable profits of the company after satisfying the dividend rights of the preference shareholders. The dividend on equity shares is not fixed and it may vary from year to year depending upon the amount of profits available for distribution. The equity share capital may be

a. With voting rights; or
b. With differential rights as to voting, dividend or otherwise in accordance with such rules and subject to such conditions as may be prescribed.

5.3.1 Distinction between Preference Shares and Equity Shares

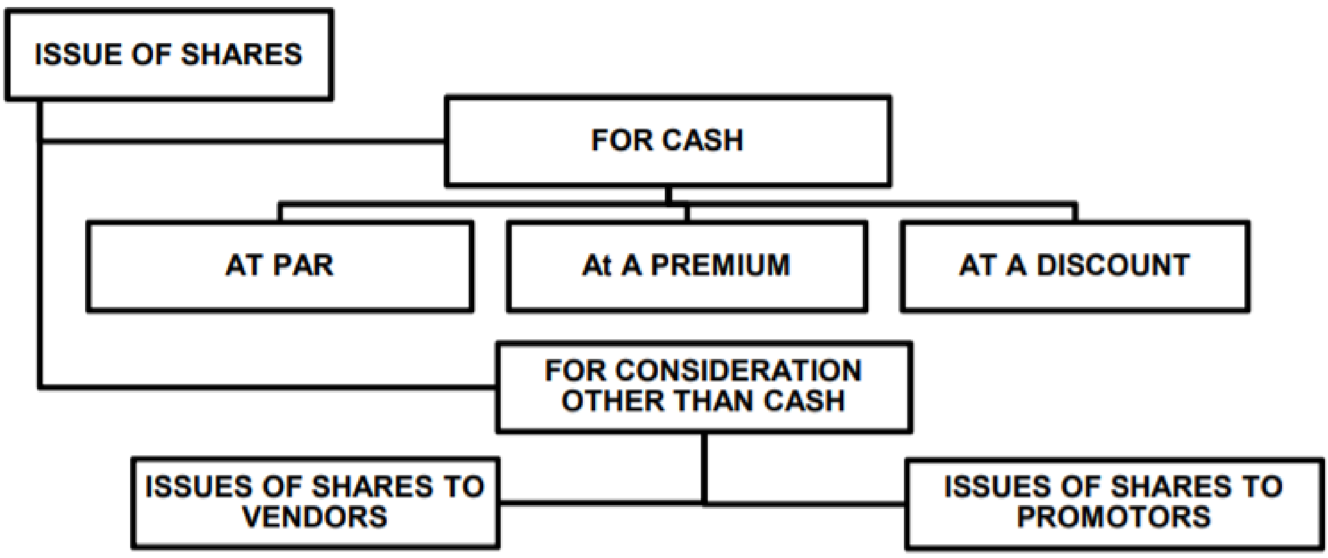
1.Preference Dividend is paid before paying any dividend on equity shares.	1. Equity shareholders will get dividend only after paying dividend to preference shareholders.
2. At the time of liquidation after payment of creditors, preference shares are redeemed before equity shares.	2. Equity shares are repaid after full repayment is made on preference shares.
3. The rate of dividend is fixed.	3. Rate of dividend is not fixed, it may vary from year to year.
4.In case of preference shares (cumulative preference shares) arrears of dividends will accumulate.	4. There is no question of accumulation of arrears of dividend.
5. Preference shares (convertible pref. shares) can be converted into equity shares.	5. Equity shares cannot be converted into preference shares.
6. Preference shareholders donot have voting rights unless their rights are affected.	6. Equity shareholders have voting right.
7.Redeemable preference share are redeemable according to the provision of Sec 80A of the Companies Act.	7. There is no provision for redemption of equity shares.

5.4 ISSUE OF SHARES:

A salient characteristic of the capital of a company is that the amount on its shares can be gradually collected in easy instalments spread over a period of time depending upon its growing financial requirement. The first installment is collected along with application and is thus, known as application money, the second on allotment (termed as allotment money), and the remaining instalment are termed as first call, second call and so on. The word final is suffixed to the last installment. However, this in no way prevents a company from calling the full amount on shares right at the time of application.

The important steps in the procedure of share issue are:

- **Issue of Prospectus:** The Company first issues the prospectus to the public. Prospectus is an invitation to the public that a new company has come into existence and it needs funds for doing business. It contains complete information about the company and the manner in which the money is to be collected from the prospective investors.
- **Receipt of Applications:** When prospectus is issued to the public, prospective investors intending to subscribe the share capital of the company would make an application along with the application money and deposit the same with a scheduled bank as specified in the prospectus. The company has to get minimum subscription (Refer Box 1) within 120 days from the date of the issue of the prospectus. If the company fails to receive the same within the staid period, the company cannot proceed for the allotment of shares and application money should be returned within 130 days of the date of issue of prospectus.
- **Allotment of Shares:** If minimum subscription has been received, the company may proceed for the allotment of shares after fulfilling certain other legal formalities. Letters of allotment are sent to those whom the shares have been allotted, and letters of regret to those to whom no allotment has been more. When allotment is made, it results in a valid contract between the company and the applicants who now became the shareholders of the company.



5.5 ACCOUNTING FOR SHARE CAPITAL: Shares of a company are issued either at par, at a premium or at a discount. Shares are said to have been issued at par when their issue price is exactly equal to their nominal value according to the terms and conditions of issue. When the shares of a company are issued more than its nominal value (face value), the excess amount is called premium and the issue is said to have been made at a premium. When the shares are issued at a price less than the face value of the share, it is known as shares issued at a discount. Irrespective of the fact that shares are issued at par, premium or discount, the share capital of a company as stated earlier, is collected in instalments to be paid at different stages.

5.5.1 ACCOUNTING TREATMENT

Issue of Shares at Par Value:

On application: The amount of money paid with various installments represents the contribution to share capital and should ultimately be credited to share capital. However, for the sake of convenience, initially individual accounts are opened for each instalment. All money received along with application is deposited with a scheduled bank in a separate account opened for the purpose. The journal entry is as follows:

Bank A/c Dr.
To Share Application A/c
(Amount received on application for — shares @ Rs. ______ per share).

On allotment: When minimum subscription has been received and certain legal formalities on the allotment of shares have been duly complied with, the directors of the company proceed to make the allotment of shares. The allotment of shares implies a contract between the company and the applicants who now become the allottees and assume the status of share-holders or members.

The journal entries with regard to allotment of shares are as follows:

1. For Transfer of Application Money

   Share Application A/c Dr.
   To Share Capital A/c
   (Application money on _____ Shares allotted/ transferred to Share Capital)

2. For Money refunded on rejected application

   Share Application A/c Dr.
   To Bank A/c
   (Application money returned on rejected application for — shares).

3. For Amount Due on Allotment

   Share Allotment A/c Dr.
   To Share Capital A/c
   (Money due on allotment of _______ shares @ Rs. per share).

4. For Adjustment of Excess Application Money

   Share Application A/c Dr.
   To Share Allotment A/c
   (Application Amount on — Shares @ Rs. per shares adjusted to the amount due on allotment).

5. For Receipt of Allotment Amount

   Bank A/c Dr.
   To Share Allotment A/c
   (Allotment money received on — Shares @ Rs. — per share Combined Account)

Sometimes a combined account for share application and share allotment called 'Share Application and Allotment Account' is opened in the books of a company. The combined account is based on the reasoning that allotment without application is impossible while application without allotment is meaningless. These two stages of share capital are closely inter-related.

When a combined account is maintained, journal entries are recorded in the following manner:

1. For Receipt of Application and Allotment

   Bank A/c Dr.
   To Share Application and Allotment A/c
   (Money received on applications for shares @ Rs. _____ per share).
2. For Transfer of Application Money and Allotment Amount Due

   Share Application and Allotment A/c Dr.
   To Share Capital A/c

(Transfer of application money to Share Capital Account for amount due or allotment of — Share @ Rs. _____ per share).

3. For Money Refunded on Rejected Applications

   Share Application and Allotment A/c Dr.

   To Bank A/c
   (Application money returned on rejected application for ___ shares).
4. On Receipt of Allotment Amount

   Bank A/c Dr.

   To Share Application and Allotment A/c
   (Balance of Allotment Money Received).

On Calls: Calls play a vital role in making shares fully paid-up and for realising the full amount of shares from the shareholders. In the event of shares not being fully called-up till the completion of allotment, the directors have the authority to ask for the remaining amount on shares as and when they decide about the same. It is also possible that the timing of the payment of calls by the shareholders is determined at the time of share issue itself and given in the prospectus.

Two points are important regarding the calls on shares. First, the amount on any call should not exceed 25% of the face value of shares. Second, there must be an interval of at least one month between the making of two calls unless otherwise provided by the articles of association of the company.

When a call is made and the amount of the same is received, the journal entries are as given below:

1. For Call Amount Due
   Share Call A/c Dr.
   To Share Capital A/c
   (Call money due on — Shares @ Rs. ____ per share)
2. For Receipt of Call Amount
   Bank A/c Dr.
   To Share Call A/c
   (Call money received).

The word/words First, Second, or Third must be added between the words "Share" and 'Call' in the Share Call account depending upon the identity of the call made. For example, in case of first call it will be termed as 'Share First Call Account', in case of second call it will be 'Share

Second Call Account' and so on. Another point to be noted is that the words 'and Final' will also be added to the last call, say, if second call is the last call it will be termed as 'Second and Final Call' and if it is the third call which is the last call, it will be termed as 'Third and Final Call'. It is also possible that the whole balance after allotment may be collected in one call only. In that case the first call itself shall be termed as the 'First and Final Call'.

The following points should be kept in mind while issuing the share capital for public subscription:
1. The application money should be at least 5% of the face value of the share.
2. Calls are to be made as per the provisions of the articles of association.
3. Where there is no Articles of Association of its own, the following provisions of Table A will apply:
(a) A period of one month must elapse between two calls;
(b) The amount of call should not exceed 25% of the face value of the share;
(c) A minimum of 14 days' notice is given to the shareholders to pay the amount; and
(d) Calls must be made on a uniform basis on all shares within the same class.
Note: The procedure for accounting for the issue of both equity and preference shares is the same. To differentiate between the two the words 'Equity' and 'Preference' is prefixed to each and every instalment.

Illustration 1:
Mona Earth Mover Ltd. decided to issue 12,000 shares of Rs.100 each payable at Rs.30 on application, Rs.40 on allotment, Rs.20 on first call and balance on second and final call. Applications are received for 13,000 shares. The directors decided to reject application of 1,000 shares and their application money being refunded in full. The allotment money is duly received on all the shares, and all sums due on calls are received except on 100 shares.
Record the transactions in the books of Mona Earth Movers Ltd.

Books of Mona Earth Movers Limited
Journal

Date	Particulars	L.F. No.	Debit	Credit
	Bank A/c Dr. To Share Application A/c (Application money on 13,000 shares @ Rs.30 per share received).		3,90,000	3,90,000
	Share Application A/c Dr. To Share Capital A/c (Application money transferred to share capital).		3,90,000	3,90,000
	Share Allotment A/c Dr. To Share Capital A/c (Money due on allotment of 12,000 shares @ Rs. 40 per share).		4,80,000	4,80,000
	Share Application A/c Dr. To Bank A/c		30,000	30,000

	(Application money on 1,000 shares returned).			
	Bank A/c Dr. To Share Allotment A/c 4,80,000 (Money received on 12,000 shares @ Rs. 40 per share on allotment).		4,80,000	4,80,000
	Share First Call A/c Dr. To Share Capital A/c (Money due on 12,000 shares @ Rs. 20 per share on first Call).		2,40,000	2,40,000
	Bank A/c Dr. To Share First Call A/c (First Call money received except for 100 shares).		2,38,000	2,38,000
	Share Second and Final Call A/c Dr. To Share Capital A/c (Money due on 12,000 shares @ Rs. 10 per share on Second and final Call).		1,20,000	1,20,000
	Bank A/c Dr. To Share Second and Final Call A/c (Second and final call money received except for 100 shares)		1,19,000	1,19,000

Illustration 2:

Eastern Company Ltd. issued 40,000 shares of Rs. 10 each to the public for the subscription of its share capital, payable at Rs. 4 on application, Rs. 3 on allotment and the balance on Ist and final call. Applications were received for 40,000 shares. The company made the allotment to the applicants in full. All the amounts due on allotment and first and final call were duly received. Give the journal entries in the books of the company.

Books of Eastern Company Limited
Journal

Date	Particulars	L.F. No.	Debit	Credit
	Bank A/c Dr. To Share Application A/c (Application money on 40,000 shares @ Rs.4 per share received).		160,000	160,000
	Share Application A/c Dr. To Share Capital A/c (Application money transferred to share capital).		160,000	160,000
	Share Allotment A/c Dr. To Share Capital A/c (Money due on allotment of 40,000 shares @ Rs. 3 per share).		120,000	120,000
	Bank A/c Dr. To Share Allotment A/c (Money received on 40,000 shares @ Rs. 3 per share on allotment).		120,000	120,000
	Share First and Final Call A/c Dr. To Share Capital A/c (Money due on 40000 shares @ Rs. 3 per share on First and final Call).		120,000	120,000
	Bank A/c Dr. To Share First and Final Call A/c (First and final call money received)		120,000	120,000

Issue of Shares at a Premium:
It is quite common for the shares of financially strong and well-managed companies to be issued at a premium, i.e. at an amount more than the nominal or par value of shares. Thus, when a share of the nominal value of Rs. 100 is issued at Rs. 105, it is said to have been issued at a premium of 5 percent.

When the issue of shares is at a premium, the amount of premium may technically be called at any stage of the issue of shares. However, premium is generally called with the amount due on allotment, sometimes with the application money and rarely with the call money. The premium amount is credited to a separate account called 'Securities Premium Account' and is shown on the liabilities side of the company's balance sheet under the heading 'Reserves and Surpluses'. It can be used only for the following four purposes as laid down by Section 78 of The Companies Act 1956:

a. To issue fully paid bonus shares to an extent not exceeding unissued share capital of the company;
b. To write-off preliminary expenses of the company;
c. To write-off the expenses of, or commission paid, or discount allowed on any of the shares or debentures of the company; and
d. To pay premium on the redemption of preference shares or debentures of the company. The Journal entries for shares are issued at a premium are as follows:

The Journal entries for shares are issued at a premium are as follows:

1. For Premium Amount called with Application money

 Bank A/c Dr.
 To Share Application A/c
 (Money received on application for — shares @ Rs. — per share including premium)
 Share Application A/c Dr.
 To Share Capital A/c
 To Securities Premium A/c
 (Transfer of application money to share capital and securities premium accounts)

2. Premium Amount called with Allotment Money

 Share Allotment A/c Dr.
 To Share Capital A/c
 To Securities Premium A/c
 (Amount due on allotment of shares @ Rs — per share including premium)
 Bank A/c Dr.
 To Share Allotment A/c
 (Allotment money received including premium)

Illustration 3:

Jupiter Company Limited issued 35,000 equity shares of Rs. 10 each at a premium of Rs.2 payable as follows: On Application Rs. 3, On Allotment Rs. 5 (including premium) Balance on First and Final Call. The issue was fully subscribed. All the money was duly received.Record journal entries in the books of Jupiter Company.

Date	Particulars	L.F. No.	Debit	Credit
	Bank A/c Dr. To Equity Share Application A/c (Application money on 35,000 shares @ Rs.3 per share received).		105,000	 105,000
	Share Application A/cDr. To Share Capital A/c (Application money transferred to share capital).		105,000	 105,000
	Share Allotment A/c Dr. To Share Capital A/c To Security Premium A/c (Amount due on allotment of 35,000 shares @ Rs. 5 per share		175,000	 105,000 70000

	including premium)			
	Bank A/c Dr. To Share Allotment A/c (Money received including premium).		175,000	 175,000
	Share First and Final Call A/c Dr. To Share Capital A/c (Amount due on First and Final Call of Rs. 4 per share on 35,000 shares)		140,000	 140,000
	Bank A/c Dr. To Share First and Final Call A/c (First and final call money received)		140,000	 140,000

Issue of Shares at a Discount:

There are instances when the shares of a company are issued at a discount, i.e. at an amount less than the nominal or par value of shares, the difference between the nominal value and issue price representing discount on the issue of shares. For example, when a share of the nominal value of Rs. 100 is issued at Rs. 98, it is said to have been issued at a discount of two per cent.

As a general rule, a company cannot ordinarily issue shares at a discount. It can do so only in cases such as 'reissue of forfeited shares' (to be discussed later) and in accordance with the provisions of section 79 of The Companies Act.

It states that, a company is permitted to issue shares at a discount provided the following conditions are satisfied:

a. The issue of shares at a discount is authorised by an ordinary resolution passed by the company at its general meeting and sanctioned by the Company Law Board now Central Government.
b. The resolution must specify the maximum rate of discount at which the shares are to be issued but the rate of discount must not exceed 10 per cent of the nominal value of shares. The rate of discount can be more than 10 per cent if the Government is convinced that a higher rate is called-for under special circumstances of a case.
c. At least one year must have elapse since the date on which the company became entitled to commence the business.
d. The shares are of a class which has already been issued.
e. The shares issued within two months from the date of receiving sanction for the same from the Government or within such extended period as the Government may allow.
f. If the offer prospectus at the date of issue must mention particulars of the discount allowed on the issue of shares.

Whenever shares are issued at a discount, the amount of discount is brought into the books at the time of allotment by debiting an account called 'Discounton the Issue of Shares Account'.

The journal entry to be passed for the purpose is as given below:

Share Allotment A/c Dr.
Discount on the Issue of SharesA/c Dr.

To Share Capital A/c

(Amount due on allotment of — shares @ Rs — per share and discount on issue brought into account.)

'Discount on the Issue of Shares Account', havingadebitbalance,denotesaloss to the company and is shown on the asset side of the company's balance sheet under heading 'Miscellaneous Expenditure'. It is written-off by being charging it to the Securities Premium Account if any and, in its absence, by being gradually charged to the Profit and Loss Account over a period of 5 to 10 years.

Illustration 4:

Fine Arts Limited issued to the public for subscription of 10,000 shares of Rs.10 each at a discount of 10% payable at Rs. 4 on application, Rs. 3 on allotment and Rs.2 on 1st and the final call. The issue was fully subscribed and all the money was duly received. Write journal entries for the above in the books of the company.

Date	Particulars	L.F. No.	Debit	Credit
	Bank A/c Dr. To Share Application A/c (Application money on 10,000 shares @ Rs.4 per share received).		40,000	 40,000
	Share Application A/c Dr. To Share Capital A/c (Application money transferred to share capital).		40,000	 40,000
	Share Allotment A/c Dr. Discount on Issue of Share A/c Dr. To Share Capital A/c (Amount due @ Rs. 3 per share on Allotment and @ Re. 1 per share discount on 10,000 shares allotted)		30,000 10000	 40,000
	Bank A/c Dr. To Share Allotment A/c (Share Allotment Money received)		30000	 30,000
	Share First and Final Call A/c Dr. To Share Capital A/c (Final Call of Rs. 2 per share due on 10,000 shares)		20,000	 20,000
	Bank A/c Dr. To Share First and Final Call A/c (First and final call money received)		20,000	20,000

SHORT ANSWER QUESTIONS (2 Marks)

1. What is Share?
2. What is Authorised Share Capital?
3. What is Preference Share?
4. What is Equity Share?

ESSAY TYPE QUESTIONS (6 Marks)

1. Explain the categories of share capital?
2. Explain briefly about the procedure for issue of shares?
3. What are the main differences between Equity shares and Preference shares?

EXERCISES

1. Anitha Limited issued 30,000 equity shares of Rs. 100 each payable at Rs. 30 on application, Rs. 50 on allotment and Rs. 20 on 1st and final call. All money was duly received.
Record these transactions in the journal of the company.

2. The Anu Control Device Ltd was registered with the authorised capital of Rs. 3, 00,000 divided into 30,000 shares of Rs. 10 each, which were offered to the public. Amount payable as Rs. 3 per share on application, Rs. 4 per share on allotment and Rs. 3 per share on first and final call. These shares were fully subscribed and all money was dully received. Prepare journal and Cash Book.

3. Sruthi ltd issued 10000 shares of Rs. 100 each for the subscription. Payable at Rs. 40 per share on application, Rs. 40 per share on allotment and the balance Rs. 20 on first and final call. All the amounts were duly received. Make journal entries in the books of the company.

4. Laasya ltd decided to issue 10000 shares of Rs. 200 each for the subscription. Payable at Rs. 50 per share on application, Rs. 100 per share on allotment and the balance Rs. 50 on first and final call. All the money was duly received. Write journal entries in the books of the company.

5. Krishna Furniture's Ltd issued 20000 shares of Rs. 100 each at a premium of Rs. 10 per share payable as follows,
    On application Rs. 40 (including premium Rs. 5 per share)
    On allotment Rs. 40 (including premium Rs. 5 per share)
The remaining balance Rs.30 on first and final call, the issue was fully subscribed. All the money was duly received. Make the journal entries in the books of the company.

6. Siri Ltd having an Authorised capital of Rs. 10000000 in share of Rs. 10 each issued 10000 at a premium of Rs. 2 per share, payable at Rs. 4 on application (including premium Rs. 1 per share), Rs. 5 on allotment (including premium Rs. 1per share), the remaining balance Rs. 3 on first and final call, the issue was fully subscribed. All the money was duly received. Prepare the journal entries in the books of the company.

7. Padmavathi Ltd issued to the public for subscription of 10000 shares of Rs. 100 each at a discount of 10% per share, payable at Rs. 30 on application, Rs. 40 on allotment and Rs. 20 on first and final call, the issue was fully subscribed. All the money was duly received. Write the journal entries in the books of the company.

8. Sai ltd issued 20000 shares of Rs. 100 each at a discount of 10% per share, the shares were payable at Rs. 40 on application, Rs. 30 on allotment and Rs. 20 on first and final call, the issue was fully subscribed. All the money was duly received. Record the journal entries in the books of the company.

Ψ

UNIT 6

COMPANY ACCOUNTS - II

Company Account – II – (As per Companies act 2013)Company final accounts – Financial statements as per Companies act 2013 – (Simple problems) with Outstanding, prepaid, closing stock adjustments.

Learning Objectives

After studying this unit, the student will be able to

- Understand about the gross profit
- Understand about the net profit
- Learn about distribution of profit to the share holders
- Learn how to transfer net profit to reserves

1.0 Having understood how a company raises its capital, we have to learn the nature, objectives and types of financial statements it has to prepare including their contents, format, uses and limitations. The financial statements are the end products of accounting process. They are prepared following the consistent accounting concepts, principles, procedures and also the legal environment in which the business organizations operate. These statements are the outcome of the summarizing process of accounting and are, therefore, the sources of information on the basis of which conclusions are drawn about the profitability and the financial position of a company. Hence, they need to be arranged in a proper form with suitable contents so that the shareholders and other users of financial statements can easily understand and use them in their economic decisions in a meaningful way.

1.1 Meaning of Financial Statements:

Financial statements are the basic and formal annual reports through which the corporate management communicates financial information to its owners and various other external parties which include– investors, tax authorities, government, employees, etc. These normally refer to (a) the balance sheet (position statement) as at the end of accounting period, and (b) the profit and loss account (income statement) of a company. Now a days, the cash flow statement is also taken as an integral component of the financial statements of a company.

1.2 Nature of Financial Statements:

The chronologically recorded facts about events expressed in monetary terms for a defined period of time are the basis for the preparation of periodical financial statements which reveal the financial position as on a date and the financial results obtained during a period. The American Institute of Certified Public Accountants states the nature of financial statements as, "the statements prepared for the purpose of presenting a periodical review of report on progress by the management and deal with the status of investment in the business and the results achieved during the period under review. They reflect a combination of recorded facts, accounting principles and personal judgements."

The following points explain the nature of financial statements:

a. **Recorded facts:** Financial statements are prepared on the basis of facts in the form of cost data recorded in accounting books. The original cost or historical cost is the basis of recording transactions. The figures of various accounts such as cash in hand, cash at bank, bills receivable, sundry debtors, fixed assets, etc. are taken as per the figures recorded in the accounting books. The assets purchased at different times and at different prices are put together and shown at costs. As these are not based on market prices, the financial statements do not show current financial condition of the concern.
b. **Accounting Conventions:** Certain accounting conventions are followed while preparing financial statements. The convention of valuing inventory at cost or market price, whichever is lower, is followed. The valuing of assets at cost less depreciation principle for balance sheet purposes is followed. The convention of materiality is followed in dealing with small items like pencils, pens, postage stamps, etc. These items are treated as expenditure in the year in which they are purchased even though they are assets in nature. The stationery is valued at costand not on the principle of cost or market price, whichever is less. The use of accounting conventions makes financial statements comparable, simple and realistic.
c. **Postulates:** Financial statements are prepared on certain basic assumptions (pre-requisites) known as postulates such as going concern postulate, money measurement postulate, realisation postulate, etc. Going concern postulate assumes that the enterprise is treated as a going concern and exists for a longer period of time. So the assets are shown on historical cost basis. Money measurement postulate assumes that the value of money will remain the same in different periods. Though there is drastic change in purchasing power of money, the assets purchased at different times will be shown at the amount paid for them. While, preparing profit and loss account the revenue is included in the sales of the year in which the sale was undertaken even though the sale price may be received over a number of years. The assumption is known as realisation postulate.
d. **Personal Judgments:** Under more than one circumstance, facts and figures presented through financial statements are based on personal opinion, estimates and judgments. The depreciation is provided taking into consideration the useful economic life of fixed assets. Provisions for doubtful debts are made on estimates and personal judgments. In valuing inventory, cost or market value, whichever is less is being followed. While deciding either cost of inventory or market value of inventory many personal judgments are to be made based on certain considerations. Personal opinion, judgments and estimates are made while preparing the financial statements to avoid any possibility of over statement of assets and liabilities, income and expenditure, keeping in mind the convention of conservatism. Thus, financial statements are the summarized reports of recorded facts and are prepared following the accounting concepts, conventions and requirements of Law.

1.3 Objectives of Financial Statements: Financial statements are the basic sources of information to the shareholders and other external parties for understanding the profitability and financial position of any concern. They provide information about the results of the concern during a specified period of time and status of the concern in terms of assets and liabilities, which provide the basis for taking decisions. Thus, the primary objective of financial statements is to assist the users in their decision-making. The specific objectives include the following:

- **To provide information about economic resources and obligations of a business:** They are prepared to provide adequate, reliable and periodical information about economic resources and obligations of a business firm to investors and other external parties who have limited authority, ability or resources to obtain information.
- **To provide information about the earning capacity of the business:** They are to provide useful financial information which can gainfully be utilized to predict, compare, and evaluate the business firm's earning capacity.
- **To provide information about cash flows:** They are to provide information useful to investors and creditors for predicting, comparing and evaluating, potential cash flows in terms of amount, timing and related uncertainties.
- **To judge effectiveness of management:** They supply information useful for judging management's ability to utilize the resources of a business effectively.
- **Information about activities of business affecting the society:** They have to report the activities of the business organisation affecting the society, which can be determined and described or measured and which are important in its social environment.
- **Disclosing accounting policies:** These reports have to provide the significant policies, concepts followed in the process of accounting and changes taken up in them during the year to understand these statements in a better way.

1.4 Types of Financial Statements: The financial statements generally include **two** statements known as balance sheet and profit and loss account which are required for external reporting and also for internal needs of the management like planning, decision-making and control. These two basic statements are supported by number schedules, annexures, supplementing the data contained in the balance sheet and profit and loss account. Apart from these two basic financial statements, there is a need to know about movements of funds and changes in the financial position of the company. For this purpose, a statement of changes in financial position of the company or a cash flow statement help in this direction.

Balance Sheet: The purpose of balance sheet is to show its resources and obligations for acquiring its resources i.e., assets and liabilities. According to American Institute of Public Accountants, balance sheet is "a tabular statement of summary of balances (debits and credits) carried forward after an actual and constructive closing of books of accounts and kept according to principles ofaccounting". Balance sheet is the statement prepared on a particular date and shows classified properties and assets on the right hand side and obligations or liabilities on the left hand side.

Profit and Loss Account or Income Statement: The profit and loss account is the accounting report which summarizes the revenues and expenses and ascertains the profit/loss for a specified accounting period. It also represents the changes in the owner's equity between two successive periods. It is an essential statement for preparation of balance sheet and hence annexed to it. Income statement is the moving picture of an organisation and reflects the results of operations for a period. Income statement gives a quantitative interpretation of policies, expenses, knowledge, foresight and aggressiveness of the management of a business from the point of view of income, expenses, gross profit, operating profit and net profit or loss.

As per the accounting concept of income, income (profit) is excess of realized revenues over related expired cost of the period and loss is known as excess of expired cost of a period over related realized revenues of the period. Thus, profit or loss is the difference between the realized revenues of the period and the related expired costs. It may be noted that normally accrual basis of accounting is followed for measuring the revenues and expenses for the period. In addition, another statement called Profit and Loss Appropriation Account is prepared to record various appropriations of profits like transfer to reserve and provision for dividends.

Form and Contents of Income Statement: Income statement may be divided into three components viz., (a) trading account which shows the gross profit earned, (b) profit and loss account which shows net profit earned or net loss incurred, and (c) profit and loss appropriation account which shows all appropriations from the current year and balance of profit or loss of last year and surplus or deficit at the end of the period. In this context, it should also be noted that its heading does not including the word 'Trading', and that it must also show the name of the company concerned. The simplified form and contents of Profit and Loss Account and Profit and Loss Appropriation part are given below:

PROFORMA OF TRADING AND PROFIT & LOSS ACCOUNT

Trading and Profit & Loss Account of ……………… for the Year ending………………

Dr. Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		xxx	By Sales	xxx	
To Purchases	xxx		Less : Returns	xxx	xxx
Less Returns	xxx	xxx	By Closing Stock		xxx
To Carriage Inward		xxx	By Goods destroyed		xxx
To Wages		xxx			
To Freight & Cartage		xxx	By Gross loss (Transfer to P & L A/c)		xxx
To Import/Excise Duty		xxx			
To Factory Expenses		xxx			
To Gross Profit C/d		xxx			
		xxx			xxx
To Gross Loss b/d (If any)		xxx	By Gross Profit b/d		xxx
To Salaries		xxx	By Discount Received		xxx

To Rent, Rates and Taxes		xxx	By Commission earned		xxx
To Fire Insurance Premium		xxx	By Rent Earned		xxx
To Repairs and Maintenance		xxx	By Interest earned		xxx
To Depreciation on Assets		xxx	By Profit on sale of fixed assets		xxx
To Audit Fees		xxx	By income from investments		xxx
To Bank Charges		xxx	By Net loss (transfer to capital)		xxx
To Legal Charges		xxx			
To Discount allowed		xxx			
To Interest paid		xxx			
To Carriage outward		xxx			
To Freight outward		xxx			
To Commission to salesman		xxx			
To Travelling Expenses		xxx			
To Entertainment Expenses		xxx			
To Reserve for Bad debts		xxx			
To Advertising and Publicity		xxx			
To Bad debts		xxx			
To Loss on goods destroyed		xxx			
To Interest in Capital		xxx			
To Interest on Loan		xxx			
To Loss on sale of Fixed Assets		xxx			
To Net Profit(transfer to capital		xxx			
		xxx			xxx
To Transfer to general reserve		xxx	By Balance b/d (Previous year balance of profit)		xxx
To Transfer to other Reserves, if any		xxx	By Net Profit b/d (for the current year)		xxx
To Proposed dividend		xxx			
To Balance c/d		xxx			
		xxx			xxx

Income Statement(Vertical Form):

Income statement may also be presented in vertical form with detailed data. This is considered more suitable for further analysis and providing necessary data for decision-making. The form and contents of vertical income statement is shown below (Vertical Form):

Elements of Revenues and Expenses	Rs.	Rs.
Sales :		
Cash sales	xxx	
Credit sales	xxx	
Total sales	xxx	
Less: Sale Returns	xxx	
Net Sales – (1)		xxx
Less: Cost of Goods Sold (2):		
(Opening Stock +Purchases including (incidental expenses and materials) + wages + Manufacturing expenses + any other direct expenses)	xxx	
Less: Closing Stock	xxx	xxx
Gross Profit – (3) i.e. (1) minus (2)		xxx
Less: Operating Expenses – (4)		
+ Salaries	xxx	
+ Administrative Expenses	xxx	
+ Selling Expenses	xxx	
+ Distribution Expenses	xxx	
+ Depreciation	xxx	xxx
Operating Profit – (5) (i.e. 3-4)		xxx
Add: Non-Operating Income, if any, such as Commission, Profiton sale of Assets, Income from Investments, etc.		xxx
		xxx
Less: Non-Operating Expenses, if any, such as Loss by Fire		xxx
Net Profit before interest and taxes – (6)		xxx
Less: Interest Charges – (7)	xxx	xxx
Interest on Loans	xxx	
Interest on Debentures	xxx	xxx
Net Profit before Tax – (8) (i.e. 6-7)		xxx
Less: Provision for Tax – (9)		xxx
Net Profit – (10) (i.e. 8-9) (Profit after tax)		xxx

The following process is to be followed for preparation of income statement in account form:

a. Recording all the revenue receipts appearing on the credit side of the trial balance on the credit side of income statement after making suitable adjustments for revenues received in advance or revenues realized but not received, etc.
b. Recording all the revenue expenditure items appeared on the debit side of trial balance on the debit side of income statement after making adjustments for outstanding, prepaid expenses, depreciation, provisions for bad debts, taxes, etc.
c. Recording non-operating incomes and gains on the credit side of income statement.
d. Recording non-operating losses on the debit side of the income statement.

e. Ascertaining the difference between totals of credit items and totals of debit items.
f. If the credit items are more than the debit items, it is known as net profit and if it is the other way round, it will be treated as loss.
g. In India, the accounting year for preparing financial statements for companies is April 01 to March 31 (same as that of financial year of Government). It may be noted that The Companies Act does not prescribe any format for the profit and loss account. However, Part II of Schedule VI of the Act gives detailed requirements as to the profit and loss account and clearly states that it "shall be made out as clearly to disclose the result the working of the company during the period covered by the account, and shall disclose every material feature."

BALANCE SHEET

Form and Contents of Balance Sheet:

Balance sheet is usually prepared in horizontal ('T') form with assets shown on the right hand side and capital and liabilities on the left. In case of companies, the assets and liabilities are arranged on permanency basis. Accordingly, all permanent long term assets, and capital and liabilities are shown at the beginning and liquid assets and liabilities are shown subsequently in order of their liquidity or maturity. The registered companies are required to follow Part I of Schedule VI of The Companies Act for recording assets and liabilities in the balance sheet. According to section 211(i) of The Companies Act, the balance sheet shall be prepared in a prescribed format, depict true and fair view of financial position and follow general instructions for preparation of balance sheet under the given headings with notes at the end. This format is not applicable to banking and insurance companies which have to follow the formats prescribed by their respective legislations. The prescribed form of balance sheet as per Part I ofSchedule VI of The Companies Act has been duly given in Appendix I of this chapter for perusal and clarity. It may be noted that the balance sheet of a company may be prepared either in horizontal form or in vertical form. These are as follows:

Figures for the previous year Rs.	Liabilities	Figures for the current year Rs.	Figures for the previous year Rs.	Assets	Figures for the current year Rs.
	Share Capital: **Authorised:** Preference Equity **Issued:** Preference Equity Less: Calls Unpaid: Add: Forfeited Shares **Reserves and Surplus:** Capital Reserve Capital Redemption Reserve Securities Premium Other Reserves			**Fixed Assets:** Goodwill Land Building Household Premises Plant and Machinery Furniture Live Stock Vehicles Patents and Trademarks **Investments:** Government or Trust Securities Shares, Debentures, Bonds **Current Assets:**	

	Profit and Loss Account (Credit Balance) **Secured Loans:** Debentures Loans and Advances from banks Loans and Advances from subsidiary companies Other Loans and Advances **Unsecured Loans:** Loan on Fixed Deposits Loans and Advances from subsidiaries Short term Loans Other Loans **Current Liabilities:** Acceptances Sundry Creditors Outstanding Expenses **Provisions:** For dividends For Taxes For Contingencies For PF Schemes For Insurance For Pension and Others			Interest accrued Stores and Spare Parts Loose Tools Stock in Trade Work in Progress Sundry Debtors Cash and Bank Balance **Loans and Advances:** Advances to subsidiary companies Bills Receivables Advance Payments **Miscellaneous Expenditure:** Preliminary Expenses Discount on issue of shares and debentures Other Differed Expenditure Profit and Loss A/c (debit balance if any)	

The Balance sheet can be prepared in the abridged form also which is shown below:

Liabilities	Rs.	Assets	Rs.
1. Share Capital 2. Reserves and Surplus 3. Loans and Advances 4. Secured Loans 5. Unsecured Loans 6. Current Liabilities and Provisions: a) Current Liabilities b) Provisions		1. Fixed Assets 2. Investments 3. Current Assets and Loans and Advances: a) Current Assets b) Loans and Advances 4. Miscellaneous Expenditure 5. Profit and Loss a/c (debit balance)	

Vertical Form of Balance Sheet

Balance Sheet of .....as on .....

Particulars	**Schedule Number**	**Figures At the End of Current year Rs.**	**Figures At the End of Previous year Rs.**
I. Source of Funds:			
1. Shareholder's Funds:			
(a) Share capital			
(b) Reserves and Surplus		xxx	xxx
		xxx	xxx
Net Worth or Shareholders Funds		xxx	xxx
2. Loan Funds:			
(a) Secured loans		xxx	xxx
(b) Unsecured loans		xxx	xxx
Total (Capital Employed)		xxx	xxx
II. Application of Funds			
1. Fixed Assets:		xxx	xxx
(a) Gross block		xx	xx
(b) Less: depreciation		xxx	xxx
(c) Net block		xxx	xxx
(d) Capital work-in-Progress			
		xxx	xxx
		xxx	xxx
2. Investments:		xxx	xxx
3. Current Assets, Loans and Advances:		xxx	xxx
(a) Inventories		xxx	xxx
(b) Sundry Debtors		xxx	xxx
(c) Cash and Bank Balances		xxx	xxx
(d) Other Current Assets		xxx	xxx
(e) Loans and Advances		xxx	xxx
		xxx	xxx
Less: Current Liabilities and Provisions:			
(a) Current liabilities			
(b) Provisions		xx	xx
		xx	xx
Net Current Assets:		xxx	xxx
4.(a) Miscellaneous expenditure to the extent not written-off or adjusted.			
(b) Profit and Loss account (debit balance, if any)		xxx	xxx
		xxx	xxx
Total		xxx	xxx

The schedules, accounting policies and other explanatory notes form part of the financial statements. Schedules contain the detailed information relating to all items appearing in the balance sheet and profit and loss account as they appear in the Annual Report of a company. The details to be provided under various heads of liabilities and assets are as follows.

Liabilities Side:

1. **Share Capital:** It is the first item on the liabilities side of the balance sheet and shows details of Authorised capital, and issued and paid-up capital in terms of the number and amount of each type of share, and so also the amounts of calls in arears and the forfeited shares as explained Chapter 1.
2. **Reserves and Surplus:** This item includes various reserves such as capital reserves, capital redemption reserves, balance of securities premium account, general reserve, credit balance of profit and loss account, and other reserves specifying the nature of each reserve and the amount in respect thereof including the additions during the current year.
3. **Secured Loans:** Long-term loans, which are taken against some security, are included under this head. Debentures and secured loans and advances from banks, subsidiary companies, etc., are fall under this category and are shown separately under this head.
4. **Unsecured Loans:** Loans and advances for which no security is given are shown under this heading. This item includes public deposits, unsecured loans and advances from subsidiary companies, short-term loans and advances and other loans and advances from banks.
5. **Current Liabilities and Provisions:** Current liabilities refer to such liabilities, which mature within a period of one year. They include acceptances, (bills payable), sundry creditors, advance payments and un-expired discounts, unclaimed dividends, interest accrued but not paid, and other liabilities. Provisions refer to the amounts set aside out of revenue profits for some specific liabilities payable within a period of one year. Those include provision for taxation, proposed dividends, provision for contingencies, provision for provident fund, provision for insurance, pension and similar staff benefit schemes, etc.

Assets Side:

1. **Fixed Assets:** The expenditure incurred on various fixed are to be shown separately for various fixed assets which include goodwill, land, buildings, leaseholds, plant and machinery, railway sidings, furniture and fittings,patents, livestock, vehicles, etc. These assets are shown at cost less depreciation till the date.
2. **Investments:** Under this head, various investments made such as investment in government securities or trust securities; investment in shares, debentures, and bonds of other companies, immovable properties, etc., are to be shown separately in the balance sheet.
3. **Current Assets:** Current assets include interest accrued on investments, inventories, sundry debtors, bills receivables, cash and bank balances, and other advances like prepaid expenses, etc.
4. **Miscellaneous Expenditure:** The expenditure which has not been written of fully its balance is shown under this heading. These expenses include preliminary expenses, advertisement expenditure, discount on issue of shares and debentures, share issue expenses, etc.
5. **Profit and Loss Account:** When the Profit and Loss account shows a debit balance, i.e., loss which could not be adjusted against general reserves, the same is shown as a last item on the asset side.

Some Peculiar Items:

There are certain items relating to financial statements of companies which need clarification to ensure their correct treatment while preparing the final accounts of a company. Some of these have already been clarified in the previous chapters which include items like share capital, discount on issue of shares, securities premium, calls in arears, calls in advance, forefeited shares, discount (or loss) on issue of debentures, etc. The nature and treatment of some other peculiar items is explained hereunder.

a. **Preliminary expenses:** This refers to the expenses that are incurred in connection with the formation of a company which include items like cost of printing various documents, fees paid to the lawyers for draftingof such documents, stamp duty, registration and filing fees paid at the time of registration of the company, etc. The amount spent on these items is put under one head called 'preliminary expenses' which is written-off over a period of 3 to 5 years. The amount to be written-off annually is debited to the profit and loss account, and the balance is shown under the heading 'Miscellaneous expenditure' on the assets side of the balance sheet.
b. **Expenses on Issue of Shares and Debentures:** When shares and debentures are issued to the public, the company has to incur expenses on preparation and printing of prospectus, advertisement on the issue, merchant bankers fees, brokerage, etc. Such expenses are also capitalised and written-off over a period of 3 to 5 years, and treated in the same manner as preliminary expenses, but are shown separately.
c. **Interest on Debentures:** The rate of interest payable on debentures is always mentioned with the debentrures, and paid half yearly on September 30 and March 31 (or June 30 and December 31). The amount of interest paid on debentures is given in the trial balance which is usually for the half year. This implies that a provision must be made for the remaining half year whether or not it is specified in adjustments. In other words, one has to ensure that full years interest on debentures is charged to profit and loss account and the unpaid part, if any, must be shown as outstanding interest in the balance sheet on the liabilities side.
d. **Provision for Taxation:** This refers to the provision for income tax (corporation tax) chargeable on profits, and it is made by debiting the profit and loss account and crediting the provision for taxation account which is shown on the liabilities side under the heading 'Current liabilities and Provisions' in the balance sheet.
e. **Dividends:** Dividend refers to that part of profits which is distributed among its shareholders. The general practice is to declare the dividend for an accounting year at the annual general meeting of the company while presenting the Annual Report (including Financial Statements) for approval, and it is shown as proposed dividend in the appropriation part of the profit and loss account (debit side) and so also in the balance sheet on the liabilitieis side under the heading 'Current Liabilities andProvisions'. Sometimes, the companies also declare and pay some dividend during the course of an accounting year in anticipation of profits. This is known as interim dividend and since the same stands paid, it is simply shown in the appropriation part of the Profit and Loss Account (debit side). In such a situation, the dividend declared in addition to the interim dividend at the time of presenting the Annual Report is termed as final dividend which is treated in the same manner in accounts as the proposed dividend. It may be noted that no dividend is payable on the calls-in-arears. Any amount of dividend, interim or final, which remains unclaimed (unpaid) is shown as

unclaimed dividend under the heading current liabilities. In this context, there is another important aspect to be kept in view namely, 'Dividend Tax' payable by the company. While dividends are tax free in the hands of shareholders, the company has to pay tax on dividends declared at the prescribed rate which is termed as 'Corporate Dividend Tax' and a provision has to be made thereof. The is shown along with dividends in the appropriation part of the profit and loss account on the debit side, and so also in balance sheet under current liabilities and provisions.

f. **Transfer to Reserves:** Invariably, the companies transfer a part of their profits to reserves. The amount transferred to general reserve or any specific reserve is shown in the appropriation part of the profit and loss account and added to the concerned reserve shown under the heading 'Reserves and Surplus' in the balance sheet.

Illustration 1: Big & Co. Ltd. is a company with an Authorised capital of Rs. 5,00,000 divided into 5,000 equity shares of Rs. 100 each. 2,500 shares were fully paid-up on 31.12.2018. The following are the balances extracted from the books of the company as on 31.12.2018:

Stock	50,000	Advertisement	3,800
Sales	4,25,000	Bonus	1,500
Purchases	3,00,000	Debtors	8,700
Wages (Productive)	70,000	Creditors	35,200
Discount allowed	4,200	Plant and Machiery	80,500
Insurance paid up to 31.3.2019	6720	Furniture	17,100
Salaries	18,500	Cash and Bank	1,34,700
Rent	6,000	General Reserve	25,000
General Expenses	8,950	Loan from managing Director	15,700
Profit and Loss A/c Balance (Cr)	6,220	Bad Debts	3,200
Printing and Stationery	2,400	Calls in arrears	5,000

You are required to prepare **profit and loss account** for the year ended 31.12.2018 and the balance sheet as on that date of the company. The following further information is given:

a. Closing stock, Rs. 91,500.
b. Depreciation to be charged on plants, machinery and furniture at 15% and 10% respectively.
c. Outstanding liabilities: wages Rs. 5,200, salary Rs.1,200 and rent Rs.600.
d. Dividend @ 5% on paid-up share capital is to be provided.

Profit and Loss account of Big & Co. for the year ended 31.12.2018

Expenses		Rs.	Revenues	Rs.
To Opening stock		50000	By Sales	425000
To Purchases		300000	By Closing Stock	91500
ToWages70000				
add:outstanding	5200	75200		
To Gross profit c/d		91300		
		516500		516500
To Salaries	18500		By Gross profit b/d	91300
Add: outstanding	1200	19700	By discount received	3150
To discount allowed		4200		
To insurance	6720			
Less: prepaid	1680	5040		
To Rent 6000				
Add: outstanding	600	6600		
To General expenses		8950		
To printing and stationery		2400		
To advertisement		3800		
To bonus		10500		
To bad debts		3200		
To depreciation on furniture		12075		
To depreciation on plant & machinery		1710		
To Net Profit c/d		16275		
		94450		94450
To Transfer to general reserve				
To Transfer to other Reserves, if any			By Balance b/d	
To Proposed dividend 5% on 245000			(previous year balance of profit)	6220
(i.e., excluding calls in arrears)		12250	By Net profit b/d (for the current	
To Balance c/d		10245	year)	16275
		22495		22495

Balance Sheet of Big & Co. for the year ended 31.12.2018

Liabilities		Rs.	Assets		Rs.
SHARE CAPITAL:			**Fixed Assets**:		
Authorised:			Plant and Machinery	80500	
5000 shares of Rs. 100 each		500000	Less: depreciation	12075	68425
			Furniture	17100	
Issued and Subscribed:			Less: depreciation	1710	
2500 shares of Rs.100 each					15390
fully called	250000		**Current Assets and Loans and**		
less: calls – in – arrears	5000	245000	**Advances:**		
Reserves and Surplus:			Stock		91500
General Reserve			Debtors		38700
Profit and Loss a/c			Cash and Bank Balance		134700
Unsecured Loans:			Prepaid Insurance		1680
Loan from Managing Director		15700			
Current Liabilities and Provisions:					
Creditors		35200			
Outstanding wages		5200			
Outstanding salaries		1200			
Outstanding rent		600			
Provision for Proposed dividend		12250			
		350395			350395

Exercises

1. The following is the trial balance on June 30, 2018 of the Modern Manufacturing Company Ltd.

Stock, 30th June, 2017	7500	Dividend paid on August, 2017	500
Sales	35000	Interim Dividend paid in Feb., 2018	400
Purchases	24500	Capital @1 for 10,000 shares fully paid	10000
Wages (Productive)	5000	Debtors	3750
Discount (Dr.)	700	Creditors	1750
Discount (Cr.)	500	Plant and Machiery	2900
Salaries	750	Cash in Bank	1620
Rent	495	Reserve	1550
General Expenses	1705	Loan to managing Director	325
Profit and Loss A/c, 30th June, 2017 (Cr)	1503	Bad Debts	158

Stock, on June 30, 2018 Rs. 8,200. You are required to make out the trading account, and profit and loss account for the year ended June 30, 2018 and the balance sheet as on the date. You are also to make provision in respect of the following:
(i) Depreciate machinery @ 10% per annum; (ii) Reserve 5% for discount on debtors; (iii) One month rent Rs. 45 was due on 30th June; and (iv) Six month's insurance, included in general expenses, was unexpired at Rs. 75.

(Gross profit Rs. 6,200; Net profit Rs. 2,044.50; Balance Sheet total Rs. 16,392.50)

2. The following is the trial balance of Alfa Ltd., for the year ended June 30, 2015.

Land and Buildings	300000	Sundry creditors	40000
Plant and Machinery	450000	Bills payable	20000
Furniture and fittings	40000	General Reserve	200000
Goodwill	60000	P & L A/c Balance (on 1.7.14)	90000
Sundry debtors	60000	Sales	625000
Bills receivable	26000	Purchase returns	15000
Investments (5% Govt. Securities)	30000	Equity share capital	500000
Cash in hand	2000	8% Preference share capital	200000
Cash at bank	55000		
Preliminary expenses	29000		
Purchases	400000		
Sales returns	10000		
Stock on 1-7-14	85000		
Wages	47000		
Salaries	55000		
Rent, rates and taxes	9000		
Carriage inwards	6500		
Law charges	2500		
Trade expenses	23000		
	1690000		1690000

Prepare the Profit and Loss Account and Balance Sheet of the company after taking the following particulars into consideration:

a. The original cost of land and building plant and machinery and furniture and fittings was Rs. 2,50,000, Rs. 6,00,000 and Rs. 60,000 respectively. Additions during the year were : building Rs. 50,000 and plant Rs. 20,000.
b. Depreciation is to be charged on plant and machinery and furniture and fitting at 10 per cent on original cost.
c. Of the sundry debtors, Rs. 10,000 are outstanding for a period exceeding 6 months, Rs. 5,000 are considered doubtful, while the others are considered good.
d. The directors are entitled to a commission at 1 per cent of the net profits before charging such commission.
e. Stock on 30th June, 2015 is Rs. 1,30,000.
f. Provide Rs. 34,800 for income tax

(Gross profit Rs. 2,21,500; Net profit Rs. 25,095; Balance sheet total Rs. 11,10,500)

3. The following balances appeared in the books of Parasuram Flour Mills Ltd., as on December 31, 2015 **:**

Stock of wheat	9500	Furniture	5100
Stock of flour	16000	Vehicles	5100
Wheat purchases	405000	Stores and spare parts	18300
Manufacturing expenses	90000	Advances	24500
Flour sales	550000	Book debts	51700
Salaries and wages	13000	Investments	4000
Extablishment	4700	Share capital	72000
Interest (Cr.)	500	Pension fund	23000
Rent Received	800	Dividend equalization fund	10000
Profit and loss account (Cr.)	15000	Taxation provision	8500
Director's fees	1200	Unclaimed dividends	900
Dividend for 2014	9000	Deposits (Cr.)	1600
Land	12000	Trade creditors	124000
Buildings	50500	Cash in hand	1200
Plant and machinery	50500	Cash at bank	40000

Prepare the company's trading and profit and loss account for the year and balance sheet as on December 31, 2015 after taking the following adjustments into account:

a. Stock on December 31, 2015 were: Wheat at cost, Rs. 14,900: Flour at market price, Rs. 21,700;
b. Outstanding expenses: Manufacturing expenses, Rs. 23,500; and salaries and wages, Rs. 1,200;
c. Provide depreciation : Building at 2% ; Plant and machinery at 10%: Furniture at 10% ; and Vehicle 20%.
d. Interest accrued on Government Securities, Rs.100.
e. A tax provision of Rs. 8,000 is considered necessary.
f. The directors propose a dividend of 20%.
g. The Authorised capital consists of 12,000 equity shares of Rs. 10 each of which 7,200 shares were issued and fully paid up.

(Gross profit Rs. 47,600; Net profit Rs. 21,310; Profit and loss appropriation balance Rs. 13,410; Balance sheet total Rs. 2,92,010).

4. An unexperienced accountant prepared the following trial balance of Bang Vikas Ltd., for the year ending 31.12.2015. The cash in hand on 31.12.2015 was Rs. 750.

Depreciation on machinery	33000	Authorised Capital 6,000 shares of Rs. 10 each	60000
Calls in arrears	7500	Subscribed capital	400000
Land and buildings	300000	6% debentures	300000
Machinery	297000	Profit and loss account (Cr.)	13625
Interim dividend paid	37500	Sundry Debtors	87000
Stock on 1.1.2015	75000	Sales	415000
Sundry Creditors	40000	Sinking fund	75000
Bills payable	38000	Preliminary expenses	5000
Furniture	7200		
Bank balance	39900		
Purchases	185000		
Provision for bad debts	4375		
Investments	75000		
Salary and wages	99300		
Repairs	4300		
Fuel	2500		
Rates and taxes	1800		
Travelling expenses	2000		
Discounts	6400		
Director's fees	5700		
Bad debts	2100		
Debenture interest	9000		
Carriage	1800		
Freight	8900		
Sundry expenses	2350		
Public deposits	10000		
	1295625		1295625

After locating the mistakes and making the following adjustments prepare trading and profit and loss account and balance sheet in the prescribed form.
Adjustments: (i) Stock on 31.12.2015 Rs. 95,000 and (ii) Write-off preliminary expenses.
Note: Rectified trial balance need not be prepared.
(Gross profit Rs. 2,36,800; Net profit Rs. 60,475; Balance of profit and loss appropriation account Rs. 36,600; Balance sheet Rs. 9,01,100; Difference in trial balance Rs. 750)

5. The Silver Ore Co. Ltd. was formed on April 1, 2015 with an Authorised capital of Rs.6,00,000 in shares of Rs. 10 each. Of these 52,000 shares had been issued and subscribed but there were calls in arrear on 100 shares @ Rs. 2.50. From the following trial balance as on March 31, 2016 prepare the trading and profit and loss account and the balance sheet:

Cash at bank	105500	Advertising	5000
Share capital	519750	Cartage on plant	1800

Plant	40000	Furniture and buildings	20900
Sale of silver	179500	Administrative expenses	28000
Mines	220000	Repairs to plant	900
Promotion expenses	6000	Coal and oil	6500
Interst of F.D. up to Dec. 31, 2015	3900	Cash	530
Dividends on investments	3200	Investments share of tin mines	80000
Royalties paid	10000	Brokerage on above	1000
Railway track and Wagons	17000	6% F.D. in Syndicate Bank	89000
Wages of mines	74220		

a. Depreciate plant and railways by 10%; furniture and building by 5%;
b. Write off a third of the promotion expenses;
c. Value of silver ore on March 31, 1969 Rs. 15,000, The directors forfeited on December 20, 1968, 100 shares on which only Rs. 7.50 had been paid.
(Gross profit Rs. 97,900; Net profit Rs. 70,398; Balance sheet total Rs. 5,90,148)

Ψ

UNIT 7

ACCOUNTING PACKAGES – I(Tally)

Accounting Packages-I – Introduction – Tally – salient features –creating company- Altering company-Accounting features- Inventory features-Statutory & taxation.

Learning Objectives:

After studying this Chapter, you will be able to:

- Understand the meaning and concept of Tally Accounting Software
- Understand sailent features of Tally
- Understand how to create, alter the details of Company
- Understands about Accounting, Inventory, Statutory & Taxation features

1.0Introduction to Tally Accounting Software:

Tally.is one of the most widely used financial software. Tally.reports can help a business owner make informed decisions to increase efficiency, reduce costs, and organize business operations.With Tally, accurate, up-to-date business information is available at your fingertips anytime. It provides a Comprehensive solution for the accounting and inventory needs of a business.It provides the capability to generate fully accurate tax returns in a matter of minutes and is also capable of extracting, interpreting and presenting financial data.

Tally is the world's fastest and most powerful concurrent Multi-lingual business Accounting and Inventory Management software. Tally., designed exclusively to meet the needs of small and medium businesses, is afully integrated, affordable and highly reliable software. Tally.is easy to buy, quick to install, and easy to learnand use.

Tally.is designed to automate and integrate all your business operations, such as sales, finance,purchasing, inventory, and manufacturing. With Tally, accurate, up-to-date business information is literallyat your fingertips anywhere. The powerful new features and blazing speed and power of Tallycombinedwith enhanced MIS, Multilingual, Data Synchronization and Remote capabilities help you simplify all your businessprocesses easily and cost-effectively.

2.0. Salient Features of Tally

A leading accounting package: The first version of Tally was released in 1988 and, through continuousdevelopment, is now recognised as one of the leading accounting packages across the world, with over aquarter million customers. Tally's market share is more than 90%.

a. **No accounting codes:** Unlike other computerised accounting packages which require numeric codes,Tally pioneered the 'no accounting codes' concept. Tally.ERP 9 users have the freedom to allocatemeaningful names in plain English to their data items in the system.

b. **Complete business solution:** Tally provides a comprehensive solution to the accounting andinventory needs of a business. The package comprises financial accounting, book-keeping and inventoryaccounting. It also has various tools to extract, interpret and present data.
c. **Integrated/Non-integrated accounting and inventory:** With Tally, the user is able to choose tomaintain accounts only. If accounting with inventory is opted for, the user can choose whether it should beintegrated or not.
d. **Flexible and easy to use:** Tally.is very flexible. It mimics the human thought process, which meansthatTallyan adapt itself to any business need. Tally users need not change the way theirbusiness is run to adapt themselves to the package.
e. **Speed:** Tally.provides the capability to generate instant and accurate reports, which assist themanagement to take timely and correct decisions for the overall productivity and growth of the company.
f. **Power:** Tally.allows the user to maintain multiple companies and with unlimited levels of classification& grouping capabilities. It also allows drill down facility from report level to transaction level.
g. **Flexibility:** Tally. provides flexibility to generate instant reports for any given period (month/year) orat any point of time besides providing the facility to toggle between Accounting & Inventory reports of thesame company or between companies.
h. **Concurrent multilingual capability:** Tally.offers you the exclusive capability of maintaining youraccounts in any Indian language, viewing them in another language and printing them in yet another Indianlanguage.
i. **Real time processing:** Immediate posting &updation of books of accounts as soon as the transactions areentered, thereby facilitating instant statements & Reports. It also faciliates a real-time multi-user environment.
j. **Versatility:** Tally is suitable for a range of organisations, from small grocery stores to large corporationswith international locations and operations.
k. **Multi-platform availability:** Tally.is available on multiple versions of windows. It runs on a single PCor on a network. On a network, it supports access via any combination of platforms.

Online Help: The Tally. Online Help (Alt+H) provides instant assistance on basic and advancedfeatures or any other relevant topics of Tally.

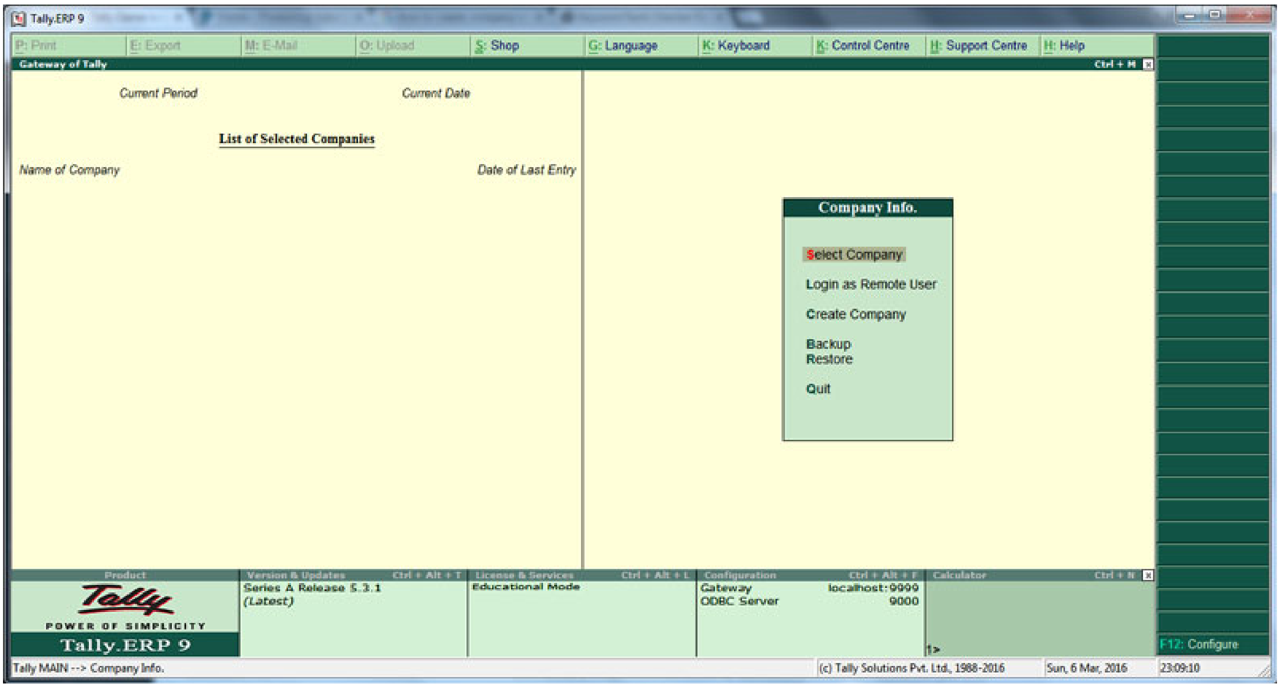
a. **Tally.NET:** is an enabling framework which establishes a connection through which the remote user canaccess the client's data without copying / transferring the data.
b. **Remote Access:** Tally provides remote capabilities to access the data from anywhere and anytime.
c. **Control Centre:** works as an interface between the user and Tally.installed at different sites andenables the user to centrally configure and administer Site/User belonging to an account.
d. **Support Centre:** allows a user to directly post his support queries on the functional and technical aspectsof the Product.
e. **Auditor's Edition:** Tally.offers a special Auditors' Edition of Tally., which provides auditing andcompliance capabilities exclusively for Chartered Accountants.

3.0. Company Creation in Tally:

To start accounting with tally the first and foremost thing you should know is , **how to create company** in tally ERP9 .For users operating multiple business can create several companies in Tally erp 9 software at single cost. Nowadays Tally erp 9 has outgrown from the concept just an accounting software. it helps you for better statutory compliance by updating statutory files available at tally solution website.You can operate tally remotely using tally.net features, process payroll and many more features are updating regularly by tally solutions. The most recent improvement is GST. Tally erp 9 is GST compatible from version Tally erp 9 release 6.

Procedure:

1. Open Tally Software by double clicking on the Tally.ERP 9 icon.
2. If you are opening Tally ERP 9,First time after installation, you will be landed to a menu called **company info** menu. (If you are in Gateway of Tally Press **Alt+F3** to get that menu).
3. Select **Create Company** option in the menu and press enter key.
4. The screen displayed in-front of you is **company creation screen.**
5. Type the name of the company ,address,Financial year begins and all other details asked by the creation screen.
6. Press Enter Key, Finally the program will ask you the confirmation to Save ,**Yes or No.**
7. To save and create company do Press Enter Key, Press Y Key or click on Yes.The program will create a company and you will be entered into it.

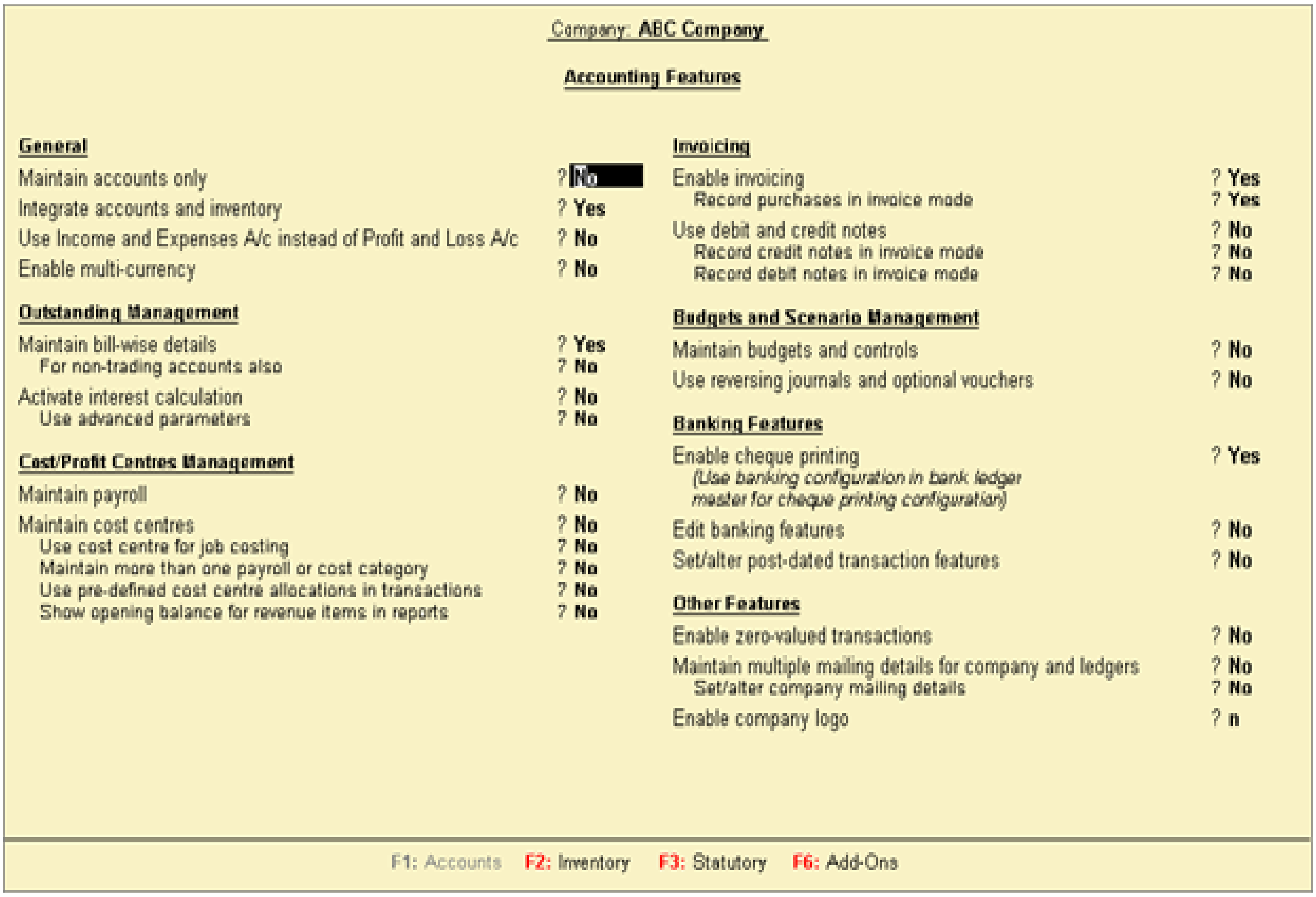


3.1.Accounting Features

Using the **Accounting Features** , you can enable various options required for making transactions in your business.

To enable the accounting features

1. Go to **Gateway of Tally > F11: Features > F1: Accounts** . The Company Operations Alteration screen appears as shown below:



2. Enable the required options.
3. Press **Ctrl+A** to accept.

If inventory vouchers and features are not appearing for your company, set the option **Maintain accounts only** to **No** , to use the **Inventory** features.

General Accounting Features

Option	Functionality	Additional Information
Maintain accounts only	Enable this option if you do not have any inventory transactions.	
Integrate accounts and inventory	Enable this option to include the stock or inventory balance from the inventory records. Provides a drill down to the stock registers from balance sheet. Disable this option to maintain accounts and inventory separately.	Stock records often contain compensating errors caused by wrong allocation to items. This feature enables finalization of financial books without waiting for the reconciliation of stocks.
Use Income and Expenses A/c instead of Profit and Loss A/c	Enable this option to display income and expenses a/c as the menu item instead of profit and loss a/c in the **Gateway of Tally** menu.	Income and expenses statements are generally used for non-trading accounts and profit and loss a/c are used for trading accounts.
Enable multi-currency	Enable this option to enable working with multiple currencies.	

Outstanding Management Features

Option	Functionality	Additional Information
Maintain bill-wise details	Enable this option to display the option **Maintain balances bill by bill in all ledgers** created under sundry debtors and creditors. When you enter details of sales and purchases with the bill wise option activated, Tally.ERP 9 prompts you to identify the invoice with an appropriate reference number.	The reference number can then be used to allocate payments to the correct invoice to maintain an accurate account of outstanding. Bill wise details for non-trading accounts is useful when one needs to track either an installment to be paid or a loan amount to be received over a certain period of time.
Activate interest	Enable this option to calculate	The advanced parameters are

calculation	interest automatically based on the interest rate and style of calculation specified.	useful when interest rates change from time to time. Set this option to **Yes** to enable this function.

Cost/Profit Centres Management Features

Option	Functionality
Maintain payroll	Enable this option to maintain payroll information in Tally.ERP 9 for the selected company.
Maintain cost centres	Enable this option to maintain and allocate expenses to cost centres.
Use cost center for job costing	Enable this option to track all income and expenses.
Maintain more than one payroll or cost category	Enable this option to create more than one Payroll or Cost Category.
Use pre-defined cost centre allocations in transactions	Enable this option to define Cost Centre Allocations.
Show opening balance for revenue items in reports	Enable this option to display the opening balance in Cost Centre report for the cost centres which are allocated to the ledgers, grouped under Income and Expenses Group.

Invoicing Features

Option	Functionality
Enable invoicing	Enable this option to create Sales and Purchase vouchers in the invoice format.
Record purchases in invoice mode	Enable this option to enable voucher class option in purchase voucher type.
Use debit and credit notes	Enable this option to use the debit note and credit note voucher types.
Record credit notes in invoice mode	Enable this option to create credit notes in invoice mode.
Record debit notes in invoice mode	Enable this option to create debit notes in invoice mode.

Budgets & Scenario Management Features

Option	Functionality
Maintain budgets and controls	Enable this option to create multiple budgets. The Budgets menu option is displayed in**Gateway of Tally** > **Masters Info.** > **Accounts Info. menu** .
Use reversing journals and optional vouchers	Enable this option to display the **Scenario** option in **Accounts Info** menu . You can create and alter scenarios. You can record Reversing Journal and make it Optional for the entries to not affect the books.

Banking Features

Option	Functionality
Enable cheque printing	Enable this option to use cheque printing .
Edit banking features	Enable this option to alter banking features.
Set/alter post-dated transaction features	Enable this option to record post-dated transactions and view related reports.

Other Features

Option	Functionality
Enable zero-valued transactions	Enable this option to allow zero valued transactions in vouchers.
Maintain multiple mailing details for company and ledgers	Enable this option to maintain multiple mailing details for your company and ledgers .
Set/alter company mailing details	Enable this option to create or alter **Address Types** .
Enable company logo	Enable this option to print the company logo on the selected vouchers, reports, and invoices. Specify the path of the logo image file in the field **Location of logo** . **For example** , C:\Tally.ERP9\CompLogo.bmp. The company logo is printed on the top left of the respective voucher, report, or

	an invoice. It is mandatory to save the logo as **Bitmap** or **JPEG** image file. Ensure that the extensions**.bmp** / **.jpg** is specified while providing the location of logo. The recommended size forlogo image is 96 x 80 (Width x Height) pixels .

F2: Inventory Features in Tally.ERP 9

This feature enables you to set the Inventory Features required for the transactions.

Go to **Gateway of Tally** > **F11: Features** > **F2: Inventory**

General

Integrate Accounts and Inventory

This field performs the same function as explained in Accounting Features.

Allow Zero Valued Entries in Vouchers

Set this option to Yes, to allow zero valued entries in Inventory vouchers.

Storage & Classification

Maintain Multiple Godowns

Set this option to **Yes**, if you have more than one stock point/storage Locations/ Godowns, and you want to track stock movement across these Locations. You can create any number of Stock Locations/Godowns. The Godowns/Locations option is displayed in Gateway of Tally > Inventory Info. menu only if you set this option to Yes. You will be able to identify your stocks at each location as well as assign stock movement to one or more locations during voucher entry.

Maintain Stock Categories

Set this option to **Yes**, if you wish to create and maintain Stock Categories. This creates a new field Category in the Stock Item Creation screen.

Maintain Batch-Wise Details

Set this option to **Yes**, to maintain batch information pertaining to Stock Items. A new field Maintain in Batches is displayed in the Stock Item Creation screen.

Set Expiry Dates for Batches

Set this option to **Yes**, if you want to set expiry dates for the batches. This displays an additional field **Use Expiry Dates** in the Stock Item Creation screen.

This is useful for businesses that deal in goods that have expiry dates like medicines, food and other perishables. During voucher entry, by default the date of the voucher is considered as the date of manufacture of the product. This date can be changed, but not to a date later than the voucher date. At the same time, the Expiry date cannot be a date prior to the voucher date.

Use different Actual & Billed Quantity

Set this option to **Yes**, if you want to specify quantities, that are different from those delivered/ received, when invoicing.

Order Processing

Allow Purchase Order Processing

Set this option to **Yes**, to create Purchase Orders. This feature can also be used for pre-closure of purchase order.

Allow Sales Order Processing

Set this option to **Yes**, to create Sales Orders. This feature can also be used for pre-order closure of sales order.

Allow Job Order Processing

Set this option to **Yes**, to create Job Work Out/In Orders.

Invoicing

Allow Invoicing

This field performs the same function as explained in Accounting Features.

Enter Purchases in Invoice Format
This field performs the same function as explained in Accounting Features.

Use Debit/Credit Notes
This field performs the same function as explained in Accounting Features.

Use Invoice Mode for Credit Notes
This field performs the same function as explained in Accounting Features.

Use Invoice Mode for Debit Notes
This field performs the same function as explained in Accounting Features.

Separate Discount Column on Invoices
This option is active only if **Allow invoicing** is set to **Yes**. Set this option to **Yes**, if you want a separate column for discounts in invoices.

Purchase Management

Track Additional Costs of Purchase
Set this option to **Yes**, to obtain a break-up of purchase costs, without the need to separately debit ledger accounts for expenses.

Sales Management

Use Multiple Price Levels
Set this option to **Yes** to create Multiple Price Levels. Refer Enable and Create Price Lists for more details.

Additional Inventory Vouchers

Use Tracking Numbers (Delivery/Receipt Notes)
Set this option to **Yes**, if you want to use tracking numbers to maintain the relation between Delivery notes and Invoices/Bills. This is available for both Purchases and Sales.

Use Rejection Inward/Outward Notes
Set this option to **Yes**, if you wish to record rejection of goods separately and not through a common Debit Note or Credit Note.

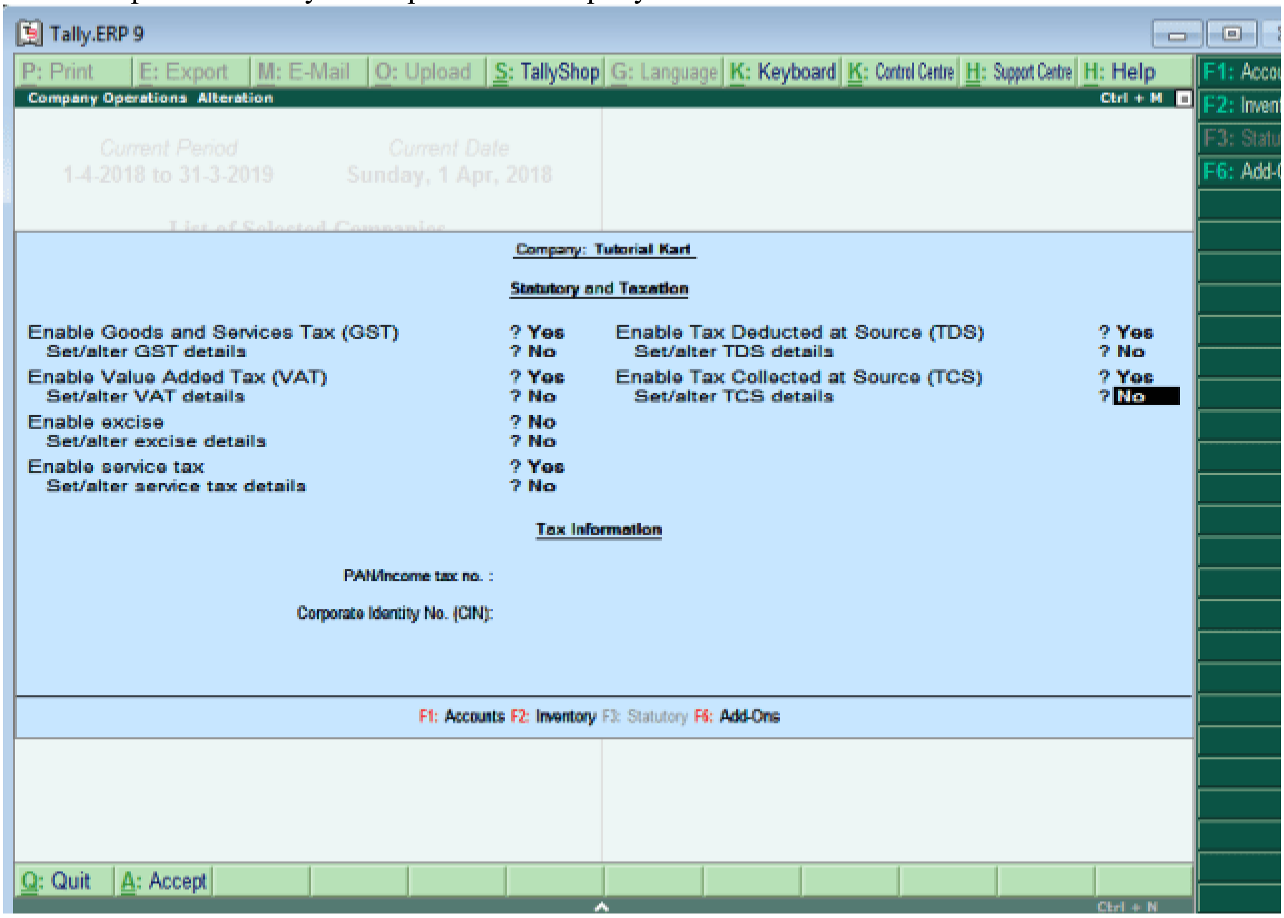
Use Material In/Out
Set this option to **Yes**, to record transfer of item quantity towards the party and transfer material from one Godown (Location) to the other.

Track Stock Item Cost
Set this option to **Yes**, to analyse the cost involved for an item.

Statutory Features:

Tax Information:

- PAN/Income Tax No: Update the company permanent account number (PAN) / Income tax number in this field.
- Corporate Identify No: Update the company CIN number in this field.



After updating all the required details for statutory and taxation, choose A: Accept to save the details.

1. Enable Dealer – GST (Set/Alter Dealer – GST Details)

Set these options to Yes, to enable/alter the GST for Dealers feature. Refer GST for Dealers for further information.

Follow Excise rules for Invoicing

Set this option to Yes, to follow Excise rules for invoicing. The Company Excise Details screen is displayed as shown:

Provide the above Excise information, for it to be printed on invoices and Accept, Yes to save.

2. Enable Goods and Service tax (GST)

Set/Alter GST Details

Set these option to Yes, to enable the VAT features for the company. Refer Value Added Tax for more details.

3. Enable Service Tax

Set/Alter Service Tax Details

Set these option to Yes to enable the Service Tax features for the company. Refer Service Tax for further details.

4. Enable Tax Deducted at Source (TDS)

Enable TDS : This is one of the unique features of Tally.ERP 9. This facility will allow you to deduct Income Tax at source (TDS) on behalf of the government as per specified rates in the IT Act on specified types of services, Incomes , gains and would deposit it into the accounts of respective authorities on behalf of the service provider.

Example: If your Company paid Rs.2,00,000 /- as Professional and Technical Fees to N.Jatania& Co for their consultancy services, it is your duty to deduct the Income Tax and pay the collected tax to the respective authorities. If you record the transaction the entry will appear as shown below :

(before carrying on with this transaction you should know the Income Tax Rules as to where TDS will be deducted and at what rate.)

5. Enable Tax Collected at Source (TCS)

Set/Alter TCS Details

Set these option to Yes to enable the TCS features for the company. Refer TCS for further details.

SHORT ANSWER QUESTIONS (2 Marks)

1. What is Tally?
2. What is GST?
3. Write any two features of Tally?
4. Write a syntax of company creation in Tally?

ESSAY TYPE QUESTIONS (6 Marks)

1. What are the features of Tally?
2. How to create a company in tally? Write the procedure?
3. Write the inventory features in Tally?

Ψ

UNIT 8

ACCOUNTING PACKAGES – II(Tally)

Accounting Packages-II – Vouher entry – groups – ledger – Types of vouchers - Functional Keys.

Learning Objectives:

After studying this Chapter, you will be able to:

- Understand the meaningof Voucher entry in Tally
- Understands about groups creation and ledger creation
- Understands about various types of vouchers
- Understands about various functional keys

1. Definition of Voucher

A **voucher** is a pre-numbered document used in processing payments. This document is typically prepared by the accounts payable department after receiving the supplier's invoice. In the process, the supplier's invoice is matched with the related purchase order and receiving report to ensure that only goods received and services rendered to the company will be processed for payment. Matching these three documents prevents the company from paying incorrect and sometimes fraudulent invoices.

A voucher can be electronic, but most often, it is a manual, paper document.

2.0. Voucher Entry in Tally.ERP 9:

A voucher is a document that contains details of a financial transaction and is required for recording the same into the books of accounts. For every transaction, you can use the appropriate Tally voucher to enter the details into the ledgers and update the financial position of the company.

The voucher entry menus options are available under **Transactions** in the **Gateway of Tally** . The **Payroll** and **Order Vouchers** are available as separate options which can be enabled based on the requirements.

The **Payroll Vouchers** can be enabled from **F1: Accounting Features** , whereas the **Order Vouchers** can be activated from **F2: Inventory Features** .

Note: If the company is maintained with Accounts Only Company, Inventory Vouchers option will not be displayed under Transactions..

Vouchers :

A voucher is a document that contains details of a financial transaction and is required for recording the same into the books of accounts. For every transaction, you can use the appropriate Tally voucher to enter the details into the ledgers and update the financial position of the company.

The voucher entry menus options are available under Transactions in the Gateway of Tally .
The Payroll and Order Vouchers are available as separate options which can be enabled based on the requirements.
The Payroll Vouchers can be enabled from
F1: Accounting Features , whereas the Order Vouchers can be activated from
F2: Inventory Features .

Note: If the company is maintained with **Accounts Only Company** , **Inventory Vouchers** option will not be displayed under**Transactions** .

Predefined Vouchers in Tally.ERP 9:

Tally comprises of the following predefined Vouchers, to suit different business requirements for recording various transactions. Tally also allows you to create user-defined Vouchers (Voucher Types) as per your requirements.
● Contra Voucher
● Payment Voucher
● Receipt Voucher
● Journal voucher
● Sales Voucher / Invoice
● Debit Note Voucher
● Credit Note Voucher
● Purchase Voucher / Invoice

Contra Voucher:
As per the Accounting Principles, a Contra entry is a transaction involving transfer of cash between one Cash A/c to another or one Cash A/c to another Bank A/c i.e., is a transaction indicating transfer of funds from:
● Cash account to Cash account
● Cash account to Bank account
● Bank account to Cash account
● Bank account to Bank account
To view the Contra Voucher Entry Screen,
● Go to **Gateway of Tally** > **Accounting Vouchers**
● Select **F4: Contra** from the Button Bar or press **F4** .
Click on the following links for more:
● Creating Contra Entry in Single Entry Mode
● Creating Contra Entry in Double Entry Mode
Note: Use the options available in the Button Bar for more additional features and navigation.

Payment Voucher:
Payment voucher is used to account all the payments made by the company by way of Cash/Bank.
Payment voucher can be passed using **Single Entry** or **Double Entry mode** by configuring the setting **Use Single Entry mode for Pymt/Rcpt/Contra** in **F12 configuration** .

Receipt Entry
Any money received from debtors against sales Invoices or on Account and for all transactions where money is received are accounted or entered into Tally.ERP 9 using the Receipt Voucher.
To view the Receipt Voucher screen,

● Go to Gateway of Tally > Accounting Vouchers.
● Select F6: Receipt from the button bar or press F6.
For example, if your company receives money from a customer for an earlier transaction say sales, and the same is passed through a Receipt Voucher:
● Credit the customer account and debit the Cash account, if you receive cash or
● Debit the Bank account where you need to deposit the money, if you receive Cheques.

Purchase Entry:
When a company buys goods on credit or cash, Purchase voucher is used to record all the Purchase transactions of the company.
To pass a Purchase Voucher,
● Go to Gateway of Tally > Accounting Vouchers.
● Click on F9:Purchase on the Button Bar or press F9 .
For example, if you are purchasing goods from Supplier A for a value of Rs. 10000/-
● Debit Purchase Account.
● Credit Party Account.

Sales Voucher:
Sales Voucher is used to record the Sales transactions of the company. You can pass an entry using the Voucher mode or the Invoice mode where the calculations can be automated and the transactions can be fed into the system easily.

Debit Note Entry:
Debit Note is a document issued to a party stating that you are debiting their Account in your Books of Accounts for the stated reason or vise versa. It is commonly used in case of Purchase Returns, Escalation/De-escalation in price, any other expenses incurred by you on behalf of the party etc.
Debit Note can be entered in voucher or Invoice mode.
You need to enable the feature in **F11: Accounting** or **Inventory features** .
● To use it in **Voucher mode** you need to enable the feature in **F11 :Accounting Features - Use debit and credit notes** .
● To make the entry in **Invoice mode** enable the option **F11: Accounting Features - Record debit notes in invoice mode** .

Credit Note:
Credit Note is a document issued to a party stating that you are crediting their Account in your Books of Accounts for the stated reason or vise versa. It is commonly used in case of Sales Returns, Escalation/De-escalation in price etc.
A Credit Note can be entered in voucher or Invoice mode.
You need to enable the feature in F11: Accounting or Inventory features .
● To use it in Voucher mode you need to enable the feature in F11: Accounting Features - Use debit and credit notes .
● To make the entry in Invoice mode enable the option F11: Accounting Features - Record credit notes in invoice mode .

Items in Voucher Screen:

A voucher entry screen in Tally.comprises of the following sections:

Type of Voucher
It is essential to check if you are using the right voucher for the transaction. You can change the voucher type byselecting a new type from the button bar, if required. For example on the selection of a payment voucher, Tally.automatically displays the list of voucher types you have created. You can select the voucher type required.

Voucher Number
Tally.automatically sets the voucher number for you. You can change the voucher number manually, ifrequired.

Reference
You can enter a reference of your choice. A purchase order number or an invoice number can be entered as areference.

Date of Voucher
The date of the voucher you enter is displayed at the top-right of the voucher creation screen. The date is takeninitially from the Gateway of Tally - Current Date and you may need to change it frequently to ensure that thevouchers are dated as you want.

Effective Date
A voucher type can be configured to allow for an effective date. The line below the date of voucher displays the datewhen the voucher will be effective. This will be available only if the effective date option is activated in the particularvoucher type.

Particulars
This is where you enter the ledger names and the debit and credit amounts. Each line displays a prompt of DrorBy for debit entries and Cr or To for credit entries.Depending on the voucher type, Tally.selects either ‘Dr’ or ‘Cr’ for the first prompt, which you cannot change.

Thereafter, you can change the prompt (if necessary) by typing over it with a ‘D’ or a ‘C’. To select a ledger, typethe first letter of its name.

Tally.then displays a List of ledger accounts beginning with the letter highlighted.Only ledgers suitable for the voucher type are displayed. The revised current balance is shown after the amount isentered. On selecting the next ledger, Tally.suggests the balancing amount as the value to be entered, whichmay be accepted or typed over. The voucher entry cannot be completed until the debits equal the credits.

Narration
Here you type whatever appropriately describes the transaction. Remember, you can have a separate narration foreach line of particulars, if you configure the voucher type in that way.Once the narration is complete, press Enter to bring up the Accept? The box. Once you accept the data, Tally.presents another voucher entry screen.

Accounting Vouchers

Tally.is pre-programmed with a variety of accounting vouchers, each designed to perform a different job. Thestandard accounting vouchers are:

- Contra Voucher (F4)
- Payment Voucher (F5)
- Receipt Voucher (F6)
- Journal Voucher (F7)
- Sales Voucher/Invoice (F8)
- Credit Note Voucher (Ctrl+F8)
- Purchase Voucher (F9)
- Debit Note Voucher (Ctrl+F9)

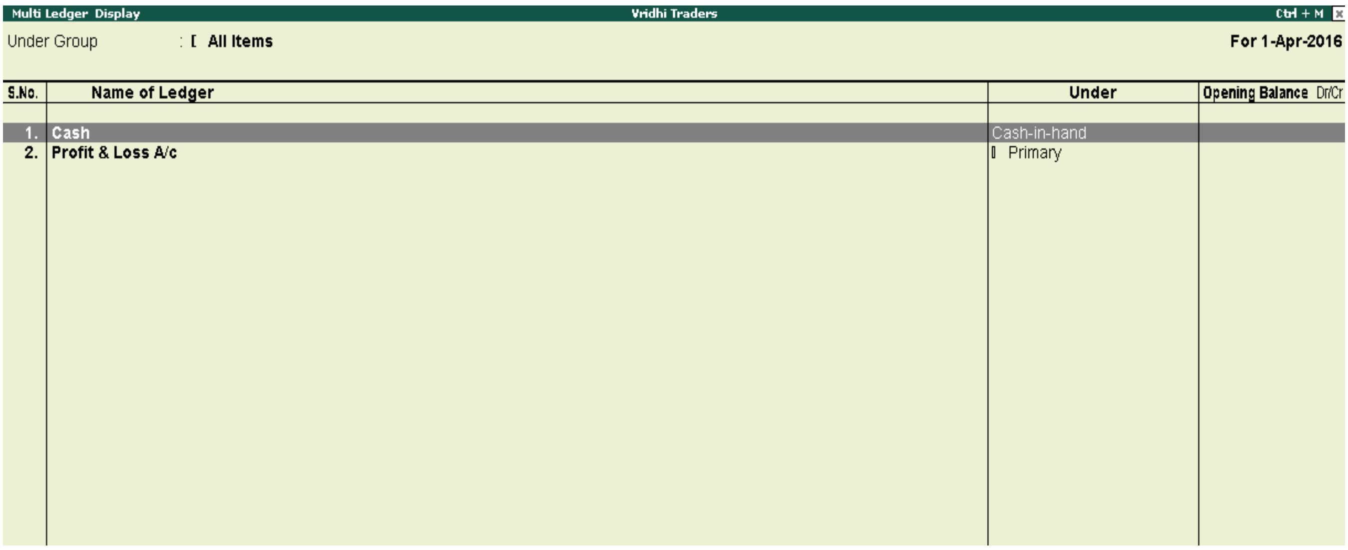
3.0.Ledgers and Groups

Ledgers

A 'Ledger' is an account head. For instance, the sales account head will be called a 'Sales Ledger' inTally.ERP 9. Similarly, a customer would be an account head, and will be called a 'party ledger'.You can create ledgers specific to your business transactions.
For a newly created company, there are two pre-defined ledgers available in Tally.ERP 9:

- Cash
- Profit & Loss A/c

To view the list of ledgers, go to **Gateway of Tally > Accounts Info.> Ledgers > Display (Multiple Ledgers) >Select All Items**.The**Multi Ledger Display Screen** appears as per Figure 1.6



Groups

A 'Group' is the accounting group under which ledgers of the same nature can be classified. For instance, Tally. has a default Group 'Sales Accounts', under which all the sales ledgers will be classified.There are 28 pre-defined groups in Tally., which feature in the chart of accounts of many organisations. Outof these, 15 groups are primary groups and the remaining 13 are sub-groups.

Among the 15 primary groups, 9 groups are balance sheet items and the remaining 6 groups are Profit & Loss A/citems. You can use these groups to build your chart of accounts, as well as create and used group's specific to yourbusinesstransactions.However, you may also alter the nomenclature of these 28 groups.Maintaining Chart of Accounts in Tally.

Multi Group Alteration — Vridhi Traders — Ctrl + M

Under Group : All Items

S.No.	Name of Group	Under
1.	Capital Account	Primary
2.	Loans (Liability)	Primary
3.	Current Liabilities	Primary
4.	Fixed Assets	Primary
5.	Investments	Primary
6.	Current Assets	Primary
7.	Branch / Divisions	Primary
8.	Misc. Expenses (ASSET)	Primary
9.	Suspense A/c	Primary
10.	Sales Accounts	Primary
11.	Purchase Accounts	Primary
12.	Direct Incomes	Primary
13.	Direct Expenses	Primary
14.	Indirect Incomes	Primary
15.	Indirect Expenses	Primary
16.	Reserves & Surplus	Capital Account
17.	Bank OD A/c	Loans (Liability)
18.	Secured Loans	Loans (Liability)
19.	Unsecured Loans	Loans (Liability)
20.	Duties & Taxes	Current Liabilities
21.	Provisions	Current Liabilities
22.	Sundry Creditors	Current Liabilities
23.	Stock-in-Hand	Current Assets
24.	Deposits (Asset)	Current Assets
25.	Loans & Advances (Asset)	Current Assets
26.	Sundry Debtors	Current Assets
27.	Cash-in-Hand	Current Assets
28.	Bank Accounts	Current Assets

To view the list of the 28 groups, known as the **List of Accounts**, go to **Gateway of Tally > Accounts Info. >Groups > Display (Multiple Groups) > Select All Items.**

The **Multi Group Display Screen** appears as per Figure 1.7Figure 1.7 List of Multiple Groups ScreenOut of the 15 Primary groups, the following appear in the Profit & Loss Account:

1. Sales Accounts
2. Purchase Accounts
3. Direct Incomes or Income (Direct)
4. Indirect Incomes or Income (Indirect)
5. Direct Expenses or Expenses (Direct)
6. Indirect Expenses or Expenses (Indirect)

Ledger Creation
In Tall, we can create the ledgers in two ways given below:

I. **Single Ledger Creation:** Here we can create one ledger at a time.
II. **Multiple Ledger Creation:** Here we can create different ledgers at one go and also ledgers which belong toparticular group.

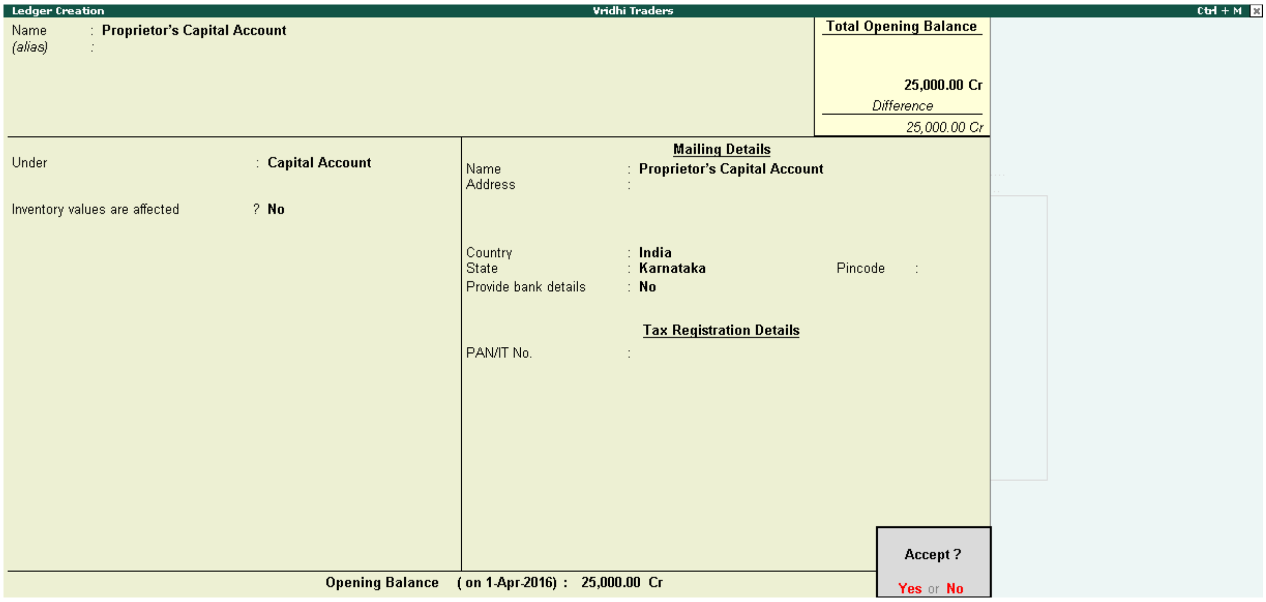
I. Single Ledger Creation

Creation of Proprietor's Capital Account ledger from single ledger creation screen.
1. Go to **Gateway of Tally > Accounts Info. > Ledgers > Create (Single Ledger Creation)**

2. Enter **Name** as **Proprietor's Capital Account**

1. Select **Capital Account** from the **List of Groups**The**Ledger Creation Screen** appears as per Figure 1.8Figure 1.8 Ledger Creation screen — Proprietor's Capital Account

2. Press **Y** or **Enter** to accept the screenTally.displays the total debit and credit opening balances in the right upper corner of screen while the ledgersare being created in the ledger creation screen. This is to avoid differences in the opening balance.



II. Multiple Ledger Creation

Now let us create the following ledgers using the Multi Ledger Creation option:
To create Multiple Ledgers at once, follow the below given steps:

1. Go toGateway of Tally > Accounts Info > Ledgers > Multiple ledgers > Create

2. From **Under Group** field select **All Items** Note
If you select Purchase Account in the 'Under Group' field, then the ledger will be created under PurchaseAccount Head.

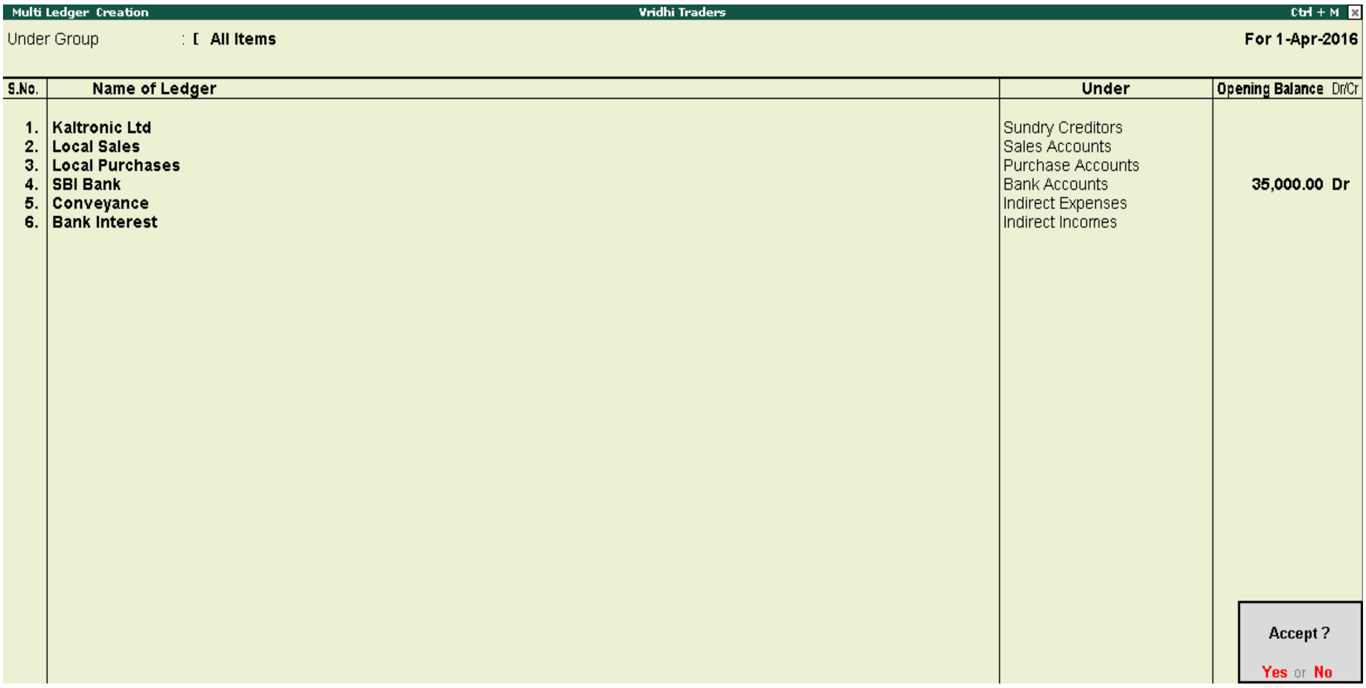
3. Under **Name of Ledger** enter the name as **Kaltronic Ltd**

4. Select as **Sundry Creditors** from the **List of Groups**

5. Press **Enter** and **move to next line** as there is **no opening balance**

6. Similarly, select the other ledgers as shown in figure 1.9:

7. Press **Enter** or **Y** to **Accept**Figure 1.9 Multi Ledger Creation Screen
Now that we have learnt how to create ledgers under Tally.default pre-defined groups, let us move on tounderstand how to make alterations to ledgers that are already created.



1.4.1.4 Group Creation

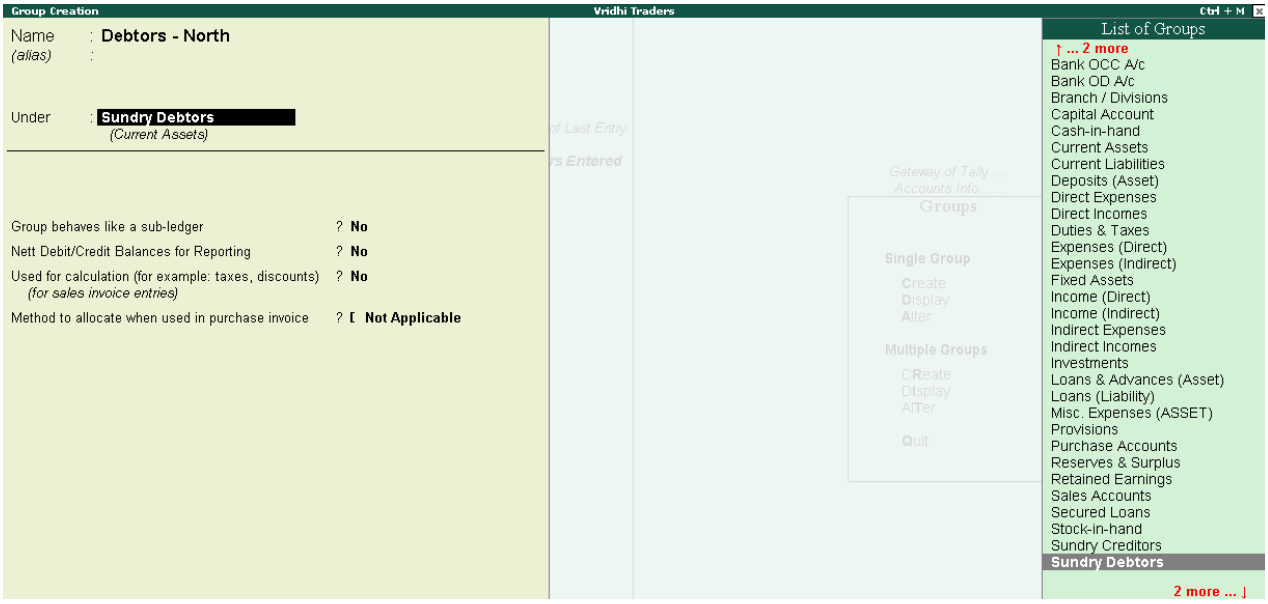
In Tally., there are 28 predefined groups, this mean that it is not necessary to create the Account Group inTally.. However, considering the different requirement of an organisation and its nature, Tally.hasalsoprovided flexibility to create the account group, if need be.Group creation is similar to ledger creation in Tally.. As with ledgers, there are two ways of creating groups:

I. **Single Group Creation:** Involves creation of a single group at a time

II. **Multiple Group Creation:** Involves creation of multiple groups at a time
Single Group CreationThe group to be created, and the primary group under which it has to be classified, is specified in the table below:To create the group,

Group to be createdClassification Debtors – NorthSundry Debtors
1. **Go to** Gateway of Tally > Accounts Info. > Groups > Create (Single Group)
2. Enter **Name** as **Debtors - North**
3. Against the field **Under** select **Sundry Debtors** from the **List of Groups**

The **Group Creation Screen** appears as per Figure 1.10
Note: To create a Multi Group in Tally, go to Gateway of Tally >. Accounts Info > Groups > Under Multiple Groups > Select Create.


Group Creation
Vridhi Traders
Ctrl + M
Name : Debtors - North
(alias) :
Under : Sundry Debtors
(Current Assets)
Group behaves like a sub-ledger ? No
Nett Debit/Credit Balances for Reporting ? No
Used for calculation (for example: taxes, discounts) ? No
(for sales invoice entries)
Method to allocate when used in purchase invoice ? Not Applicable
List of Groups
... 2 more
Bank OCC A/c
Bank OD A/c
Branch / Divisions
Capital Account
Cash-in-hand
Current Assets
Current Liabilities
Deposits (Asset)
Direct Expenses
Direct Incomes
Duties & Taxes
Expenses (Direct)
Expenses (Indirect)
Fixed Assets
Income (Direct)
Income (Indirect)
Indirect Expenses
Indirect Incomes
Investments
Loans & Advances (Asset)
Loans (Liability)
Misc. Expenses (ASSET)
Provisions
Purchase Accounts
Reserves & Surplus
Retained Earnings
Sales Accounts
Secured Loans
Stock-in-hand
Sundry Creditors
Sundry Debtors
2 more ...

Short-Cut Key on Tally 9.o (Function Keys)

FunctionKey	Functionality	Availability
F1	To select a company	At all masters menu screen
	To select the Accounts Button	At the Accounting Voucher creation and alteration screen
F1 (Alt+F1)	To select the Inventory Button	At the Inventory/Payroll Voucher creation and alteration screen
F1 (Ctrl+F1)	To select Payroll Vouchers to alter	At the Accounting/Inventory voucher creation or alteration screen.
F2	To change the current date To select company inventory features	At almost all screens in TALLY At the F11: Features screen
F3	To select the company To select Company Statutory & Taxation features	At almost all screens in TALLY At F11: Features screen
F4	To select the Contra voucher	At Accounting / Inventory Voucher creation and alteration screen
F5	To select the Payment voucher	At Accounting / Inventory Voucher creation and alteration screen
F6	To select the Receipt voucher	At Accounting / Inventory Voucher creation and alteration screen
F7	To select the Journal voucher	At Accounting / Inventory Voucher creation and alteration screen
F8	To select the Sales voucher	At Accounting / Inventory Voucher creation and alteration screen
F8 (Ctrl+F8)	To select the Credit Note voucher	At Accounting / Inventory Voucher creation and alteration screen
F9	To select the Purchase voucher	At Accounting / Inventory Voucher creation and alteration screen
F9 (Ctrl+F8)	To select the Debit Note voucher	At Accounting / Inventory Voucher creation and alteration screen
F10	To select the Reversing Journal voucher	At Accounting / Inventory Voucher creation and alteration screen
F10 (Ctrl + F10)	To select the Memorandum voucher	At Accounting / Inventory Voucher creation and alteration screen
F11	To select the Functions and Features screen	At almost all screens in TALLY
F12	To select the Configure screen	At almost all screens in TALLY

SHORT ANSWER QUESTIONS (2 Marks)

1. What is Tally?
2. What is Voucher?
3. What is pre – defined vouchers in Tally?
4. How many types of function keys in Tally? What are they?

ESSAY TYPE QUESTIONS (6 Marks)

1. Write the procedure for voucher creation in Tally?
2. Write the procedure for ledger creation in Tally?
3. Write about function keys and their Functions?

Ψ

ACCOUNTING & TAXATION (A & T)

Paper – III

Taxation - II

INDEX

UNIT 1

Income from Business

Learning Objectives

After studying this unit, the student will be able to

- Understand about admissible expenses and inadmissible expenses
- Understand about admissible income and inadmissible income
- Learn about actual profit or loss of the business
- Learn about chargeable expenses under the head of business

Introduction

The profits/gains from business or professions carried on by the assessee at any time during the P.Y. are assessed to tax under the head income from business or profession. Further, the profits or gains shall be computed according to the method of accounting regularly employed by the assessee. If the Profit & loss account prepared by the assessee is not computed from income tax point of view, such account has to be adjusted from income tax point of view, in order to ascertain the correct taxable profits or gains from business or profession.

Before knowing the tax provisions of Sections 28 to 44, it is important to understand the meaning of the terms Business, Profession, Vocation and format for computing taxable income from business or profession.

Business [Section 2(13)]

According to section 2(13) of the Income tax Act, the term Business means any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

Profession [Section 2(36)]

According to Section 2(36) Profession refers to an occupation, where intellectual skill and technical expertise in a specified field is acquired for earning a livelihood. Lawyer, Doctor, Auditor are the some of the examples of Profession. Further, Profession includes Vocation.

Vocation means an activity upon which a person spends the major portion of his time and out of which he makes his living. Music, Dancing, writing books and contribution of articles to Journals constitute the vocation of an assessee.

Format for Computation taxable Income from Business

Particulars	Amount	Amount
Net Profit or Loss as per P & L A/c		xxx
Add: 1. Inadmissible expenses debited to P & L A/c	xxx	
2. Business/Professional income not credited to P& LA/c	xxx	
3. Overvaluation of opening stock	xxx	
4. Undervaluation of closing stock	xxx	xxx
5. Notionalloss		
Less: 1. Admissible expenses not debited to P & L A/	xxx	
2. Tax-free incomes credited to P/L account	xxx	
3. Non-Business Income credited to P&L A/c	xxx	
4. Under valuation on opening stock	xxx	
5. Overvaluation of closing stock	xxx	Xxx
Notional profit*		xxx
Taxable income from profit		

Note: No person can make profit by trading with himself in another capacity. For instance, if the amount of sales, which is credited to Profit & Loss account, includes a sum of 7 20, 000 representing the value of goods withdrawn for the use of assessee's family members and if these goods were purchased at a cost of 7 10,000, there is notional profit to the extent of 7 10,000 (20,000 – 10,000) and this profit should be deducted from net profit, as tax is levied on real profits but not notional profits. On the other hand, if there is a notional loss, it should added back to the net profit.

2. Instead of net profit, if net loss is given in the problem the above rules shall be reversed i.e., items to be added shall be deducted and those to be deducted shall be added.

Tax Treatment

Inadmissible Expenses

Inadmissible expenses are those expenses, which are not allowed under the Act. If such expenses are debited to Profit & Loss account by the assessee, they should be added back to the net profit. Following are some of the examples of in admissible expenses:

1. Any business expense paid in cash exceeding 7 20,000, 100% of such payment shall be disallowed. (The monetary limit of 7 20,000 has been raisedto 7 35,000 in the case of payment made for plying or leasing in good carriage.
2. Bad debts still recoverable.
3. Employer's contribution to the provident fund not paid on or before the due date of filing returns.
4. Betterment charges paid to corporation under Town Planning Act.
5. Capital losses like loss on sale machinery, loss on sale of car etc.
6. Charities and donations.
7. Capital expenses like purchase of machinery, extension of building, Cost of

permanent sign board fixed on office premises.

8. Contribution to staff welfare fund.
9. Contribution to unapproved or un recognized fund or political party.
10. Direct taxes like income tax, advance income tax, wealth tax, interest on loan taken for the payment of income tax etc.
11. Difference in trial balance.
12. Expenses relating to other heads of income like municipal taxes of house property let out.
13. Expenses incurred to earn tax-free incomes like cultivation expenses.
14. Excess depreciation.
15. Excessive and unreasonable payments made to the relatives.
16. Fines and penalties
17. Fringe benefit tax.
18. Family planning expenses
19. Gifts and presents(non-publicity).
20. Interest on capital.
21. Illegal expenses.
22. Legal expenses to acquire a title or to cure a defect in the assessee's title of assets.
23. Loss from discontinued business.
24. Personal expenses or losses like Life / medical insurance premium paid on own life or any member of assessee's family, Amount invested in NSS, NSC, PPF, Proprietor's salary, Proprietor bonus, Drawings, theft from residence, rent paid for self, casual help, house hold expenses, expenses for arranging personal party etc.
25. Preliminary expenses:

    Preliminary expenses (i.e., expenses relating to the preparation of feasibility report, project report, conducting market survey or any other survey relating to assessee's business) or 5% of cost of the project, which ever less, is deductible in equal installments over the period of five years commencing from the previous year in which such expenses were incurred.
26. Patents / copy rights /Technical know-how purchased:

    Assessee can claim depreciation U/S 32 @ 25% for Patents / copy rights / Technical know-how purchased during the previous year.
27. Provisions and reserves like Reserve for future losses, Provision for bad and doubtful debts etc.
28. Sales tax, excise duty, custom duty, local taxes of the premises used for business not paid on or before the due date (31st July of every A.Y.).
29. Salary or interest on loan payable outside India without TDS.
30. Speculation losses.

Business Incomes

If Business incomes are not credited to P/L account, such incomes should be added to net profit, to get income taxable under the head income from business. Following are some of the examples of business incomes:

1. Amount of liability foregone by the creditor.
2. Bad debts recovered but allowed earlier.
3. Cash assistance received by the assessee against exports under any scheme of government of India or export incentives.
4. Interest from debtors for delayed payments.
5. Profit on sale of import license.
6. Sales/Commission/sundry receipts/Discount received.
7. Rent received from employees.
8. Speculation incomes.
9. Custom/excise duties recovered but earlier allowed as deduction.

Admissible Expenses

Admissible expenses are those expenses, which are allowed under the Act. If such expenses are not debited to P/L account by the assessee, they should be deducted from the net profit. Following are some of the examples of admissible expenses:

1. Advertisements expenses. (Advertisement given in magazines or souvenir of a political party is inadmissible).
2. Audit fees.
3. Bank commission.
4. Bad debts.
5. Bank cash transaction tax.
6. Contribution towards rural development program and conservation of natural resources.
7. Cost of khacha well, bore well(but Cost of pucca well is inadmissible).
8. Commodity transaction tax.
9. Demurrage paid to rail ways.
10. Discount and allowances as per IT Act.
11. Depreciation allowable.
12. Establishment expenses.
13. Expenditure on guest house or holiday home facility.
14. Electricity bill/land revenue / repairs / Fire insurance premium/rent of the premises, which is used for business.
15. Entertainment expenses.
16. Expenditure on campaign against nationalization.
17. Expenditure on scientific research.

(i) Revenue expenditure on research carried on by the assessee is fully deductible, if such research relates to the assessee's business.

(ii) Capital expenditure on research carried on by the assessee is fully deductible, if such research relates to the assessee's business. (Deduction is available even if the asset is not put into use for research by the assessee during the previous year)except acquisition of land.

(iii) Contribution to approved research association or university or other institutions engaged in scientific research is deductible at the rate of 175% of actual contribution.

(iv) Contribution to an approved university, college or other institutions for the purpose of research in social science or statistical research is deductible at the rateof125%ofactualcontribution.

(v) Contribution to national laboratory is deductible at the rate of 200% of actual contribution.

18. Festival expenses.
19. General expenses.
20. Gifts and presents not made in personal capacity.
21. Income tax expenses. (IT proceeding expenses, expenses on filing IT returns)
22. Loss of stock due to the fit by an employee.
23. Legal expenses for filing income tax appeal.
24. Legal expenses to defend an existing title to a capital assets.
25. Municipal taxes of quarters let out to employees and other expenses incurred according to the provisions of law.
26. Postage and telegrams.
27. Printing and stationary.
28. Professional tax paid.
29. Railway freight and octroi expenses.
30. Services charges.
31. Subscription to a trade or professional association.
32. Salaries/wages/perquisites/allowances to employees.
33. Staff welfare expenses.
34. Security transaction tax.
35. Tournament expenses.
36. Telephone installation charges under OYT scheme.
37. Traveling expenses related to business.
38. Training expenses.
39. Welfare expenses.

Tax Free Incomes

If incomes, which are exempted from tax, are credited to P/L account, such incomes should be deducted from net profit, to get income taxable under the head income from business. Following are some of the examples of tax free incomes:

1. Agricultural Income.
2. Bad debts recovered but disallowed earlier.
3. Custom duty/excise duty recovered but disallowed earlier.
4. Dividend from an Indian company / UTI.
5. Dharmada, mandir and gaushala receipts (CIT vs. Channoo Lal Das,(1978), 113 ITR 579 (Allahabad).
6. Gift from father / on occasion of gruhapravesam / relatives.
7. Interest from PO savings bank account.
8. Refund from LIC.
9. With drawl from PPF.

Business income not taxable under the head Profits and Gains of business or profession:

1. Rent al income in the case of dealer in property.
2. Dividend on shares in the case of a dealer in shares.
3. Winnings from lotteries etc.
4. Interest received on compensation or enhanced compensation.

Speculative Transaction [Section 34 (5)]

Speculative Transaction means a transaction in which a contract for the purchase or sales of any commodity including stock and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips.

Illustration:1

How will you deal with the following while computing profits and gains of business?

(a) Salary paid to proprietor Rs15,000.

(b) Commission paid to 'X' Rs 5,000 for securing business orders.

(c) Loss due to embezzlements by an employee Rs10,000.

(d) Registration expenses of business asset Rs20,000.

(e) Amount paid to keep the competitor away from the business 25,000.

Solution

(a) Salary paid to proprietor -- **disallowed**

(b) Commission paid to secure business order in the normal course of business -- **allowed.**

(c) Loss due to embezzlement by an employee is incidental to the business -- **Allowed .**

(d) Registration expenses of a business asset is a capital expenditure -- **not allowed**

(e) Amount paid to keep the competitor away is in order to increase the earning capacity is a capital expenditure -- **not allowed.**

Illustration 2

State, with reasons, whether the following are allowed as deductions under the Income Tax Act 1961.

(i) Re-roofing expenses of the factory in place of worn-out asbestos sheets Rs.10,000.

(ii) Contribution paid to Government to repair to Government to repair the approach road to factory 40,000.

(iii) Amount deposited in staff welfare Fund 10,000.

(iv) Legal expenses for drafting the deed of agreement 18,000.

(v) Commission paid on raising the loan Rs 12,000.

(vi) Goods stolen by pretended customer Rs16000.

Solution

(i) Re-roofing expenditure in place of worn-out sheets is a non-recurring expenditure not resulting in current repairs -- **not allowed**.

(ii) Contribution paid to Government to repair the approach road to factory -- **allowable** expenditure.

(iii) Deposit of staff welfare fund -- **inadmissible.**

(iv) A legal expense for drafting deed of agreement is a capital expenditure covered u/s 35 D -- **not allowed** in full.

(v) Any expenditure incurred on raising loans -- **Allowed**

(vi) Loss on theft during the normal business hours -- **allowable**

Illustration: 3

State the admissibility of the following items of expenditure in computing business income of an assessee.

(a) Donations to PM National Relief Fund 80,000.

(b) Amount spent on the construction of recreation club for the exclusive use of employees 1,20,000.

(c) Loss of stock 6,000.

(d) While proceeding to deposit the daily proceeds of a business in the bank by the cashier, the cash of 80,000 was stolen by stranger.

(e) Compensation of 50,000 was paid to a retrenched employee whose continuation in service was detrimental to the interest of the business.

(f) Lump sum consideration paid for acquiring technical know-how on 20-4-15 60, 00,000.

(g) Legal charges paid to defend a criminal paid to defend a criminal suit pending against the proprietor Rs, 22,000.

Illustration 4 Following is the Profit & Loss A/c of Mrs. Saroja (resident) forthe year ending 31.3.19.

Particulars	Amount	Particulars	amount
To Cost of goods sold	7,50,000	By Sales proceed of goods	23,00,000
To Salary to employees	9,90,000		
To Expenses	1,00,000		
To Net profit	4,60,000		
	-------		-------
	23,00,000		23,00,000

The salary of Rs 9, 90,000 comprises Rs 90,000 as employee's contribution towards recognized provident fund. Out of Rs. 90,000, Rs. 60,000 is credited in the employee's PF within due date and 30,000 is credited after due date. Compute the net income of Mrs. saroja for the A.Y. 2019-20.Solution:

Computation of Net Income for the A.Y. 2019-20

Particulars	Amount
Net profit	4,60,000
Add: Employee's contribution towards provident fund [it is first introduced in income by virtue Sec 2(24)(x)]	90,000
Total	5,50,000
Less: Employee's contribution towards provident fund, if credited onorbeforetheduedateSec.36(1)(va)	60,000
Net income	4,90,000

Illustration- 5 : Net profit as per profit and loss account of Mr. Shanmukh (resident) for the year ending 31st March 2019 is 7 8,00,000 salary paid to employees, debited to P/L A/c is 7 50,000, out of which 7 10,000 is employee's provident fund contribution which is credited as follows: (i) 7 9,000 after due date but within the previous year and (ii) 7 1,000 after due datebutwithinnextpreviousyear.ComputethenetincomeoffortheA.Y.2019-20.

Solution:

Computation of Net Income for the A.Y. 2019-20

Particulars	Amount
Net profit	8,00,000
Add: Employee's contribution towards provident fund	10,000
Total	8,10,000
Less: Employee's contribution towards PF if credited before the due date	Nil
Net income	8,10,000

Illustration 6.

Given below is the profit and loss account of Kalyan for the year ending 31-3-2019.

Dr.	Rs. (A)		Rs. (A) Cr
To Salaries	40,000	By Gross profit	4,00,000
To Bad Debts	10,000	By Discount	10,000
To Provision for bad debts	15,000	By Commission	10,000
To Insurance	4,000	By Bad debts recovered	20,000
To Advertising	10,000	By Rent received	30,000
To Interest on Capital	5,000		
To Interest on loan	5,000		
To Depreciation	25,000		
To Net Profit	3,56,000		
	4,70,000		4,70,000

1. Allowable depreciation as per IT Rules 30,000.
2. Insurance includes life insurance premium of the proprietor 2,000.

Solution:

Computation of Business Income of Kalyan for the A.Y. 2019-20.

	Rs. (A)	Rs.(A)
Balance as per Profit and loss Account		3,56,000
Add : Inadmissible Expenses		
Provision for bad debt	150,00	
Life insurance premium	2,000	
Interest on capital	5,000	
Depreciation taken separately	25,000	47,000
		4,03,000
Less : Inadmissible Income		
Rent received	30,000	
Expenses not charged to P&L A/c		
Depreciation	30,000	60,000
Business Income		3,43,000

ILLUSTRATION 7

From the following Profit and Loss Account of a manufacturer, calculate the income under bead 'Profits and Gains of Business or Profession' for The year Ending on 3lst March

Particular's	Amount	Particular's	Amount
salaries to employees	1,95,000	Gross Profit	5,80,000
Advertisement expenses (in cash)	24,000	Interest on securities	14,000
General expenses	16,000	Income from house property	25,000
Entertainment expenses	22,000	Bad debts recovered (allowed earlier)	12,000
Bad debts	1,500		
Drawings by the proprietor	24,000		
Sales-tax (due and paid on 1-7-2017)	6,000		
Interest on proprietor's capital	7,000		
Repairs	2,500		
Rent	21,000		
Legal expenses	5,000		
Depreciation	15,000		
Bonus (due)	6,000		
Bonus to the proprietor	4,000		
Car purchased	72,000		
Expenses on car during the year	12,000		
Donations	2,000		
Provisions for bad debts	6,000		
Net Profit	1,90,000		
	6,31,000		6,31,000

From the examination of books of accounts, the following other information's are available:

1. Advertisement expenses were spent on insertions in newspapers.
2 3,000 were spent on purchase of land and are included in legal expenses.
3. Half of the repair expenses were on let-out building.
4. Depreciation allowable on all assets including car is 14,400.
5. Bonus was paid to employees on 30-6-2019 and date of filing of return is 31-7-2019.

SOLUTION

Computation of Business income for the A.Y. 2019-20

Particular's	Amount	Amount
Computation of Business income of a manufacturer		
Profit as given in the profit and loss A/C		1,90,000
Add;		
Drawing	24,000	
Interest on proprietors capital	7,000	
Bonus to proprietor	4,000	
Car purchased	72,.000	
Donations	2,000	
Provisions for bad debts	6,000	
Legal charges (being Capital Exp)	3,000	
Repairs on let-out building	1,250	
Depreciation	15,000	
Advertisement expenses paid in cash	24,00	1,58,250
		3,48,250
Less: Income to be treated under separate heads		
Income from interest on securities	14,000	
Income from house property	25,000	39,000
		3,09,250
Less; Allowable depreciation		14,400
Income from business		2,94,850

Note;

Bonus allowed to be Debited as it was paid before due date of filing of return

ILLUSTRATION 8

Profit and loss account of m/s raju & company for the A.Y. 2019-20

Particular's	Amount	Particular's	Amount
General expenses	1,07,000	Gross profit	5,40,000
Fire insurance premium	2,000	Bad debts recovered	
Bad debts	1,000	But disallowed earlier	4,000
Salaries	1,65,000	Interest from Govt.	
Advertisement (in cash)	22,250	Securities	4,000
Proprietor's Salary	1,12,000	Rent received from employee	12,000
Interest on capital	2,000	Interest from debtors for	
Income-tax	1,000	delayed payment	6,000
Depreciation	2,000		
Sales-tax (due)	5,000		
Advance income-Tax paid	1,000		
Donations	500		
Motor car expenses	750		
Municipal taxes of quarters			
Let to employees	5,000		
Net profit	1,39,000		
	5,66,000		5,66,000

General expenses include 4000/- Paid as compensation to an old employee whose services were terminated in the interest of the business and 2,200/- by way of help to a poor student depreciation calculated according to the rates comes to 2, 900/-.sales tax was paid on 1-05-2019.date of filing of return is 31-07-2019.
50% of motor car expenses are for proprietor's personal use. Compute business income

SOLUTION

Computation of Business income for the A.Y. 2019-20

Particular's	Amount	Amount
Net Profit as per P& L A/c Add: Inadmissible expenses Advertisement in cash (100% of 22,2 Proprietor's salary Interest on capital Income- Advance Income-tax Donation Motor car expenses Help to poor student Depreciation	 22,250 1,12,500 2,000 1,000 1,000 500 375 2,200 2000	1,39,000 1,43,825
		2,82,825
Less; expenses allowed but not debited Depreciation		 2,900
		2,79,925
Less; Incomes not taxable under this head Bad debts recovered disallowed earlier Interest on Govt. securities	 4,000 4,000	 8,000
Taxable business income		2,71,925

Notes
1. Rent of quarters given to employees is business receipt and their expenses are for the business.
2. Sales tax due is allowed as it was paid before due date of filing of return.
3.100% of advertisement expenses exceeding 10,000 paid in cash are disallowed.
4. Interest on debtors is Business income

Exercise:

Q. No. 1

Mr. X reveals the following information

Purchases made during the year include a payment of 2,10,000 made to a relative on 1-11-2018in following manner:

(a) 1,50,000 were paid by account payee cheque.
(b) 40,000 were paid by bearer cheque: and
(c) The balance amount was paid in cash.

The Assessing Officer has allowed R 1,40,000 as reasonable amount to be allowed for this transaction.

(1) In this case how much amount will be disallowed u/s 40A(2) and 40A(3);
(2) What difference it will make if the reasonable amount allowed by Assessing Officer is 2,00,000.

(Hints:)

(1) Disallowed u/s 40A(2) 70,000, i e, payments to a relative shall be disallowed up to the amount considered as excessive or unreasonable by the Assessing Officer and u/s 40A(3) Nil.
(2) Disallowed u/s 40A(2)10,000 and u/s 40A(3) 50,000, e., 100% of payment made in casher bearer cheque i.e., 2,00,0001,50,000 paid by cheque.

Q. No. 2
To what extent following are allowed as deductions in computing the income of business carried on by Ram:
(1) Entertainment expenditure incurred during the previous year ending 31-3-2019 is Rs.50,000,
(2) Daily allowance given to Mr. Mohan, an employee is at the rate of2,000 per day. He was on tourfor 5 days and was given 10,000 as daily allowance during previous year 2018-19.
(3) Ten items were presented during previous year 2018-19on advertisement each costing 2,000.
(4) Income-tax deposited in advance during the previous year 2018-19 amounted to10,000.
Hints :
(1) Fully Allowed (2) Fully Allowed (3) Fully Allowed (4) Disallowed

Q.no.3
Following is the Profit and loss account of kesarimalya for the previous year 2018-19

PROFIT AND LOSS ACCOUNT

Particulars	Amount	Particulars	Amount
To Salaries	25,650	By Gross profit	80,000
To Rent	1,000	By Bank interest	450
To Commission on sales	100	By Bad Debts recovered (last year allowed)	2,000
To Income-tax	2,600	By Rent from house property	4,800
To Entertainment expenses	600	By Interest on commercial securities	2,000
To Commission paid to collect interest on securities	25		
To Embezzlement by cashier	1,000		
To Municipal tax of H.P.	600		
To Bad Debts (allowed)	450		
To Repairs to house	1,625		
To Office expenses	9,180		
To Depreciation	5,000		
To L.I.C. premium	1,320		
To Net profit	40,100		
	89,250		89,250

Depreciation on the assets is 4,500.
Compute the taxable business income for the assessment Year 2019- 20.
[Hints: Business profit 39,520]

Q.No4

Mr. Sairam a Trader furnishes the following information:

Profit and Loss Account for the year ending 31st March 2019

Particulars	Amount	Particulars	Amount
To General expenses	4,80,000	By Gross Profit	22,00,000
To Salary to staff	2,40,000	By Commission	40,000
To Salary to Sairam	1,20,00	By Bad Debts recovered (earlier allowed)	60,000
To Interest on capital	60,000		
To Interest on overdraft	40,000	By Interest on listed debentures	1,00,000
To Extension of Building	1,50,000		
To Interest on Loan	40,000		
To Depreciation	1,20,000		
To Travelling expenses	80,000		
To Audit Fees	72,000		
To Fire Insurance	78,000		
To Bonus to staff	1,00,000		
To Contribution toRPF	1,22,000		
To Advertisement	2,00,000		
To Reserve for bad debts	60,000		
To Bad debts written off	90,000		
To Net Profit	3,48,000		
	24,00,000		24,00,000

Other Information:

a) Depreciation allowable as per IT Rules 7 1,40,000 (excludes depreciation on permanent signboard.)

b) Advertisementincludes750,000 being cost of permanent sign board.

c) Incomeof760,000 accrued during the previous year not entered in P&L A/c.

d) Loan was taken to pay Income Tax arrears.

e) 7 40,000 paid as damages for failure to fulfill a contract in time is included in General Expenses.

Compute Taxable Income from Business for the Assessment Year 2019-20
[Ans.7,63,000]

Short Answer Type Questions

1.Define business.

2.Mention any four disallowed expenses

3.Mention any four disallowed incomes.

4.Write any expenses allowed under the heads of Income from business

Ψ

UNIT – 2

Income from Profession

Learning Objectives

After studying this unit, the student will be able to

- Understand about professional incomes
- Understand about profession expenses
- Learn about nonprofessional income and expenses
- Learn about net professional income

Introduction

A profession is an occupation requiring either purely an intellectual skill or manual skill controlled by the intellectual skill of the operator e.g. medicine, law, engineering, auditing, painting, etc. All professions are business but all businesses are not profession. Only those businesses or professions where the profits are dependent mainly upon the personal qualifications and in which no capital expenditure is required or only capital expenditure of a comparatively small amount is required. Profession includes vocation also u/s 2 (36).

Computation of professional income

As has been discussed earlier, profession means all such human activities which require human skill and technical expertise. A doctor or a lawyer or a chartered accountant is the persons who, if not working with any employer, practice independently to earn their living. These include many people like beauticians, musicians, magicians, artists, etc.

Profession [Section 2(36)]

According to Section 2(36) Profession refers to an occupation, where intellectual skill and technical expertise in a specified field is acquired for earning a livelihood. Lawyer, Doctor, Auditor are the some of the examples of Profession. Further, Profession includes Vocation.

Vocation means an activity upon which a person spends the major portion of his time and out of which he makes his living. Music, Dancing, Writing books and contribution of articles to Journals constitute the vocation of an assessee.

Format for computation of Income from Profession
In case of Doctor or Medical Practitioner

Particulars	Amount	Amount
Professional Receipts:		
1. Out or car expenses: Depreciation relating	xx	
to profession work.	xx	
1. Expense fees for conducting operation	xx	
2. Consultation fees	xx	
3. Visiting fees	xx	
4. Sale of medicines	xx	
5. Gifts received from patients for professional services rendered	xx	
6. Examiner's fees	xx	
7. Nursing home receipts		xxx
8. Any other professional		
receipts Total Professional Receipts	xx	
Less: Professional Expenses:		
2. Rent, Light, Water charges salary to staff, telephone expenses of clinic or hospital		
3. Cost of medicines are determined in two ways	xx	
a. If accounts are maintained on cash basis:		
Cost of actual medicines purchased during the previous year	Xx	
or	xx	
b. If accounts are maintained on mercantile basis:	xx	
Opening stock + New purchases-Closing stock	Xx	
4. Depreciation on surgical equipment and X-ray M/C etc., at prescribed rates	xx	
5. Depreciation of books at prescribed rates.	xx	
6. Mditure incurred to increase professional knowledge.	xx	xxx
7. Hospital or clinic expenses.		
8. Any other expenditure incurred during the year pertaining to profession.		
Income from profession		xxx

In case of Chartered Accountant

Particulars	Rs	Rs
Professional Receipts:		
1. Audit fees	xx	
2. Gain from accountancy work	xx	
3. Institute fees	xx	
4. Examiners fees	xx	
5. Gifts from clients	xx	
6. Consultancy services	xx	
7. Any other professional	xx	Xxx
receipt Total Professional		
Receipts	xx	
Less: Professional Expenses:	xx	
1. Audit office expenditure	xx	
2. Institute Expenses	xx	
3. Depreciation on book at prescribed rates.	xx	
4. Motor car expenses relating to professional work	xx	
5. Membership fees	xx	
6. Depreciation on office equipment or vehicles	xx	
7. Any other expenditure incurred to increase	xx	
professional knowledge	xx	
8. Stipend to trainees	xx	
9. Subscriptions	xx	
10. Depreciation on office furniture	xx	xxx
Income from Profession		xxx

Illustration 1

Mr. Subba Rao is a Chartered Accountant in Mysore. His Receipts and Payment Account for the P.Y. ending31.03.19 is as follows:

Receipts	Rs	Expenses	Rs
To Balance B/d	56,000	B Salary	1,00,000
To Dividend	64,000	By Rent	60,000
To Professional income	5,60,000	By Telephone charges	24,000
To House Rent	90,000	By Professional expenses	20,000
To Race course income (net)	24,000	By Motor Car expenses	48,000
To Lottery prize (net)	1,20,000	By Misc .expenses	30,000
		By Purchase of car(31.09.15)	1,80,000
		By Advance income tax	1,00,000
		By Personal expenses	1,80,000
		By Purchase of professional books	8,000
		By Electricity	4,000
		By LIC premium	16,000
		By Bal C/d	1,44,000
	9,14,000		9,14,000

Additional information:

a) 1/3ofcarexpensesrelatestopersonaluse.

b) DepreciationofMotorCarallowedis20%.

c) Rentincludes730,000 paid for residential accommodation.

d.Misc. expenses include donation paid to a notified Temple 7 20,000.

ComputehistotalincomefortheA.Y.2019-20

Solution:

Computation of Taxable Income from Profession for the a/y 2019-2020

Particulars	Amount	Amount
Professional Receipts:		
Professional Income		5,60,000
Less: Professional Expenses:		
Salary	1,00,000	
Rent (60,000 - 30,000)	30,000	
Telephone charges	24,000	
Professional expenses	20,000	
Motor Car expenses (48,000 2/3)	32,000	
Depreciation on Car (1,80,000 ,2/3 ,20%)	24,000	
Misc. expenses (30,000 - 20,000)	10,000	
Purchase of professional books (8,000 x 100%)	8,000	
Electricity	4,000	2,52,000
Income from profession		3,08,000

Illustration 2 (Taxable income from profession CA)

The following is the Receipt and Payment Account of Mr. Aruna Chartered AccountantfortheP.Y.endedon31-3-2019.

Particulars	Rs	Particulars	Rs
To Balance b/d	1,50,000	By Staff salary	3,00,000
To Audit fees	2,00,000	By Stipend to Audit Clerks	1,00,000
To Tax consultancy fees	2,50,000	By Office rent	90,000
To Project report fees	2,50,000	By Software development Expenses10,000	
To Accounting software charges	50,000	By Office expenses	1,25,000
		By Books :Annual	30,000
To Guest lectures in CA Institute	25,000	Non Annual	30,000
To Bank interest	25,000	By Car expenses	65,000
To Remuneration as member		By CA institute membership fee	5,000
tax reforms commission	20,000	By Contribution to PPF	50,000
		By Balance c/d	1,65,000
	9,70,000		9,70,000

Other Information:

a) ¼carusageispersonal.

b) Depreciation on cars. 10,000

c) Depreciation on office furniture 77,000

Compute income from profession taxable for the A.Y. 2019-20.

Computation of Taxable Income from Profession

Computation of professional Income for the a/y 2019-2020

Particulars	Amount	Amount
Professional Receipts:		
Audits		2,00,000
Tax consultancy fees	2,50,000	
Project report fees	2,50,000	
Accounting software charges	50,000	
Guest lectures in CA Institute	25,000	
Member tax reforms commission	20,000	7,95,000
Less: Professional Expenses:		
Staff salary	3,00,000	
Stipend to Audit Clerks	1,00,000	
Office rent	90,000	
Software development expenses	10,000	
Office expenses	1,25,000	
Books:		
Annual (100%)	30,000	
Non-annual(60%)	18,000	
Car expenses (65,000 x 3/4)	48,750	
CA institute membership fee	5,000	
Depreciation on car (75% on 10,000)	7,500	
Depreciation on furniture	7,000	7,41,250
Taxable Professional Income		53,750

Illustration: 3

From the following statement, compute the income from profession of Dr. S. Kamal if accounts are maintained on cash / receipt system

Particular's	Amount	Particular's	Amount
To Dispensary rent	36,000	By visiting fees	45,000
To Electricity and water charges	6,000	By consultation fees	1,25,000
To Telephone expenses	6,000		
To Salary to nurse and compounder	36,000	By sales of medicines	72,000
To Dep. on surgical equipment	6,000		
To Purchase of medicines	36,000	By Dividends	5,000
To Depreciation of medicines	4,000		
To Income Tax	5,500		
To Donation to Rama Krishna Mission	4,000		
To Motor Car expenses	9,600		
To Dep. on Car	4,800		
To Net Income	93,100		
	2,47,000		2,47,000

Note;

1. Electricity and water charges include domestic Bill of 2,500
2. Half of motor car expenses are for professional use
3. Telephone expenses include 40% for Personal use
4. Opening stock Of medicines was 6,000 and closing stock was 4,000

Solution;

Computation of professional income (on cash bases) of dr. S. K. Kamalfor the a/y 2019-2020

Particulars	Amount	Amount
Professional receipts;		
Visiting fees	45,000	
Consultation fees	1,25,00	
Sale of medicines	72,000	2,42,000
Less; Professional expenses		
Dispensary rent	36,000	
Electricity and water charges (6,000-2,500)	3,500	
Telephone expenses (6,000 × 60%)	3,600	
Salary of staff	36,000	
Depreciation of surgical equipment	6,000	
Cost of medicine (6,000+36,000-4,000)	38,000	
Depreciation on x- ray machine	4,000	
Motor car expenses (9,600-4,800)	4,800	
Depreciation on car(4,800-2,400)	2,400	1,34,300

Professional gain		1,07,700

Illustration 4

Mr. Divakar & company are chartered accountants in Delhi. They have submitted the following Income and expenditure account for the Year. Compute the Income from profession.

Expenses	Amount	Income	Amount
To Drawings	48,000	By Audit fees	2,24,000
To Office rent	42,000	By Financial Consultancy	98,000
To Telephone installation		service	
charges	15,000	By Dividends from an Indian	6,000
under O,Y.T. scheme	4,200	By company (Gross)	4,000
To Electricity Bill	66,000	By Dividend on units of UTI	24,000
To Salary of Staff	1,200	By Accountancy works	
To Charities	9,600		
To Gifts given to relatives	21,000		
To car Expenses	2,500		
To Subscription for Journals	1,200		
To Institute fee	12,000		
To Stipends given to trainees	1,33,300		
To Net Income			
	3,56,000		3,56,000

Note:

1. Depreciation of car during the year amounts to 5,000.
2. 30% of the time car is used for personal purposes.

SOLUTION :

Computation of income from profession of M/s Diwakar &Co

Particulars	Amount	Amount
Professional Receipts		
Audit fees	2,24,000	
Financial consultancy works	98,000	
Accountancy works	24,000	
Gross Professional Receipts		3,46,000
Less: Professional Expenses		
Office rent	42,000	
Telephone Installation Charges	15,000	
Electricity Bill	4,200	
Salary of Staff	66,000	
Car Expenses [21,000x 70%]	14,700	
Subscription for journal	2,500	
Institute fees	1,200	
Stipends to trainees	12,000	
Depreciation	3,500	1,61,100

Professional Gain		1,84,900

Exercise:

Problem 1

Ram prasad is a registered medical practitioner. He has prepared the following Income and expenditure account for the Year during 31st March, 2019. You are required to prepare a statement showing his income from profession.

Income and Expenditure Account

Particulars	Amount	Particulars	Amount
Household Expenses	20,000	Consultation fees	10,000
Car purchased	30,000	Visiting fees	20,000
Travelling Expenses (Personal)	4,000	Gains on Race (gross)	10,000
Charity & Donations	1,000	Share in sale proceeds of an	
Income Tax	2,000	ancestral house	34,000
Salaries	8,000	Profit on sale of securities	6,000
Gift to daughter	7,000	Dividend on shares (gross)	5,000
Establishment Exp.	1,000	Interest on P.O. Savings Bank	600
Surgical Equipment	4,000	Gifts from Father-in-Law	2,000
Books	2,000	Bad debts recovered (Not	
Life Insurance premium	2,000	allowed in earlier year)	2,000
Wealth-Tax	1,000	Interest on fixed deposit	1,300
Interest on Capital	1,000		
Surplus	7,900		
	90,900		90,900

Rate of depreciation allowable on car is 15% and surgical equipment's is at 15%. In case of books for profession the rate of depreciation is 60%.

[Hints : Professional gain 14,700]

Problem 2.siva, a practicing chartered accountant submits you the following income and expenditure account for the year ended 31st march 2019. Compute his professional income.

Expenditure	Rs.(A)	Income	Rs. (A)
To Office rent	40,000	By Audit fees	90,000
To Office expenses	20,000	By Accountancy works	40,000
To Staff salaries	30,000	By Rent from property	20,000
To Books and journals	6,000	By Dividends	10,000
To Insurance (let out house)	40,000	By Interest on bank	
To General expenses	10,000	Deposit	22,000
To Travelling expenses	8,000	By Financial consultancy	28,000
To Municipal taxes	4,000	By Examiners fees	30,000
To House hold expenses	10,000	By lottery winnings	15,000
To Donations	5,000	By Gifts from clients	10,000
To Stationery, printing	15,000		
To Depreciation on office Equipment	8,000		
To Surplus	69,000		
	2,65,000		2,65,000

Additional information

1. Gifts worth A 6,000 received from relatives.
2. Closing stocks stationeryA 2,000
3. Salaries include A 10,000 paid to domestic servant.

[Ans: A 67,000]

Problem 3

Mr. Prasad is a leading tax consultant, who maintain his books of account on each basis furnishes the following particulars for the year ending 31st march,2019.

Receipts and Payments Accounts for the year ended 31-03-2019

Receipts	Rs.(A)	Payments	Rs. (A)
Balance b/d	16,000	Purchase of computer	30,000
Fees from clients		Car expenses	20,000
2017-18	40,000	Office expenses	10,000
2018-19	1,60,000	Salary to staff	
Gifts from clients	20,000	2017-18	12,000
Examiner's Fees	10,000	2018-19	28,000
		Repairs	5,000
		Income-Tax	8,000
		Life insurance	12,000
		Balance c/d	1,21,000
	2,46,000		2,46,000

Notes:

1. Depreciation on computers 60 %
2. Depreciation on motor car A 10,000. Car is used partly for official and partly for private purposes. The A.O. felt that 40 % of car's use in attributable to private purpose. Compute professional income for the Assessment Year 2019-20.

Problem 4

The following is the Receipts and Payments Account of a Medical practitionerDr.Shyamfor the year ended31-3-2019.

Receipts and Payments Account for the year ended 31-3-2019

Receipts	Rs	payments	Rs
To Balance b/d	1,20,000	By Clinic rent	25,000
To Visiting fees	80,000	By Staff salaries	80,000
		By Rent and taxes	
To Consultation fees	65,000	By Electricity & water	25,000
To Sale of medicine	45,000	charges By Purchase of	14,000
To Operation theatre rent	25,000	medical books	
To Dividend	25,000	(annual publication)	
		By Purchases of	
		Surgical equipment	
		By Motor car expenses	14,000
		By Medical association members	40,000
		fees By Audit fees	10,000
			5,000
		By Staff welfare expenses	20,000
		By Diwali expenses	12,000
		By Entertainment	6,000
		expenses By Medicines	12,000
		purchased	30,000
		By Balance c/d	67,000
	3,60,000		3,60,000

Additional Information:

a) Giftfrompatient74,000was given to him by apoatient not included in the account.

b) 1/4ofMotorcarexpensesrelatetopersonaluse.

c) The rate of depreciation on surgical equipment is15%.

d) Interest received is on Bank deposits.

e) Auditfeeincludeincometaxappealexpensesof710,000.

Compute his taxable income from profession for the assessment year 2019-20.

[ans Loss from Profession 37,500]

Short Answer Type Questions

1. Define profession.
2. Mention any four professional incomes to the doctor.
3. Mention any four professional incomes to the chartered accountant.
4. Mention any four professional income to the lawyer.
5. Mention any four professional expenses.
6. Write briefly differences between business and profession.

Ψ

UNIT 3
Income from Capital Gains

Learning Objectives

After studying this unit, the student will be able to

- Understand about Capital gain
- Understand about long term capital gain
- Learn about cost of acquisition
- Learn about taxable capital gain

'Capital Gains' is the fourth head of income. Under this head of income we study the computation and taxability of gain arising from the sale or transfer of capital assets. For the first time income was made chargeable to tax in 1947-48. This charge was abolished from 1-4-1948. But it was revived from the assessment year 1957-58 and has continued since then. The taxability of income under this head depends upon the following factors:

1. Capital asset
2. Nature of capital asset
3. Sale or transfer of capital asset.

Basis of charge [Section 45]

Any profit or gain arising on the transfer of a capital asset [Sec.2 (14)] is chargeable to tax under the head 'Capital Gains' in the previous year in which the transfer tool place (Sec. 45), if it is not eligible for exemption under Sections 54,54B,54D,54EC,54F,54G,54GA and 54H. Incidence of tax on capital gains,

Types of Capital Assets Capital Assets Nature of Capital Assets

1. Financial Assets Shares, listed debentures / government securities, units of UTI / mutual funds, and zero coupon bonds	1. If CA is held for < 1 Year = it is a STCA 2. If CA is held for > 1 Year = it is a LTCA
2. Depreciable Assets	Always treated as STCA
3. Other Assets	1. If CA is held for < 3 Years = it is a STCA 2. If CA is held for > 3 years = it is a LTCA

Note: 1. STCA = Short Term Capital Assets
2. LTCA = Long Term Capital Assets
3. CA = Capital Asset

4. For determining the nature of capital assets, the period of holding shall be counted from the date of purchase to the date of sale of capital asset by the assets .Further, if the asset is acquired by gift or will, the period of holding shall be counted from the date of purchase of capital asset by the previous owner to the date of sale of capital asset by the assets.

Meaning of Short Term Capital Assets and Long Term Capital Assets

If Financial assets held by the assets for a period of more than 12 months (from the date of acquisition to the date of sale), are treated as Long Term Capital Assets.

If the period of holding is 12 months or less, such specified assets are treated as Short Term Capital Assets.

Transfer of Capital Assets

The term transfer of capital assets includes sale, exchange, relinquishment, extinguishment, compulsory acquisition of asset under any law.

Note: The following transactions are not regarded as transfers: Transfer of capital asset by gift or will (gift of shares, debentures, warrants by the employer will be treated as transfer) and transfer of capital asset at the time of partition of HUF.

Capital Gain: Profit on transfer of capital loss is known as capital gain if loss is there then it is treated as capital loss. If there is no profit or loss then there is no capital gain . The difference between the consideration received and the cost of acquisitions capital gain or loss i.e .,If the sale price is more than the cost price then the difference is known as capital gain or if the sale price is less the cost price then the difference is known as capital loss.

Hint: Capital Gain =Selling price of the asset (-) cost of the asset.

Capital Loss = Cost of the asset (-) selling price of the asset.

Note:- If transfer expenses e.g . Selling expenses ,brokerage paid etc, are there the same is to be deducted from the sales money received.

Cost of Acquisition: Cost of acquisition means total of all the expenses incurred by the asset for acquiring the asset i.e., purchase price and expenses incurred after purchase till its first use e.g. installation charges etc.

If the cost of the asset cannot be ascertained for some valid reasons the Fair Market Value is taken as cost of acquisition.

Capital nature in making any addition or addition or alteration to the capital asset

If the asset has constructed or manufactured the asset then all expenses incurred by him on its construction or manufacture will be taken as cost of acquisition If the asset is purchased before 1st April 1981 then the cost of acquisition is higher of the following two amounts.

(a) Actual Cost (b) Fair Market Value on1-4-2001.

The benefit Is allowed for (i) depreciable assets i.e. Assets used in the business or profession like building and machinery and eligible for claiming the depreciation.
(ii)Intangible assets: Goodwill, tenancy rights, route permit licenses, loom hours.
Indexed cost of acquisition: Indexed cost of a acquisition means showing in flatter increased cost price, instead of actual price. The increase is
Justified on account of inflation. Then the result of indexed cost of acquisition is reduction in tax liability.

Cost of improvement: Cost of improvement means expenditure of

Transfer of Depreciable Assets-Capital Gain [Sec 50]

Depreciable assets are Buildings, Machinery, Plant and furniture owned by the asset and used in his business. Or profession The profit on transfer of these asset will be always treated as short term capital gain i..e. The period of asset the asset is holding shall not be considered.

If the asset is eligible to claim depreciation on an asset then profit on transfer of such asset is always treated as short term capital gain. In other words, on any business asset which depreciation cannot be claimed like land, investment etc then profit on transfer of such asset can be long term (if the period of holding is more than 3 years) or short term (if the period of holding is less than 3 years.)

Exemption from Long term Capital Gain under Sec. 54, 54B and 54D etc:

In order to promote investment in priority and specified areas, and to provide financial security of the individual Income Tax Act Provides a relief to the asset on transferring certain long-term capital assets. The net resultant is a substantial reduction in the tax liability. Generally, the following provisions are to be observed by the asset.

1. Purchase or construction or investment in the permitted line of investment with in the period of stipulation.

2. To avail the benefit of tax, the asset has to retain the ownership of new asset for minimum period of 3 years i.e. not to transfer the new asset for 3 years.

3. If the amount of Capital Gain is not utilized for purchase or for construction or investment in specified asset before the die date of filling the 'return of income', the amount can be deposited in any branch of public sector banks in accordance with the Capital gains Accounts Scheme 1988'. **The amount deposited will be given as exemption.** If part of the amount is spent for construction on purchase or for new specified investment and partly deposited in the bank within the stipulated period, then the aggregate of amount spend for constriction purchase etc, and amount deposited will be allowed as exemption. Latter on he can draw the amount from the bank and can go head for purchasing/ constructing the asset as the case may be.

(4) If the new asset is transferred before the stipulated period then the exemption availed earlier gets cancelled. The same amount shall be reduced from the cost of acquisition of the new asset to compute capital gain of the newly purchased asset.

Date of transfer [Section 2 (47)]

A transfer does not take place merely because an agreement has been entered into or consideration is paid there under in whole or in part. The word 'effected in the previous year in section 45 denotes that the title in the property has passed from the transferor to transferee. No transfer can be said to be effected till all the formalities for transferring the title to the transferee are completed.

Computation of Capital Gains [Section 48]

Computation of capital gain depends upon the nature of capital asset transferred viz., short -term capital asset or long –term capital gain while the gain arising from the transfer of long-term capital asset is known as long-term capital gain.

Short term capital gain or loss shall be computed by deducting the following amounts from the full value of sale consideration.

(i) Expenses incurred in connection with the transfer or sale of asset (i.e., selling expenses)

(ii) Cost of acquisition of asset.

(iii) Cost of improvement of the asset.

Long term capital gain or loss shall be computed by deducting out of full value of sale consideration the following amounts.

Here is the table showing all the CII numbers for FY 2001-02 to FY 2018-19:

Financial Year	**CII Number**
2001-02	100
2002-03	105
2003-04	109
2004-05	113
2005-06	117
2006-07	122
2007-08	129
2008-09	137
2009-10	148
2010-11	167
2011-12	184
2012-13	200
2013-14	220
2014-15	240
2015-16	254
2016-17	264
2017-18	272
2018-19	280

Computation of Capital Gain depends upon the nature of Capital Asset transferred , viz., Short-Term Capital Asset or Long-Term Capital Asset. The Tax incidence is generally higher in the case of Short-Term Capital Gain as compared to Long-Term Capital Gain.
The method of computation of Short-Term and Long-Term Capital Gain is as follows :

Computation of Short-Term Capital Gain	*Computation of Long-Term Capital Asset*
1. Find out full value of consideration 2. *Deduct* the following : a. expenditure incurred wholly and exclusively in connection with such transfer b. Cost of acquisition c. Cost of improvement 3. From the resulting sum deduct the exemption provided by Sec. 54, 54B, 54D, 54EC, 54G, and 54 GA. 1. The balancing amount is Short-Term Capital Gain.	1. Find out full value of consideration 2. *Deduct* the following : a. expenditure incurred wholly and exclusively in connection with such transfer b. indexed cost of acquisition c. indexed cost of improvement 2. From the resulting sum deduct the exemption provided by Sec 54, 54B, 54D, 54EC, 54G, and 54 GA. 3. The balancing amount is Long-Term Capital Gain.

Note : No deduction will be allowed in respect of payments of Securities Transaction Tax (STT) in computing income under the head “Capital Gain”.

Section 48. Computation of STCG		Section 48. Computation of LTCG	
Full value of consideration	xxx	Full value of consideration	xxx
(–) Cost of Acquisition (COA)	(xxx)	(–) Indexed Cost of Acquisition (COA)	(xxx)
(–) Cost of Improvement (COI)	(xxx)	(–) Indexed Cost of Improvement (COI)	(xxx)
(–) Expenses on transfer	(xxx)	(–) Expenses on transfer	(xxx)
STCG	**xxx**	**LTCG**	**xxx**

Formula for indexation	
Indexed COA =	**Indexed COI =**
$\dfrac{\text{Index value of transfer year}}{\text{Index value of acquisition year in which the assessee first acquired the asset}} \times \text{COA}$	$\dfrac{\text{Index value of transfer year}}{\text{Index value of improvement year}} \times \text{COI}$
Note : No Indexation bonds or debentures even if LTCA. [Proviso 3 to S 48] However indexation shall be done for Sovereign Gold Bond	

S 48. Full Value of Consideration (FVC)		
General cases	Consideration in cash	Amount received or receivable.
	Consideration in kind	FMV of asset.
Special Cases	50C	Land & Building : Higher of Stamp value or consideration.
	45(1A)	Insurance claim.
	45(2)	FMV on date of conversion of asset into SIT.
	45(3)	Admission of partner. Amount recorded in books of accounts.
	45(4)	Dissolution of firm. FMV as on date of distribution.
	45(5)	Initial compensation.

Article Explains all about **Section 54, Section 54B, Section 54D, Section 54G/ 54GA in case of shifting to SEZ, Section 54EC, Section 54F and Section 54GB**

S.No.	Basis	Section 54	Section 54B	Section 54D
1.)	Allow ability	Exemption is Allowed provided the Assessee has **Long Term** Capital Gains on transfer of Residential House	Exemption is Allowed provided the Assessee has Capital Gains on transfer of Agricultural Land	Exemption is Allowed provided the Assessee has Capital Gains on Compulsory Acquisition of Industrial Undertaking.
2.)	Allowed To	Individual/HUF	Individual/HUF	All Assessees
3.)	Conditions to be Satisfied	a.) The Asset Should have	a.) The Assessee Should have	a.) The Assessee Should have Invested

		purchased one Residential in India house either one year before or two years after the date of transfer **OR** The Assessee should Construct one residential house in India within three years after the date of transfer	purchased one or more Agricultural Land within a period of two years after the date of transfer	the Amount in Land and Building for the purpose of Industrial Undertaking within a period of Three years after the date of Payment by Government.
		b.) The Assessee Should either Purchase or Construct only one House within the specified time period.	b.) The Assessee or his parents or HUF should have been using Agricultural Land so transferred for a period of at least 2 years at the time of Sale	b.) The Assessee should have been using such Land and Building for the purpose ofIndustrialUndertaking for a period of atleast 2 years at the time of Acquisition.
		c.) The House so purchased or constructed should not be transferred for a period of at least Three Years	c.) The Land so purchased should not be transferred for a period of at least Three Years	c.) The Land and Building so purchased should not be transferred for a period of at least Three Years
4.)	Amount of Exemption	Amount of Exemption shall be equal to Amount Invested(Subject to Capital Gains)	Amount of Exemption shall be equal to Amount Invested(Subject to Capital Gains)	Amount of Exemption shall be equal to Amount Invested(Subject to Capital Gains)
5.)	Capital Gain Accounts Scheme,1988 Applicability*	Applicable	Applicable	Applicable
6.)	Consequences	If Assessee Violates	If Assessee Violates Condition c.) stated	If Assessee Violates Condition c.) stated

		Condition c.) stated above Exemption earlier allowed shall be withdrawn in special manner i.e. While Computing Capital Gains, Cost of Acquisition shall be reduced by the amount of exemption earlier taken.	above Exemption earlier allowed shall be withdrawn in special manner i.e. While Computing Capital Gains, Cost of Acquisition shall be reduced by the amount of exemption earlier taken.	above Exemption earlier allowed shall be withdrawn in special manner i.e. While Computing Capital Gains, Cost of Acquisition shall be reduced by the amount of exemption earlier taken.

S. No.	Basis	**Section 54EC**	**Section 54F**	**Section 54GB**	Section 54G / Section 54GA
1.)	Allow ability	Exemption is Allowed provided the Assessee has long term Capita l Gains on transfer of any long term Capital Asset (bein g land or building or both wef A/y 2019-20)	Exemption is Allowed provided the Assessee has Long Term Capital Gains on transfer of any Capital Asset except Residential House	Exemption is Allowed provided the Assessee has Long Term Capital Gains on transfer of any Residential House or Plot.	Exemption is Allowed provided the Assessee has Capital Gains in connection with shifting of Industrial Undertaking from Urban area to any other area.
2.)	Allowed To	All Assessee	Individual/ HUF	Individual/ HUF	All Assessee
3.)	Conditions to be Satisfied	a.) The Assessee	a.) The Assessee Should have purchased	a.) The Assessee Should have	a.) The Assessee Should have

		Should have Invested the Amount in Long Term Specified Asset within a period of Six Months from the date of transfer. However from the Assessment Year 2018-19 investment in any bonds redeemable after three years shall be eligible for exemption. WefA/y 2019-20 investment in any bonds redeemable after five years shall be eligible for exemption	one residential house property in India either one year before or two years after the date of transfer OR The Assessee should Construct one residential house property in India within three years after the date of transfer	Incorporated a new company before due date of filling of Return of Income & Should have subscribed to more than 50% of the Shares of the Company. b) This provision is not applicable to any transfer of residential property made after the 31st day of March, 2017 . however for investment in eligible start-up the transfer can take place up to 31.03.2018	Invested the Amount in Land and Building or P&M (Not Furniture & Fixture for the purpose of Industrial Undertaking either one year before or three years after the date of transfer
		b.) The Assessee is not allowed to Convert the Security into Cash i.e. The	b.) The Assessee Should either Purchase or Construct only one House within the specified time period. Also, the Assessee should not have more than one house in his	c.) The Assessee Should Invest the Amount in Plant & Machinery within one Year from the date of Purchase of Shares.	Exemption shall also be allowed for shifting expenses

		Assessee is not allowed to take Loan on the basis of security	name at the time of transfer of original asset income from which is charged under the head Income from house property		
		c.) The Asset so purchased should not be transferred before 3 years (5 years if the investment in specified asset is made on or after 01.04.2018)	c.) The House so purchased or constructed should not be transferred for a period of at least three Years d) if the assessee purchases, within the period of two years after the date of the transfer of the original asset, or constructs, within the period of three years after such date, any residential house, the income from which is chargeable under the head "Income from house property", other than the new asset,	d.) The shares and Plant & Machinery so purchased should not be transferred for a period of at least Five Years.	c.) The Asset so purchased should not be transferred for a period of atleast three years.
4.)	Amount of Exemption	Amount of Exemption shall be equal to Amount Invested (Subject to Capital Gains)	Amount of Exemption shall be equal to Capital Gains ÷Net Consideration ×Amount of Investment	Amount of Exemption shall be equal to Capital Gains ÷Net Consideration ×Amount of Investment (Subject to Capital Gains)	Amount of Exemption shall be equal to Amount Invested in Land & Building and Plant & Machinery (Not Furniture &Fixture) (Subject to Capital Gains)
5.)	Capital Gain Accounts Scheme,1988 Applicability*	Not Applicable	Applicable	Not Applicable. However If Assessee fails to make investment in P&M within one year then amount shall be	Applicable

				deposited into Specified Bank Account	
6.)	Consequences	If Assessee Violates Condition c.) stated above Exemption earlier allowed shall be considered to be Long Term Capital Gain of the Year in which the Asset has been transferred.	If Assessee Violates Condition c &d stated above Exemption earlier allowed shall be considered to be Long Term Capital Gain of the Year in which the Asset has been transferred.	If Assessee Violates Condition d.) stated above Exemption earlier allowed shall be withdrawn and shall be deemed to be the income of the assessee chargeable under the head "Capital gains" of the previous year in which such equity shares or such new asset are sold or otherwise transferred,	If Assessee Violates Condition c.) stated above Exemption earlier allowed shall be withdrawn in special manner i.e. While Computing Capital Gains, Cost of Acquisition shall be reduced by the amount of exemption earlier taken.

ILLUSTRATION 1

Mr. Santoesh sold a house on 1-9-2018 for Rs. 15,00,000. This house was inherited by him during 2001-02 from his father who had constructed it in 1991-92 for Rs.50,000 Mr. Santoesh spent Rs.50,000 on renovation of the house in 2006-07. Fair market value of the house as on 1-4-2001was Rs.4,50,000.

This house was under negotiations for sale in May, 2010 and he received Rs. 20,000 as advance money. The contract could not materialize and the advance money was forfeited. Compute the amount of capital gain assuming that he does not qualify for any exemption.

(C.I.I for 2001-02:100, 2006-07:122, 2010-11:167, 2018-2019:280)

SOLUTION

Computation of Capital Gain (Assessment year 2019-20)

particulars	Amount	Amount
Sale price on 1-9-2018		15,00,000
Less: Cost of acquisition 4,50,000		
Less: Advance money forfeited 20,000		
Net Cost 4,30,000		
Indexed cost (4,30,000x280/122)	9,86,885	
Indexed cost of improvement (50,000x280/122)	1,14,754	1101639
Long term capital gain		398361

Note: Advance money forfeited has been deducted from cost of acquisition as advance was received and forfeited prior to 1-4-2014, i.e., during the previous year 2013-14.

ILLUSTRATION 2

Mr. A purchased a piece of land for Rs. 5,00,000 during the previous year 2001-02. In 2005-06 he agreed to sell it to Mr. B for Rs.9,00,000 and accepted an advance money of Rs. 50,000. Mr. B however, filed to honor his promise and could not het the sale deed executed in his favors within stipulated time. As a result the advance money was forfeited by Mr. A. Now

(a) Mr. A has sold this land during this land during year2018-19 for Rs. 20,00,000. Determine the amount of capital gains chargeable to tax in the hand of Mr. A.

(b) Suppose Mr. A received advance money in May2016 and forfeited the same as the buyer could not pay the balance amount within stipulated period of 3 months.

(c) Suppose Mr. A transferred this land to Mr. C under a gift deed during 2012-13 and land is sold by Mr. C for Rs. 20,00,000 during 2017-18 calculate capital gain in the hand of Mr. C

(C.I.I for 2001-02:100, 2005-06:117, 2012-13:200, 2018-19:280)

SOLLUTION

(a) **Calculation of taxable capital gain of Mr. A for A.Y. 2018-19 Rs**

particulars	Amount	Amount
Full value of consideration		20,00,000
Less: Advance forfeited in 2005-06		Nil
Net consideration		20,00,000
Less: (i) Indexed cost of acquisition		
Cost in 2001-02		
Less: Advance forfeited in 2005-06		
	5,00,000	
(ii) Indexed cost of acquisition	50,000	
(4,50,000/100x280)	4,50.000	
	12,60,000	12,60,000
Taxable capital gain		7,40,000

Note: Advance money forfeited has been deducted from cost of acquisition as it was forfeited prior to 1-4-2014 (b)Calculate of taxable capital gain for the A.Y.2018-19

particulars	Amount	Amount
Full value of consideration Less: Expenses on transfer Net consideration	20,00,000 Nil	 20,00,000
Less: (i) Indexed cost of acquisition Cost in 2001-2002 Rs. 5,00,000 ((5,00,000/100) x0280) (ii) Indexed cost of improvement	14,00,000 nil	 14,00,000
Taxable Long Term Capital Gain		6,00,000

Note: Advance received and forfeited during the previous year 2013-14 or before shall be reduced from the actual cost of the asset wile calculating indexed cost of acquisition. In this case, advance money was forfeited in the previous year 2016-17, here cost is not to be reduced. But the amount of advance received is taxable in the year in which advance is forfeited and it is taxable as income from other sources.

(c) Calculation of taxable Capital gain of Mr. C for A.Y 2018-19

particulars	Amount	Amount
Full value of consideration Less: Expenses on transfer Net consideration	20,00,000 Nil	 20,00,000
Less: (i) Indexed cost of acquisition Cost to previous owner Rs. 5,00,000 P.Y of Receipt of Gift 2018-19 ((5,00,000/200)x0280) (ii) Indexed cost of improvement	7,00,000 Nil	7,00,000
Taxable Long Term Capital Gain		13,00,000

Note: Advance money forfeited by previous owner (i.e Mr. A) is not to be reduced from cost of acquisition while calculating capital gain in the hands of the present owner (i.e. Mr. C)

ILLUSTRATION 3

Find out the Indexed cost in following cases (separately for each case) for the assessment year 2018-19:

(a) Cost of plot acquired in 2006-07 for - 80,000

(b) Cost of house purchased in 1998-99 for - 90,000
Fair market value on 1-4-2001 being 1,50,00

(c) Cost of house purchased in 1996-97 for Rs. 2,00,000 but F.M.V on 1-4-2001 - 4,00,000
(C.I.I for 2001-02:100, 2006-07:122, 2018-19:280)

SOLUTION

COMPUTATION OF INDEXED COST

(a) Cost in 2006-07=80,000
Indexed cost=80,000*280/122=1,83,606

(b) Cost in 1998-99=90,000
F.M.V on 1-4-2001 is Rs. 1,50,000
Indexed cost=1,50,000*280/100= 4,20,000

(c) Cost in 1996-97 is Rs. 2,00,000
Or F.M.V on 1-4-2001 is Rs. 4,00,000
Indexed Cost =4,00,000*280/100= 11,20,000

ILLUSTRATION 4

Assessee A is the investor in shares and held 1,000 shares of Rs. 10 each in a company. On 31st March, 2012 he was allotted 1,000 bonus shares of the face value of Rs. 10 each. The cost of acquisition of original shares was Rs. 12 each. During the previous year ending 31st March, 2018 assessee sold 500 shares out of his Bonus Shares @ Rs. 14 per share. Compute the capital gain for the assessment year 2018-19 if cost inflation index for 2011-12 is 184 and 2018-19 is 280.

SOLLUTION

Sale price of 500 shares @Rs. 14 per share	7,000	
Less: Cost of 500 Bonus shares	nil	
L.T. Capital Gain		7000

Cost of Improvement (Section 55(1))

(a) In relation to a capital asset being goodwill of a business cost of improvement shall be taken to be nil; and

(b) In relation to any other asset the amount spent by assessee on improving the asset after its acquisition

The improvement to be so taken in to account should be of such capital nature as it does not fall in deductions allowed while computing the income chargeable under the heads:

(i) Income from house property,

(ii) Profits and gains of business or profession, and

(iii) Income from other sources.

ILLUSTRATION 5

Compute the taxable capital gain from particulars given below:

(i) Net consideration of a residential house Rs. 10,00,000 (2-6-2018) (C.I.I :280)

(ii) Cost of acquisition of this house Rs. 2,10,000 (1-5-2007) (C.I.I :129)

(iii) Amount invested in rural electrification bonds on 1-9-2018 for Rs. 2,00,000

SOLLUTION

particulars		**Amount**
Computation of Capital Gain		
Net Consideration	10,00,000	
Less: Cost (Indexed 2,10,000x280/129)		4,55,814
Long term capital gain	5,44,186	
Less: Exempted u/s 54 EC—Cost of new house		2,00,000
Taxable long- term capital gain	**3,44,186**	

(Adapted extract from Circular N. 495—Explanatory notes on the Finance Act 197 F No.131/29/87 T.P.L. dated 22nd Sept. 1987)

ILLUSTRATION 6

Mr. Venkateswara sold a plot of land at Jaipur on 1-6-2018(C.I.I=280) for Rs. 14,40,000. He paid Rs. 40,000 as selling expenses. The plot was received by him on the death of his father on 15-3-2008 (C.I.I-113) His father had acquired on 1-04-1990 for Rs.1,00,000 and its F.M.V on 1-4-2001 was Rs.3,10,000.

On 1-10-2018 he invested Rs. 3,00,000 in bonds issued by Rural Electrification Corporation Limited notified u/s 54EC and Rs.2,00,000 o 1-3-2019 in bonds of National authority of India.

Compute his taxable capital gain

SOLUTION

Computation of taxable capital gain

Particulars	Amount Rs	Amount Rs.
Long term capital asset:		
Sale price of plot as on 1-6-2018	14,40,000	
Less: Expenses on sale	40,000	
Net consideration		14,00,000
Less: Indexed cost [3,10,000x280/113]		7,68,142
Long term capital gain		6,31,858
Less: Exemption u/s 54EC		
Amount invested in bonds of Rural Electrification Corp.	3,00,000	
Less: Exemption u/s 54EC :		
Investment in Bonds of National Highway Authority of India		
Not allowed as investment was made after a period of more than 6 months i.e. on 1-3-2018	Nil	3,00,000
Taxable Long Term capital gain 3,31,858		

Amount of exemption

In case assessee invests the full amount of net consideration in the purchase or construction of a residential house, then full amount of long term capital gain shall be exempted. But if the assessee invests only a part of the net consideration then only a proportionate part of capital gains shall be exempted i.e., so much capital gain shall be exempted as it is in proportion of amount invested to net consideration.

Exempted Capital gain =L.T Capital gain x Amount invested to purchase or to construct a residential house
----

Example

Sale consideration received for the sale of a plot		10,10,000
Less: Selling expenses		10,000
Net Sale consideration		10,00,000
Less: Indexed cost of acquisition	4,00,000	
Long term capital gain		6,00,000

In case invests full net consideration of Rs 10,00,000(or even invests more than net sale consideration) then the full amount of capital gain of Rs. 6,00,000 shall be exempted but in case he invests only 80% of net consideration, the only 80% of capital gain shall be exempted and the balance will be taxable.

Exercise:

QUESTION NO. 1

Find out the indexed cost of following long term capital assets if they are sold during the previous year 2017-18:

Sr .no.	Asset	Year of Purchase	cost	FMV on 1-4-2001
1.	Jewellery	2004-05	80,000	------
2.	Bonds	2006-07	2,00,000	------
3.	House	2010-11	4,00,000	------
4.	Plot inherited in acquired by father	1999-2000	-1,00,000	
		1998-1999	2,00,000	

C.I.I for 2004-05 is 113, for 2006-07 is 167 and 2018-19 is 280.

(Hints : Indexed cost jewellery, Rs. 1,98,230; Bonds –No indexing; house Rs. 6,70,658 and plot Rs. 5,60,000)

QUESTION NO.2

Mr. Shyam a non-resident sent $ 1,80,000 to India on 1-7-2001. On 1-11-2001 part of this money was utilized to purchase 15,000 shares of A ltd. an Indian company @ Rs. 400 per share. On 15-3-2019 these shares were sold @ Rs. 810 per share. Compute the capital gain if telegraphic transfer rates are as follows:

	1-7-2001 (for US $)	1-11-2001 (for US $)		15-3-2018 (for US $)
Buying rate	38.40	36.80	61.80	
Selling rate	37.20	37.60	64.20	

[**Hints**: Long term capital gain RS. 19,50,830 Fully exempted u/s 10(38)]

QUESTION NO.3

Mr. Raghuveer purchased a house in Udipi in 1996 for RS. 1,50,000. He incurred the following expenses for the improvement of the house.

Renovation of the house Rs. 1,25,000 and additions of 2 rooms after one year Rs. 2,00,000. The F.M.V of the house on 1-4-2001 was Rs.6,10,000. He sold the house in May 2017 for Rs. 21,00,000.

He purchased another house property within 2 months for RS. 3,00,000 and invested in Capital gain Account scheme Rs. 50,000. Calculate taxable capital gain for the previous year 2017-18. Cost inflation index for 2001-02 was 100 for 2018-19 is 280.

[**Hints**: F.M.V on 1-4-2001 as cost; Exemption u/s 54 Rs.3,00,000 u/s 54(2) Rs.50,000 allowed; taxable L.T capital gain Rs. 42,000]

QUESTION NO. 4

Mr. Singh purchased a plot in 2002-03 for Rs.4,00,000. It was sold on 15-1-2019 for Rs.14,80,000 and he paid Rs. 20,000 as brokerage charged. He invested Rs. 2,00,000 in Bonds of National Highway Authority of India on 31-3-2019 and Rs. 3,10,000 in bonds issued by Rural Electrification Corporation Ltd. on 1-6-2019 Compute the taxable capital if C.I.I for 2002-03 was 105 and for 2018-19 is 280.

[**Hints**: L.T.C gain of Rs.3,93,333 Exemption u/s 54EC RS.3,93,333; Exemption u/s 54EC for Rural Electrification Bonds and NHAI shall be allowed as amount of capital gain was invested within 6 months from the date of sale; Taxable capital gains NIL]

Short answers:

1. What is capital Assets
2. Write about various types of capital assets
3. What is cost of acquisition.

Ψ

UNIT 4
Income from Other Sources

Learning Objectives

After studying this unit, the student will be able to

- Understand about securities, gross interest & Net interest
- Understand about taxable and tax free securities
- Learn about gross income
- Learn about income from other sources

Introduction

'Income from other sources' is the fifth and last head of income under the Income Tax Act,1961. An income which does not specifically fall under the proceeding first four heads of income (viz. Income from salaries, Income from house property, profits and gains of business or profession and capital gains) is to be included under this head. That is called "Income from other sources"

The following are the some of the items of incomes which are included under the head of Income from other sources.

1. Royalties received
2. Director's sitting fee for attending board meetings.
3. Salary on pension received from a foreign Government.
4. Income from subletting of the premises taken on lease.
5. Salary received by MPs, MLAs.
6. Examination remuneration received by teachers/lecturers/professors.
7. Ground rent received.
8. Interest on loan, saving banks or fixed deposits.
9. Agricultural income received from outside India.
10. Gratuitous payments received by a member of the family from a company in which the family had substantial interest.
11. Income from subletting the house property.
12. Director's commission for underwriting shares of a new company.
13. Rent from a vacant piece of plot (land).
14. Insurance commission.
15. Casual incomes.
16. Annuity payable under a will, contract, trust deed.

17. Interest on securities issued by a foreign government.
18. Family pension received by family members of a deceased employee.
19. In case of retirement, interest of employee's contribution if provident fund is unrecognized.
20. Income from undisclosed sources.
21. Annuity payable to the lender of a trade mark.
22. Income from markets, fisheries, rights of ferry.
23. Income received after discontinuance of business.
24. Income of a minor clubbed with income of parents (exemption uptoA1,500 for each child).
25. Pension received from the government as freedom fighters.
26. Income from racing establishments.
27. Commission received (eg. Chit funds commission).
28. Income from interest on securities (securities means bonds issued by the government and debentures of a limited company).
29. Dividends received from foreign company.
30. Winning from lotteries, gambling, betting, cross word puzzles in the nature of casual income.

Exceptions

Gifts of money received by an individual or an HUF is not taxable in the following cases.

1. Gift received from any relative.
2. Gift received on the marriage of the individual.
3. Gift received under a will or by inheritance.
4. Gift received in contemplation of death of the donor.

Meaning of 'Relative'

1. Spouse of the individual.
2. Brother of sister of the individual.
3. Brother or sister of the spouse of the individual.
4. Brother or sister of father/mother of the individual.
5. Any lineal ascendant or descendent of the individual.
6. Any lineal ascendant or descendent of the spouse of the individual.
7. Spouse of the persons referred to in clause 2 to 6.

Interest on Securities [Sec.56(2) (1d)]

Income by way of interest on securities is taxable under the head "income from other sources", if the same is not taxable as business income under section 28. But then, what is a security?

"A security is a document acknowledging the debt by a specific authority from general public. It may be names as a Debt, Loan, Paper, Debenture, Bonds, or Security or Certificate. It is secured in some manner. A mere debt is not a security unless and until it is secured".

Contents of Security

It contains face value of security, date of maturity rate of interest, date, place and period of payment of interest.

Types of Securities

Securities are issued by Companies, Government both Central and State. Local authorities are also eligible to raise funds by issuing securities; Following are the types of securities which are currently in operations;

(a) Securities issued by Central Government.

(b) Securities issued by the State Government.

(c) Debentures and bonds issued by local authority.

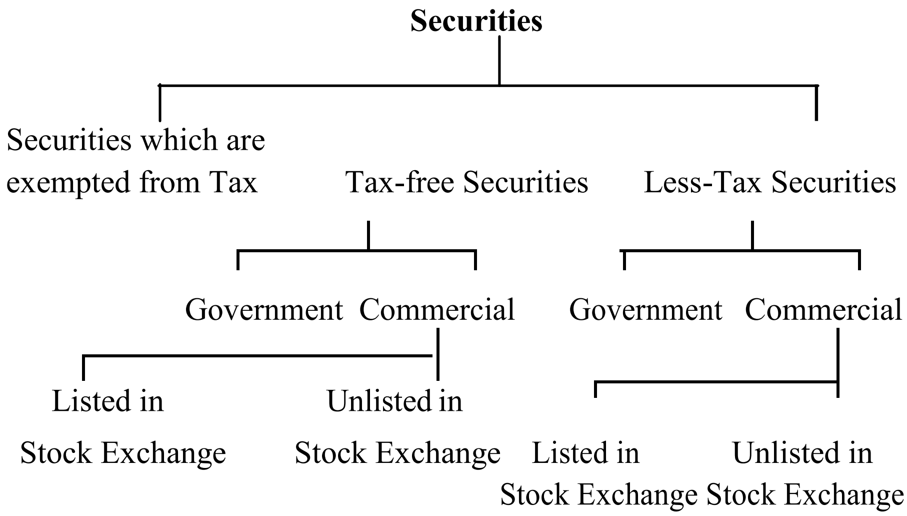
(d) Debentures and bonds issued by corporations.

(e) Debentures issued by companies.

From the tax point of view securities are classified into three types.

They are:

1. Securities which are exempted from tax
2. Tax- Free Securities
3. Less-tax securities



Securities Exempt from Tax

According to Section 10 (15) interest on these securities is fully exempt from tax and does not form part of total income of an assessee. In other words, it is not taken into account in computing total income. Under section 10 (15)(i) the Central Government by notification specifies these securities, bonds etc. The following are the securities which are exempt from tax:

1. 12 year National Savings Annuity Certificates
2. National Defense Gold Bonds 1980
3. Special Bearer Bonds 1991.
4. Treasury Savings Deposit Certificates
5. Post Office Cash Certificates (5years)
6. National Plan Certificates (10 years)
7. National Plan Savings Certificates (12 years)
8. Post Office National Savings Certificates (12 Years/7 years)
9. Post office Savings Bank (POSB) Account.
10. Public Accounts of Post Office Savings Account Rules
11. Post Office CTD (Interest up to A 5,000)
12. Fixed Deposit
13. Special Deposit Scheme 1981.
14. Non- Resident Rupee Deposit Scheme
15. Interest on 7 percent Capital Investment Bonds
16. Interest received by a Non Resident Indian from Notified Bonds

17. Interest on 9 percent Relief Bonds
18. Interest Payable to any Foreign Bank Performing Central Bank functions outside India
19. Interest on Gold Deposit Bonds issued under Gold Deposit Scheme 1999.
20. Interest on deposit made by retired Government Employee out of money due to him on account of retirement for lock-in-period of 3 years.
21. Interest on Securities held by the Welfare Commission, Bhopal Gas Victims
22. Interest on notified bonds issued by a local authority/public sector enterprises etc.
23. 10 % Secured redeemable NTPC Bonds 1986.
24. 10 % Secured irredeemable Bonds issued by Mahanagar Telephone Nigam Ltd. Etc.

Tax-Free Securities

These securities are those which are issued by a local authority, corporations, government or company in the form of Debentures of Bonds. Actually these are not tax-free. But tax is paid by the issuing authority on behalf of security holder. The person who is holder of such security is liable to pay tax not only on the interest he is to receive but also the amount of tax which has been deposited by the security issuing authority on his behalf. The amount of interest actually received by holder is the net interest i.e., before deduction of tax. To include it in the gross total income of assessee. It can be grossed up by using the following formula:

$$\text{Grossing up} = \text{Net interest received} \times \frac{100}{100 - \text{Rate of Tax}}$$

Tax free securities are of two types:

1. Tax-free Government Securities
2. Tax-free Commercial Securities

Tax-free Government Securities

These securities are no longer in existence. Even if these are issued, then no tax is deducted at source. Hence the question of grossing up does not arise.

Tax-free Commercial Securities

As mentioned earlier, these securities are not actually tax-free. Tax is paid by the issuing authority on behalf of the security holder has to pay tax not only on the interest he receives but also on the amount of tax paid by the issuing authority on his behalf. Hence, the amount received by the security holder is to be treated as per net interest.

Chargeability

An income is chargeable under this head, if the following conditions are satisfied:

1. The income must not be an exempted income.
2. The income must not be chargeable under any other head of income.

Further, incomes are chargeable under this head based on the system of maintaining the books of Accounts. For instance, under mercantile system, the incomes are taxable on accrual basis. On the other hand, if the books accounts are maintained under cash system, the incomes are taxable on receipt basis.

Format for Computing Taxable Income from other Sources

Format For Computing Taxable Income From Other Sources

Particulars	Amount
1. Dividends	xxx
2.Interest on securities	xxx
3. Bank interest on fixed deposits	xxx
4. Casual income	xxx
5. Income from Family pension	
6. Gifts	xxx
7. Insurance commission	xxx
8. Deemed incomes	xxx
9. Mining rent /Royalties / Ground rent Fully taxable	xxx
10. Withdrawal from National savings scheme Fully taxable	xxx
11. Agriculture income from a place outside India Fully taxable	xxx
12. Directors fees or commission Fully taxable	xxx
13. Salaries received by a member of parliament or MLA or MLC Fully taxable	xxx
14. Rent from land Fully taxable	xxx
15. Examination fees received by a teacher (not from the employer)Fully taxable	xxx
16. Interest on employee's contribution to an URPF Fully taxable	xxx
17. Interest on employee's contribution to an URPF Fully taxable	xxx
18. Remuneration received for writing articles in Journal/Magazine Fully taxable	xxx
19. Other incomes Fully taxable	
Less: Exemptions U/S 57	
Any expenditure incurred wholly for the purpose of earning the income is deductible provided	/ xxx
such expenditure is neither ofcapital nature nor of personal nature	
Taxable Income from Other Sources	xxx

Note: Income from each source can be computed separately.

Tax Treatment

1. Dividends:

1. Dividends from an Indian company or UTI are not taxable in the hands ofshareholders.

2. Net Dividends from a foreign company are taxable in the hands of shareholders.(If assessee claims double taxation relief, the gross dividend shall be taxable).

3.Deemed dividends from an Indian company are taxable.

No TDS is made for the following:

1. Interest on less tax government securities.

2.4¼% of national defense bonds.

3. National development bonds.

4.8th issue national savings certificates.

5. Debentures issued by the co-operative society.

6.6½% gold bonds, 1977 or 7% gold bonds, 1980.

7. Interest paid to an individual in account payee cheque for an amount not exceeding `5,000 by listed companies in which public are substantially interested.

8.Interest on foreign government securities is not grossed up, as no tax is deducted at source in India on such income.

9.Post office monthly income accounts.

10.Post office time deposits.

11.Post office recurring deposits.

12.Indira Vikas Patra and Kissan Vikas Patra.

Deductions U/S 57

1. Commission paid to the bank or remuneration payable to any person for realizing the interest on behalf of the assessee is deductible. If the assessee himself collects the interest, he cannot charge for his own labor.

2. Interest on loan borrowed for purchasing securities is fully deductible. However ,interest on loan payable outside India without TDS is not deductible.

3. Bank Interest on fixed deposits

It is fully taxable. The Bank/Co-operative society/Post-office should deduct TDS, if the following conditions are satisfied:

(i)There should a fixed deposit.

(ii)The interest should be credited annually.(iii)The interest exceeds ` 10,000.

If net interest is given in the problem, it shall be grossed up. The formula for

Grossing up of interest: Gross interest = $\dfrac{\text{Net Interest} \times 100}{100 - \text{Tax rate}}$

Note: For tax rates, refer to rates of TDS table.

4. Casual Income

Winnings from lottery, crossword puzzles, TV game shows .Tax at source is deducted, if such winnings exceed `10,000. However, in case of winnings from horserace, tax is deducted at source, if the amount of winning exceeds ` 5,000. Further, in case of winnings from other races, gambling and betting, card games etc., Tax is not deduct edat source. No expenditure is allowed to be deducted out of these incomes

If net winnings are given in the problem, it shall be grossed up. The formula for grossing up of winnings: Gross winnings = $\frac{\text{Net Winnings} \times 100}{100 - \text{Tax rate}}$

Note: For tax rates, refer to rates of TDS table.

Income from maintenance of race horses is taxable under the head income from other sources. If there is any loss (i.e. if stake money is less than expenses) from activity of maintenance of race horses, such loss can be set off from income of same activity and not from any other income.

5. Income from Family Pension

Family pension payable by the employer to heir of deceased employee shall become puted after allowing standard deduction. Such deduction is to be allowed either at 33.33% of family pension or ` 15,000, WEL.

6. Composite Rent

If the assessee receives composite rent from his tenant, the portion of the rent attributable to the building should be assessed as income from house property and the remaining portion attributable to the amenities/services must be assessed as income from other sources. On the other hand, if the composite rent is inseparable, then the entire rent should be assessed as income from other sources or income from business.

7. Income from Subletting

Rental Income from sublet portion of the house shall be assessed as income from other sources. The taxable amount of such rent is to be computed as follows:

Rent from sublet portion	xxx
Less: expenditure on sublet portion	xxx
Taxable Income	xxx

8. Rental income from machinery, plant or furniture

Rental income derived from letting out of machinery, plant or furniture without building, is to be computed after making the following deductions:

1.The amount incurred by the assessee on account of current repairs of the assets hired out.

2.The amount of insurance premium paid by assessee against damage of the assets hired out.

3.Depreciation in respect of assets hired out.

9. Gifts

If aggregate amount of gifts, received from non-relatives exceeds `50,000 in the previous year, it is fully taxable in the hands of the recipient of such gifts. This rule is however not applicable, if gifts are received from a relative or at the time of marriage orby will. (The term relative means assessee (X), spouse (Mrs. X), brothers and sisters of assessee (X)/spouse (Mrs. X), brothers/sisters of father/mother of assessee (X), Linea ascendant or descendant of Assessee (X)/spouse (Mrs. X), but not cousin and brother/sister of grandfather/mother of Mr. (X) and Mrs. (X) elder brother of father in law.

Illustration: 1

Mr. Ram holds the following securities on April 1,2018:

Rs 2, 00,000 – 5% Up Government Loan (Date of payment of interest January 1)
Rs40,000 – 6 % Unlisted debentures of ABC ltd. (Date of payment of interest June 1)
Rs25,000 – 8% Debentures of Z ltd. (Date of payment of interest: June30, December 31)

On December 1, 2018 he sells 25,000 -8% debentures of Z ltd.
Calculate the taxable income of Mr, Ram for the Assessment Year 2019-20.
Business Income is Rs 64,000 and Collection charges Rs 1000.

Computation of Mr. Ram Income from Other Sources for the Assessment Year 2019-20.

1,00,000	–5% Up Government Loan	10,000
40,000	– 6% Debentures of ABC Ltd	2,400
25,000	– 8% Debentures of Z Ltd. (A 2000 x ½)	1,000
	Gross Interest	**13,400**
Less: Deductions : Collection charges		1,000
	Interest on securities	12,400
Add: Income from Business		64,000
	Net Taxable Income	**76,400**

llustration:2

Compute the income from other sources of Mr. X as per the details given below for Financial Year 2018-19

1. Interest received on debentures 15000/-
2. Interest received from taxable bonds 20000/-
3. Interest received from Public Provident Fund 30000-
4. Dividend received from mutual funds 10000/-
5. Interest received on Fix Deposits With Bank 12000/-
6. Accrued Interest on Kisan Vikas Patra 8000/-
7. Accrued Interest on National Saving Certificates 5000/-
8. Interest received on Income Tax refund 4000/-
9. Gift received from a friend 60000/-
10. Winning from Television Shows 10,000/

Solution:

of Mr. X for the Assessment Year 2019-2020

INCOME FROM OTHER SOURCES	
Interest received on debentures	15000
Interest received from taxable Computation of Taxable income	20000
bonds	Nil
Interest received from Public Provident Fund (Exempted) 30000/-	Nil
Dividend on Mutual Fund (Exempted) 10000/-	12000
Interest received on Fix Deposits with Bank	8000
Accrued Interest on Kisan Vikas Patra	5000
Accrued Interest on National Saving Certificates	4000
Interest on Income Tax Refund	60000
Gift received from a friend (exempted if amount is 50000/- or less)	100000
Winning from Television shows	
Taxable income from other sources	**224000**

Clarification:- Since the gift received during the year is more than Rs.50000/= that is why it will be included in taxable income from other sourced.

Illustration 3

Mr. Maheshwar who draws a salary of Rs 20,000 p.m. received the following gifts on or after 1/10/2018.

(i).Gifts of Rs 5,00,000 on 16-10-2018 from a friend.

(ii).Gift of a Jewellery fair market value of which value is Rs 3,00,000 in 17/10/2018 from his would be wife.

(iii).Gift of Rs 51,000 each received from his 4 friends on the occasion of his marriage on 21-10-2018.

(iv). Gift of Rs 1,00,000 on 22-11-2018 from his mother's sister.

(v). Gift of Rs 60,000 on 25-11-2018 from his father's brother.

(vi). Gift of Rs 50,000 from his wife's friend on 1-12-2018.

(vii). Gift of Rs 21,000 on 15-12-2018 from his mother's friend

Computation of Total Income of Mr.Maheshwar For the A.Y. 2019-20

A. Income from Salary		
Salary A 20,000 x12	2,40,000	
Add : Cash gifts from Employer.	26,000	
	2,66,000	
Less : Deduction u/s 16	Nil	2,66,000
B. Income from other Sources:		
(i) Gift from a friend is taxable	5,00,000	
(ii) Gift of jewellary is taxable w.e.f. 1-1-2009	3,00,000	
(iii) Gift received from his 4 friends are exempt as they have been received on the occasion of his marriage.	Nil	
(iv) Gift from his mother's sister is exempt as the donor is covered in the definition of relative	Nil	
(v) Gift from his father's brother is exempt as the donor is covered in the definition of relative	Nil	
(vi) Gift Rs 50,000 from his wife's friend on 1-12-2018 is taxable.	50,000	
(vii) Gift of Rs 21,000 from his mother's friend is taxable	21,000	5,71,000
Total Income		8,37,000

Exercise

1.Raja held the following investments:

(a) A81,340 – 10 % (Tax free) Debentures of Limited Company.

(b) A 70,000 -12% (Tax-free Rajasthan Development Loan

(c) Collection charges A 2,000

Compute his income from interest on securities for the year ending 31-3-2019

[Ans: A 15,468]

2.Mr .Prasanth has the following investments as on 1st April.2019

1. 10,000 - 10% Municipal bonds
2.20,000 - 10% National Defense certificatesRs30,000 - 15% A.P. Government loan
3.40,000 - 13.5% Tax free Government securities
4. 56,492 – 12% Tax free debentures of Reliance energy Ltd. (unlisted)

5. 60,000 -10% Tax free debentures of Nagarjuna Ltd. (listed)

6.70,000 – 15% Panyam Cements Ltd. Debentures (listed. Less tax)

On 1st Dec,2018 Mr. Naresh bought Rs 90380 -20 % tax free debentures of XYZ Ltd., and for this purpose he took a loan at 15% and paid brokerage A 1,000. The interest on these investment was realized through bank and the banker charged 5% as collection charges on gross interest. Compute income from interest on securities.

[Ans: Income from interest on securities A 39,436.]

3. Following are the particulars of investment of Mr Bhupesh Gupta for the previous year 2019-20.

(i) A 1,00,000 – 2% Tax Free Kerala Government Securities.
(ii) A 2,60,000 -6% Tax Free Debentures of Birla Jute Co., Limited.
(iii) A 60,000 – 8.5% N.R.I. Bonds (Second Series) of S.B.I.
(iv) A 90,000 – 4% (Less Tax) A.P. Government Bonds.
(v) A1,80,000 – 10 % Fixed deposit with Indian Bank.
(vi) A 70,000 – 8% Preference Shares of a Company.
(vii) Bank Charges paid A 60/-
(viii)Interest paid on loan taken for the purchase of tax free Government Securities Rs.850/-
(ix)Income from other heads is A 2,07,414.

Compute the income from interest on securities and tax liability.

[Ans: Income from interest on Securities A 22,023]

4. Mr. Narayan had the following investment for the year ending on 31st March, 2019:

1)8% tax free Govt. of India loan ` 15,000.
2)9.5% secured debentures of a cotton mills ` 10,000.
3)7% National Plan Certificate ` 30,000.
4)12% Tax-free secured debenture of Raymond Woolen Mills Ltd. listed in Delhi stock exchange `10,000.
5)11% debentures of Reliance textile industry ` 8,000.

He took a loan of `15,000 @ 7% p.a. rate of interest to purchase debentures. Collection charges spent to collect the taxable interest this year amounted to ` 30.Compute taxable income under the head income from other sources for the Assessment Year2019-20.

5. Shree Kalyan Singh is a political leader. The particulars of his income for the F.Y. 2018-19 are as follows:

(i)Received ` 12,000 @ ` 1,000 p.m. as family pension from the Central Government.

(ii)Received a sum of ` 2,000 for delivering lectures in favor of a candidate in municipal election.

(iii)Received a sum of ` 3,000 as royalty from Friends & Company to whom he has given right to publish his book on Political Science.

(iv)He has some machines which he gives on rent. The rent received in this respect amounts to ` 15,000.

Repair charges on machines are ` 1,000.

(v)Received ` 56,000 as rent of agricultural land.

(vi)Interest received on Post-office savings bank account ` 800.(vii)Remuneration received for radio talk ` 1,000.

Compute his taxable income under the head “Income from other sources” for the Assessment Year2019-20.

Short Questions:

1.What is casual Income?

2.State the standard deduction for family pension.

3.What is the rate of TDS for casual incomes?

Ψ

UNIT 5

Deductions from Gross total Income

Learning Objectives

After studying this unit, the student will be able to

- Identify gross total income
- Understand about qualifying savings u/s 80 C
- Learn about deduction u/s 80 CCD, 80 CCF, 80 D, 80 E,80 GGA
- Understand about taxable income

Introduction:

While computing the total income of an assessee some deductions are allowed from the gross total income, in addition to deductions that are allowed from the gross total income, In addition to deductions that are allowed under different heads of income. These deductions are allowed under section 80 C to 80 U.

Note: These deductions are not allowed from (a) Long term capital gains (b) winning from lotteries, horse races etc., (c) Short term capital gain on transfer of equity shares. (d) Short term capital gain on transfer of equity oriented units of mutual funds.

The aggregate of the deductions allowable under section 80 C to 80 U is to be limited to the gross total income i.e., deductions allowable under this section should not result in negative income i.e. loss.

The following are some of the important deductions available to an assessee whose status is an **"individual".**

Deductions from Gross Total Income (GTI)

The following rules have to be kept in mind, while calculating deductions U/S 80C to 80U:

- The aggregate amount of deductions U/S 80C to 80U cannot exceed GTI.
- No deductions can be claimed from long term capital gains and casual incomes, short term capital gain liable for security transaction tax.
- Deduction U/S 80G and 80GG can be claimed only after claiming all other deductions U/S 80.

1.	80C	Qualified Savings
2.	80CCC	Payment or Deposit in respect of Pension Fund.
3.	80CCD	Payment to new pension scheme for government and for other employees.
4.	80CCE	Limit on deductions
5.	80CCF	Investment in infrastructure Bonds
6.	80D	Medical Insurance Premium
7.	80DD	Deduction in respect of medical treatment & maintenance etc. of handicapped dependents.
8.	80DDB	Medical Treatment or expenses of dependent.
9.	80E	Interest on higher education loan.
10.	80G	Donations.
11.	80GG	Deduction for rent paid.
12.	80GGA	Donation for Scientific Research & Rural Development.
13.	80GGC	Donation to political Parties.
14.	80QQB	Royalty income of authors of books.
15.	80RRB	Royalty income from patent.

The following deductions can be claimed from the GTI of an individual:

Deduction Under Section 80C

The deduction is calculated as per the following steps-Step 1: Gross qualifying amount

Step 2: Amount of deduction

Gross qualifying amount is the aggregate of the following:

1. Life insurance premium paid on own life / spouse's life/ children's life (dependent or independent, minor/major, married/unmarried) (including payment made by Government employees to the Central Government Employee's Insurance Scheme and payment made by a person under children's deferred endowment assurance policy).

Note: If policy is issued before 1-4-2012, 20% of sum assured or if policy issued after 1-4-2012, 10% of sum issued or premium paid w.e.l, qualifies.

2.Payment in respect of non-commutable deferred annuity.

3. Any sum deducted from salary payable to a Government employee for the purpose of securing him a deferred annuity (subject to a maximum of 20% of salary).

4.Contribution towards statutory provident fund and recognized provident fund.
5.Contribution towards15 years public provident fund.

Note: Amount deposited by an individual in his own account or in the account of his /her spouse or children is eligible for deduction.

6.Contribution towards an approved superannuation fund.

7. Subscription to National Savings Certificates, VIII/IX Issue (+) accrued interest onNSC and deposit in Sukanya Samriddhi account.

8. Contribution for participating in the Unit-Linked Insurance Plan (ULIP) of Unit Trust of India.

9. Contribution for participating in the unit-linked insurance plan (ULIP) of LIC Mutual Fund (i.e., formerly known as Dhanraksha plan of LIC Mutual Fund)

10. Payment for notified annuity plan of LIC i.e., JeevanDhara, JeevanAkshay, or any other insurer.

11. Subscription towards notified units of Mutual Fund or UTI

12. Contribution to notified pension fund set up by Mutual Fund or UTI (i.e., Retirement Benefit Pension Fund of UTI)

13.Any sum paid (including accrued interest) as subscription to Home Loan Account Scheme of the National Housing Bank or contribution to any notified pension fund set up by the National Housing Bank.

14. Any sum paid as subscription to any scheme of:

a. public sector company engaged in providing long-term finance for purchase/ Construction of residential houses in India (i.e., public deposit scheme of HUDCO)

b. housing board constituted in India for the purpose of planning, development or improvement of cities/towns.

15.Any sum paid as tuition fees to any educational institution in India for full time education of any 2 children of an individual.

16.Any payment towards the cost of purchase/construction of a residential property(including repayment of loan taken from Government, bank, cooperative bank, LIC ,National Housing Bank, assessee's employer where such employer is public company/public sector company/university/co-operative society) (principal amount only).

Note: Repayment of housing loan qualifies for deduction if the construction of house is completed.

17. Amount invested in debentures or equity shares, public company engaged in infrastructure including power sector or units of mutual fund, proceeds of which are utilized for the developing, maintaining, etc. of a new infrastructure facility.

18. Amount deposited as term deposit for a period of 5 years or more in accordance with scheme framed by the Government.

19. Subscription to any notified bonds of National Bank for agriculture and rural development (NBARD).

20.Amount deposited under senior citizens savings scheme.

21. Amount deposited in 5 years' time deposit scheme in post office.

Amount of Deduction: (A.Y. 2017-18)

Amount of deduction under section 80C is computed as under.

-Gross qualifying amount; or

- ` 1, 50,000 (whichever is lower).

Note: 1.Contribution towards URPF does not qualify for deduction.

2. Life insurance premium paid on father, mother, brother, sister, uncle's life does not qualify for deduction.

3. Investment or deposits in the schemes mentioned u/s 80c can be made out of taxable income or otherwise.

4. Amount due but not paid on or before 31st March of the relevant P.Y. shall not qualify for deduction u/s 80c.

5. Employer's contribution towards NPS shall not be considered for the ceiling of ` 1, 50,000

Deduction under Section 80CCD

Central Govt. or other employees can claim deduction under this section in respect of contribution made towards new Pension Scheme.

Condition: Central Govt. employee appointed after 1.1.2004 or other employees can claim deduction in the in the P.Y. in which the contribution so made.

Amount of deduction:

a) Amount contributed by the employee or 10% of salary, W.E.L. (+) Employer's contribution or 10% of employee's salary (basic + DA) W.E.L. or maximum limit ` 1, 50,000.

b)Incase of other employees deduction is limited to 10% of GTI.

* Note:

a) The aggregate amount of deduction U/S 80C, 80CCC &80CCD cannot exceed ` 1, 50,000.

b) Employer's contribution towards NPS shall not be considered for the ceiling of ` 1,50,000.(NPS = Notified Pension Scheme)

80CCF

Chapter VI-A of the Income Tax Act deals with the provisions related to deductions that are available while calculating the **total taxable income**. Thus, **Section 80C** has a comprehensive list of deductions. Section 80CCF of the Income Tax Act is a subsection of Section 80C that provides the taxpayer with a deduction on the amount invested by her/him in specific Government approved infrastructure bonds. This section enables the taxpayer to avail a deduction of up to Rs. 20,000 per year on total taxable income.

Deduction under Sec. 80D

Individual and HUF can claim deduction for medical insurance premium paid out of taxable income.

(In case of individual family means assesses, spouse, dependent children and also parents.)

Amount of Deduction

Persons for whom Payment made	Nature of payment	Allowable deduction
Assesse, spouse and dependent children	1. Mediclaim insurance premium Paid. 2. Central Govt. health scheme. 3. Preventive health checkup.	Total payment or Max .limit of 25,000 w.e. l (for senior citizen it is 30,000)
Parents (whether dependent on assesse or not)	1. Mediclaim insurance premium paid 2. Preventive health checkup.	Total payment or Max.limit of 25,000 w.e.l(for senior super citizen it is 30,000)

Deduction of Preventive health checkup: A sub limit of 5,000 has been allowed w.e.f financial year 2016-17 for preventive health checkup for self, spouse and dependent children and parents whether dependent on assessee or not. Preventive health check- up amount can be paid through any mode including cash mode.

Deduction Under Sec. 80DD

Resident Individual &HUF can claim weighted deduction for expenditure incurred on medical treatment or handicapped dependent relative/deposit made for the maintenance of dependent handicapped relative.

Condition: The disability must be certified by the Government doctor.

Amount of deduction: Extent of disability Amount of deduction

40% Nil

40% -80% = `75,000

>80% = `1,25,000

Deduction Under Sec. 80DDB

Resident individual &HUF can claim deduction for expenses incurred on medical treatment against specified disease for assessee himself or dependent family members i.e. children, Parents, brothers and sisters.

Condition: Disease must be certified by the Government doctor [If the beneficiary is senior citizen but nonresident in India during the P.Y. max. limit of ` 40,000 is applicable].

Amount of deduction:

In case of Senior Citizens: Actual expenses incurred or maximum limit of `60,000,W.E.L (-) Amount received from the insurance company.

In case of Super Senior Citizens: Actual expenses incurred or maximum limit of ` 80,000, W.E.L (-) Amount received from the insurance company.

Deduction Under Sec. 80E

Individual can claim deduction for the payment of interest on loan borrowed for his own or his relatives higher education from approved financial institutions.

Condition: Such loan amount shall be paid out of taxable income of the assessee.

Amount of deduction: The total interest paid during the P.Y. qualifies for deduction.

10. **Donations: (Sec 80 G)**

(a) Donation of any amount will be allowed as deduction

(b) Donation in kind will not be allowed as deduction

(c) Donation made out of taxable income alone qualifies for deduction, i.e., if donations are made out of tax-free income then they are not eligible for deduction.

Steps:

(1) First calculate gross qualifying amount (i.e, finding out individual limit.)

(2) Finding out the overall limit.

(3) Rate of Deduction.

Step 1. Calculating the gross qualifying amount for each donation made

Donations

No Limit Donations With Limit Donations

(1) No Limit Donations: Actual amount donated will be the gross qualifying amount. It means qualifying amount is 100 % of the amount donated e.g. If donated amount is A 15,000 then the qualifying amount is A 15,000.

(2) With Limit Donations: the qualifying amount is least of the following two amounts.

(a) Actual amount donated. (b) 10 % of Gross Total Adjusted income.

Note: Adjusted Gross Total Income = G.T.I. (-) Long Term Capital gains (-) other deductions u/s 80 except 80 G.

Step 2. Finding out the overall limit i.e., Net qualifying donations.

= Take the total of the qualifying amounts with limit and without limit – (as calculated in the above step.)

Step 3: Rate of Deduction.

Note : The rate of deduction is explained in the following.
I. Qualifying Amount is 100% and deduction rate is 100%.
II. Qualifying Amount is 100% but deduction rate is 50%.
III. Qualifying Amount is limited – and – rate of deduction is 100%.
IV. Qualifying amount is limited – and rate of deduction is 50%.

Donations for Scientific Research or Rural Development (Sec. 80 GGA)

Deduction : Actual amount donated or contributed will be given as deduction.

Deduction on 80GGC

Assessee other than local authority and artificial juridical person fully or partly funded by the Government can claim deduction for contribution made towards political party.

Condition: Any sum contributed during the P.Y. qualifies for deduction, provided such contribution made by cheque.

Amount of deduction: 100% of such contribution qualifies for deduction.

Deduction Under Sec. 80JJA

All assesses can claim deduction for profits and gains from business of collecting and processing Bio-degradable waste.

Condition: Only business engaged in collecting and processing are qualified for deduction.

Amount of deduction: 100% of such profits and gains qualifies for deduction for the 1st Five years.

Deduction Under Sec. 80QQB

Resident individual can claim deduction for the Royalty income from books of literary, artistic and scientific nature.

1. Assessee should furnish form No. 10CCD along with the return.
2. Books shall not include brochures diaries, guides, journals, magazines, newspapers, text books for schools e

80QQB

As lumsum as a percentage

As lumsum		as a percentage	
1. Amount remitted to India in convertible foreign exchange within the time limit	xxx	1. Amount remitted to India in convertible foreign exchange within the time limit	xxx
2. Lump sum consideration received	xxx	2. Gross Royalty not exceeding 15%	xxx
W.E.L	xxx	W.E.L	xxx
(-) expenditure incurred	xxx	(-) expenditure incurred	xxx

Deduction under Sec. 80RRB

Resident individual can claim deduction for royalty from patents registered after 31.3.2003.

Condition: Assessee should furnish form No. 10CCE along with the return.

Amount of deduction:

Least of the following is deductible:

1. Income from Royalty	xxx
2. Royalty under the terms of license settled by the controller	xxx
3.Maximum Limit	300,000

Deduction Under Sec. 80U

Resident individual suffering from disability can claim weighted.

Condition: Further, the disability must be certified by the Government doctor.

Amount of deduction:

Extent of disability	Amount of deduction
40%	NIL
40% - 80%	` 75,000
> 80%	1,25,000

Deduction Under Sec. 80TTA

1. Individual/HUF can claim deduction under this section for interest on deposits (not being terms deposits) in a savings account.
2. Income received from any in saving a/c held by a firm/AOP/BOI, no deduction shall be allowed on such income.
3. In case of interest on POSB a/c exemption is up to `3,500 for single account + ` 7,000 for joint a/c.

4.In case of interest on saving a/c with bank, co-operative bank account post office Education up to Rs 1,000.

Illustration 1(80C)

From the following information provided by Mr. Jaya Ram, calculate the amount of allowable deduction u/s 80C for the A.Y 2019-20.

1. Life insurance premium on his own life ` 2,700
2. Life insurance premium of the life of his wife (not dependent upon Mr. Jaya Ram) ` 16,000
3. Life insurance premium on the life of his married daughter ` 4000
4. Life insurance premium on the life of his dependent sister ` 10,000
5. Repayment of loan taken from LIC for purchase of commercial house property 30,000
6. Contribution towards unrecognized provident fund (URPF) `30,000
7. Tuition fees of daughter ` 22,000
8. Life insurance premium on the life of his major son is due on 1.12.2018 ` 3,000 but paid on 1.5.2019.
9. Accrued intent on NSC ` 5,000.
10. Contribution to PPF in the name of mother ` 20,000.

Solution:

Calculation of the amount of allowable deduction u/s 80C

1. life insurance premium on own life	2,700	
2. Life insurance premium on married daughters life	4,000	
3. Life insurance premium on wife's life	16,000	
4. Life insurance premium on dependent sister life	nil	
5. Repayment of loan	Nil	
6. Contribution to UPRF	Nil	
7. Tuition fees	22,000	
8. Life insurance premium due	Nil	
9. Accrued interest on NSCS	5,000	
10. Contribution to PPF	Nil	
Total (80C)	49,700	
Amount of Deduction:		
Qualified amount 49,700 or maximum limit 1, 50,000w.e.l49,700		

Illustration 2:
Deduction: 80c,80ccc,80ccD

Mr. Rajasekhar, (Resident) is employed by the Central Government since 2008. He submits the following particulars of his income and expenditure for the P.Y 2018-19.Compute his total income.

1. Income from salary ` 5, 00,000
2. Income from other source ` 2, 00,000
3. Contribution towards PPF `70,000
4. Deposit in notified annuity plan of LIC ` 5,000
5. Own contribution towards NPS ` 60,000 and employer's contribution NPS is ` 50,000.

Solution:

Computation of Total Income of Mr. Rajasekhar for the Assessment Year 2019-2020

Particulars		Amount
1. Income from Salary	5,00,000	
2. Income from other sources	2,00,000	
G.T.I		7,00,000
<u>Deduction u/s 80 c</u>		
Contribution to PPF	70,000	
<u>Deduction u/s 80ccc</u>		
Contribution to Annuity plan of LIC	5,000	
<u>Deduction u/s 80 CCD</u>		
Own contribution to NPS (additional deduction upto ` 50,000)50,000		
Employer's contribution to NPS50,000=10,000		
Maximum deductible amount: (70,000 + 5,000 + 10,000 = 85,000 or max. limit of `1,50,000w.e.l)		
Less: Total deduction		<u>85,000</u>
Total Amount		<u>5,15,000</u>

Illustration 3 (80D)

Calculate the maximum deductible amount u/s 80D of Mr. David (Resident) from the following details:

1. Medical insurance premium paid on own life ` 10,000
2.Medical insurance premium paid on wife's life (not dependent upon tax payer)` 4,000
3Medical insurance premium paid on son's life (dependent) ` 1,000
4Medical insurance premium paid on dependent daughter's life ` 1,000
5Medical insurance premium paid on father's life (age 68 years, Resident in India)(not dependent upon tax payer) ` 1,000
6.Medical insurance premium paid on mother's life (age: 54 years, resident in India)` 40,000
7.Medical insurance premium paid on Grandfather Life ` 2,100

Solution:
Computation of Maximum deduction amount u/s 80D

Particulars	Amount	Amount
I Tax payer's, spouse and dependent children		
1.Medical insurance premium paid own life10,000	10000	
2.Medical insurance premium paid on wife's life 4,000	4000	
3.Medical insurance premium paid on sons life 1,000	1000	
4.Medical insurance premium paid on daughter life 1,000	1000	
Total		16,000
(Total premium paid 16000 or maximum limit 25,00 w.e.l)16,000		
II.Taxpayers father and mother		
Medical insurance premium paid on mother life 40,000	25,000	
(Maximum limit 25,000 or 40,000 w.e.l)		
Medical insurance premium paid on father life 1000	1000	26,000
Maximum limit 5,000 w.e.l		
Total deduction amount		42,000

Illustration 5 (80D 80G)

Mr. Sumantha resident assessee, furnishes the following of his income/expenditure relevant for the previous year ending March 31, 2019.

Business Income	` 83,000
Long Term Capital Gain	4,10,000
Short term capital gain(not covered by the section 111A)	20,000
Other short term capital gain	10,000
Interest on debentures 9,000	
Payment of medical insurance premium on own life	3,000
Donation to the national trust for welfare of persons with autism.	4,000
Donation to the fund setup by the Gujarat government	3,000
Donation to Rajiv Gandhi foundation	1,000
Donation to PM Drought relief fund	` 5,000
Donation to approved public charitable Institution	11,000

Determine his net income for the A.Y. 2018-19

Computation of Total Income

Particulars	Amount	Amount
1. Business income	83,000	
2. Other short term capital gain	10,000	
3. Interest on debentures	9000	
Other GTI		1,02,000
(-) Deduction u/s 80D		
Medical insurance premium on own life ` or max. limit` 25,000 w.e.l	3,000 3,000	
(-) Deduction u/s 80 G		
(note-1)	14,950	17,950
Other total income		84,050
(+) Long term capital gain		4,10,000
(+) short term capital gain u/s 111		20,000
Total income		**5,14,050**

(Note 1:80G Calculation)

Particulars Deduction Amount	GQA	NQA	Rate of	Rate of
1. Donation to the national trust for welfare of persons with autism	4,000	4,000	100%	4,000
2. Donation to the fund setup by The Gujarat government	3,000	3,000	100%	3,000
3. Donation to Rajiv Gandhi foundation	1,000	1,000	50%	500
4. Donation to PM Drought relief fund	5,000	5,000	50%	2,500
5. Donation to approved public charitable Institution11,0009,90050%4,900				
Total 14,950				

Exercise:

1. Siva gross total income is Rs 50,000. He pays Rs 2000 by way of contribution to Public provident fund. Rs 3,000 as life insurance premium Rs 200 to Jawaharlal Nehru Memorial fund and Rs 500 to Prime Minister's National Relief Fund. Compute his total income.

[Ans: Rs 44,400]

2. Mr. Z had a gross total income of Rs 4 lakhs, which included Rs 10,000 as 1/4th share from association of persons for the assessment year 2019-20. During the year he has made the following donations:

(a) National Defense Fund Rs 60,000

(b) Prime Minister's National Relief Fund Rs 1,00,000

(c) Family Planning Association of India Rs 10,000

(d) All India Congress Committee Rs 1,00,000

(e) Notified charitable hospital Rs 50,000

In addition to the above, he paid a life insurance premium of Rs 15,000 on a policy of Rs 1, 00,000. Compute the relief in respect of donations and life insurance premium.

[Ans. Deductions u/s 80 G Rs 1, 84,250]

3.Mr .Y is Karta of H.U.F. has a child (son of Y'sbrother) who is mentally restarted .Mr.Y's mother is also physically disabled. The H.U.F. has spent Rs.24,000 on their treatment and rehabilitation. Can H.U.F. claim deduction u/s 80DD and if yes, how much.

[Ans.H.U.F. can claim deduction of Rs.75,000 u/s 80DD]

4.Mr.ranjith left on 1-4-2016 for U.S.A for the higher studies. For this purpose he had taken a loan from Bank. He started repaying this loan with effect from 1-4-2018 and during 2019-2020 he repaid Rs 30,000 as principal amount and RS.28,000 as interest .Can be claim any benefit under income tax act 1961 for the amount repaid by him.

[Ans. deduction u/s 80E for Rs.28,000 can be claimed]

Short Answer Type Questions

1. What is gross total income ?
2. What is Net total income?
3. Write the following

(a) 80 D (b) 80 E (c) 80 CCD (d) 80

UNIT 6
Assessment of Individual

Learning Objectives

After studying this unit, the student will be able to

- Understand about procedure for computing net income
- Learn about gross total income
- Learn about net total income
- Learn about tax liability

Introduction

An assessee means a person by whom any tax or any other sum is payable under the Income Tax Act of 1961, it includes: a) Every person in respect of whom any proceeding under this Act has been taken for the assessment of income or any refund due to him or to such other person b) Deemed Assessee c) Deemed Assessee in default.

Assessment year is defined as “the period of twelve months starting from 1st of April and ending on 31st March every year”.

Previous year is the financial year immediately preceding the assessment year. In other words, the year in which income is earned is known as previous year. The previous year for the assessmentyear2019-20 is2018-19.

Gross Total Income is the aggregate of the incomes computed under various heads of income according to the provisions of the Income Tax Act before making any deduction u/s 80C to80U.

Section 14 deals with the Gross Total Income and it include:

1) Income from Salaries.
2) Income from House Property.
3) Profits and Gains of Business or Profession.
4) Income from Capital Gains.
5) Income from other Sources.

Total income of an assessee is Gross Total Income after making deductions U/S 80C To 80U

Assessment of Individual

Format for computing total taxable income

Particulars	Amount
Taxable Income from salaries (Sec. 15 to17)	xxx
Taxable Income from House property(Sec.22to27)	xxx
Taxable Income from Business/profession(Sec.28to44)	xxx
Taxable Income from Capital gains (excluding LTCG & STCG liable for STT) (Sec. 45 to55)	xxx
Taxable Income from other sources(excluding casual incomes)(Sec.56to59)	xxx
Gross Total Income excluding LTCG &STCG Liable for STT &Casual Income	xxx
Less: Deduction U/S 80C to80U	xxx
Total Income excluding LTCG &STCG Liable for STT &Casual Income	xxx
Add: Casual Income	xxx
Long term capital gain(liable for STT)	xxx
Shorttermcapitalgaintaxableat15%	xxx
Total Taxable Income or Net Income	xxx

Note :STT=Security Transaction Tax, LTCG=Long Term Capital Gain ,STCG=Short Term Capital Gain

Format for calculating Tax Liability

Particulars		Amount
1. Tax on casual Income @30%		xxx
2. Tax on un explained cash credit,investment,money&expenditure @30%		xxx
3. Tax on long term capital gain @20%		xxx
4. Taxonshorttermcapitalgainat15%		xxx
5. Tax on other Taxable income (at slab rates)		xxx
(a) Total Tax(1+2+3+4+5)		xxx
6. Less: Rebate undersec.87A		xxx
(b) Total Tax (a-6)		xxx
7. Add: Surcharge @ 15%, if applicable		xxx
8. Add: Education cess @2%(+)		xxx
Secondary&Highereducationcess@1%		xxx
(c) Total Tax (b + 7+8)		xxx
9. Add: Interest or Penalty		xxx
(d) Total Tax (c+9)		xxx
10. Less: Tax paid on self-assessment	xxx	
Advance income tax paid	xxx	
Tax deducted at source	xxx	xxx
[Tax Payable/Tax Refundable] (d-10)		xxx

1. Income Tax Slab Rate for AY 2019-20 for Individuals

1.1 Individual (resident or non-resident), who is of the age of less than 60 years on the last day of the relevant previous year:

Taxable income	Tax Rate
Up to Rs. 2,50,000	*Nil*
Rs. 2,50,000 to Rs. 5,00,000	5%
Rs. 5,00,000 to Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

1.2 Resident senior citizen, i.e., every individual, being a resident in India, who is of the age of 60 years or more but less than 80 years at any time during the previous year:

Taxable income	Tax Rate
Up to Rs. 3,00,000	*Nil*
Rs. 3,00,000 - Rs. 5,00,000	5%
Rs. 5,00,000 - Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

1.3 Resident super senior citizen, i.e., every individual, being a resident in India, who is of the age of 80 years or more at any time during the previous year:

Taxable income	Tax Rate
Up to Rs. 5,00,000	*Nil*
Rs. 5,00,000 - Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

Plus:

Surcharge: 10% of tax where total income exceeds Rs. 50 lakh
15% of tax where total income exceeds Rs. 1 crore

Education cess: 3% of tax plus surcharge

Note: A resident individual is entitled for rebate u/s 87A if his total income does not exceed Rs. 3, 50,000. The amount of rebate shall be 100% of income-tax or Rs. 2,500, whichever is less.

2. Income Tax Rates for HUF/AOP/BOI/Any other Artificial Juridical Person:

Taxable income	Tax Rate
Up to Rs. 2,50,000	*Nil*
Rs. 2,50,000 to Rs. 5,00,000	5%
Rs. 5,00,000 to Rs. 10,00,000	20%
Above Rs. 10,00,000	30%

Plus:

Surcharge: 10% of tax where total income exceeds Rs. 50 lakh
15% of tax where total income exceeds Rs. 1 crore

Education cess: 3% of tax plus surcharge

Illustration 1

Compute the amount of Income Tax Payable for the A.Y. 2019-20 in the following cases.

a) Total income of Mr. X Rs2,70,000.
b) Total income of Mrs. Y Rs 5,60,000.
c) Total income of Mr. Z Rs 10,00,000 (senior citizen).

Solution:

Computation of Tax liability of Mr.X for the assessment year 2019-2020

Total income of Mr.XRs2,70,000.

uptoRs2, 50,000		Nil
2, 50,000 to 2,70,000 (20,000of5%)		1,000
	1,000	
Less: Rebate u/s87(A) 2500		
Or 1000 (w.e.l)	1000	
Taxable payable		Nil

Computation of Tax liability of Mrs. Y

Total income of Mrs. Y Rs5,60,000

uptoRs2,50,000	Nil
2,50,000 to 5,00,000 (2,50,000 of 5%)	12,500
5,00,000 to 5,60,000 (60,000 0f 20%)	12,000
	24,500
Add: Education cess 3%(EC+SHE)	735
Taxable payable	25235

Computation of Tax liability of Mr. Z (senior citizen)

Total income of Mr.Rs10,00,000

uptoRs3,00,000	Nil
3,00,000 to 5,00,000 (2,00,000 x 5%)	10,000
5,00,000 to 10,00,000 (5,00,000 x 20%)	1,00,000
	1,10,000
Add: Education cess 3%	3,300
Taxable payable	1,13,300

Illustration 2

From the following information compute Gross Income Tax for Assessment Year 2019-20 of Mrs. Parvati (resident).

(i) Gross Salary	3,00,000
(ii) Interest earned on N.S.C	8,000
(iii) Interest on Bank fixed Deposit	52,000
(iv) Expenses on rehabilitation of handicapped son	10,000
(v) Deposited in R.P.F.	15,000
(vi) L.I.C. Premium paid	5,000

Solution:

Computation of Total Income

Particulars	Amount	Amount
1. Gross salary	3,00,000	
Less: Deduction U/s 16	-	3,00,000
2. Income from other sources		
(a) Interest on NSC	8,000	
(b) Interest on bank deposits	52,000	60,000
Gross total income		3,60,000
1. Deduction U/s 80c		
(a) Interest on NSC	8,000	
(b) Deposited in RPF	15,000	
(c) LIC Premium paid	5,000	
2. Deduction U/s 80 DD	28,000	
Rehabilitation expenses	75,000	1,03,000
Total Income		2,57,000

Computation of Tax Liability

particulars	Amount
Tax on total income (2,57,000 - 2,50,000 = 7,000 of 5%)	350
Less: Rebate u/s 87(A) (Tax of Rs350 or Maxi. limit of Rs2500 w.e.l)	350
	Nil
Add: Education cess at2%	Nil
Add: Secondary and higher education cess at 1%	Nil
Gross Tax liability/Tax liability	Nil

Illustration 3

Mr. Keshav a resident assessee, furnishes the following of his income/expenditure relevant for the previous year ending March 31, 2019.

Business Income	Rs 95,500
Winning from lottery	Rs4,500
Donation to the PM National relief fund	Rs 11,000
Donation to the Govt. of India for promotion of family Planning	Rs3,000
Donation to the public Charitable Institute (beinganapprovedinstitutionsforsec.80G)	Rs 12,000

Compute his total income for the A.Y. 2019-20.

Computation of Total income

Particulars	Amount
1 Business income	95,500
2. Other income	-
Other GTI	95,500
Less: Deduction u/s 80 G (note-1)	17,500
Other total income	78,000
Add: Winning from lottery	4,500
Total Income	82,500

Note:

Particulars	GQA	NQA	Rate	Dedu
1. Donation to the PM Notional relief fund	11,000	11,000	100%	11,000
2. Donation to family Planning	3,000	3,000	100%	3,000
3.Donation to the public Charitable institute	12,000	7,000	50%	3,500
Total		(10,000-3,000)		17,500

NQA = 10% of adjusted GTI or total donations under Group 3, w.e.l

Adjusted GTI = other GTI – Deduction u/s 80 to 80U + casual income

95,500 +4,500 =1,00,000

Total donations = 3000+12000 =15,000

10% of adjusted GTI or Total donations under group 3, w.e.l 1,00,000 of 10% = 10,000 or 15,000 w.e.l= 7 10,000

Illustration 4

From the following particulars of Mr. Venkat (resident) calculate his tax liability for the assessment year 2019-20:

Salary	1,29,000
Business Income	70,000
Royalty on Books for Colleges	30,000
Rent from House Property	20,000
Dividend Income	15,200
Bank Interest	8,800
Income of a Minor Son	50,000
Long-term Capital Gains	30,000
Contribution to P.P.F	3,000
Life Insurance Premium Paid	1,000
Health Insurance Premium Paid	800
Donation to National Defense Fund	5,000

Solution:

Computation of Total Income

Particulars	Amount	Amount
1. Salary	1,29,000	
Less: Deduction U/s 16	-	
	1,29,000	1,29,000
2. Rent from house property(NAV)	20,000	
Less: Deduction on U/s 24		
Standard deduction – 30% of NAV (20,000 X 30%)	6,000	14,000
3. Business income		70,000
4. Income from other sources		
(a) Royalty on books	30,000	
(b) Dividend income	Tax Free	
(c) Bank interest	8,800	
(d) Income of minor son (50,000 – 1,500) Other	48,500	87,300
Gross total income		3,00,300
1. Deduction U/s 80C – life insurance premium paid + Contribution to PPF (1,000 + 3,000)		4,000
2. Deduction U/s80D–Health insurance premium paid		800
3. Deduction U/s 80G – Donation to national defence fund (5,000 x100%)		5,000
4. Deduction/s80QQB–Royalty income		30,000
Other IT		2,60,500
Add: Long term capital gain		30,000
Total income		2,90,500

Computation of Tax Liability

1. Tax on long term capital gain (30,000 x 20%)	6,000
2. Tax on other income (2,60,500)	525
Total	6525
Less: Rebate u/s 87(A)	2,500
	4,025
3. Add: E & SHE cess at 3% (5,050 x 3%)	120.75
Gross tax liability/Tax liability	4145.75

Exercise:

1. Compute taxable income and the tax liability of Mr. S. Ram (resident) for the assessment year 2019-20 from the following particulars:

(i)	Gross Salary	3,00,000
(ii)	Rent from house property	60,000
(iii)	Interest on bank deposits(after a deduction of taxatsource)	10,800
(iv)	Income from horse-race	20,000
(v)	Agricultural Income	20,000
(vi)	Long-term capital loss	25,000
(vii)	Short-term capital gains	24,000
(viii)	Interest on KisanVikas Patra(Gross)	5,000

Life Insurance premium paid by Mr.S. Ram out of his Agricultural income10

[Total income -393000, Tax liability – 10296]

2. Compute the Total income of Mr. Shyam from the particulars given below:
1.Interest on securities (Gross) Rs.27, 000
2.Rental value of the House Rs. 7500 p.m. self-acquired but transferred to H.U.F. Common pool.
3. Income from this House is (computed) is Rs.25, 200
4.Share from firm in which he has 1/3rd share Rs. 45,000
5.Commission by his wife from such firm for acting as its selling agent Rs. 25,000.

[Total income – 77,200]

3. The following are particulars of the Income of GND University teacher during the year ending 31st march 2019:
1. Income from salary (computed) Rs.6, 38,880
2. Income from House property (Computed) Rs.29.560
3. Interest (gross) Rs.2, 500
4. Own contribution to S.P.F. 84,680
Compute Total Income and Tax liability.

[Total income- 6, 04,060, Tax liability -34,311]

4. The following are particulars of the Income of Dr. Siva during the year ending 31st march 2019:
1. Income from Salary Rs.1, 66,000
2. Income from House Property 1, 00,000
3. Income from Profession Rs. 61,000

4. Interest from Bank on Fixed Deposits Rs. 23,200
Compute Total Income and Tax liability.

[Total income- 3, 15,200, Tax liability -783]

Short Answer Type Questions

1. What is Gross total income?
2. Define total income.
3. Mention any four heads of incomes.
4. Compute the tax liability of Mr. Shekar .Total Income 5, 25,000

Ψ

UNIT 7

Goods and service tax -I

Learning Objectives

After studying this unit, the student will be able to
- Understand about Indirect tax
- Understand about History of GST
- Learn about SGST, CGST, IGST
- Understand about levy and calculation of tax.

Introduction

India's biggest indirect tax reform in the form of Goods and Services Tax (GST) has completed 1 year. A comprehensive dual GST was introduced in India from 1 July 2017.

The idea of moving towards the GST was first mooted by the then Union Finance Minister in his Budget for 2006-07. The talks of ushering in GST took concrete shape with the introduction of Constitution (122nd Amendment) Bill, 2014. The Bill was passed by the Parliament on 8 August 2016. This was followed by the ratification of the Bill by more than 15 states. On 12 April 2017, the Central Government enacted four GST bills:

- Central GST (CGST) Bill
- Integrated GST (IGST) Bill
- Union Territory GST (UTGST) Bill
- The GST (Compensation to States) Bill

In a short span of time, all the states approved their State GST (SGST) laws. Union territories with legislatures, i.e., Delhi and Pondicherry, have adopted the SGST Act and the other 5 union territories without legislatures have adopted the UTGST Act.

The GST Council, a recommendatory body consisting of representatives of Central as well as state governments, has met on several occasions and taken important decisions relating to tax rate structure, exemptions, rules, composition scheme etc. Over the period, the Council has recommended a reduction in the tax rates of various goods and services. It is also considering the various issues faced by trade and industry and endeavoring to simplify the new tax regime and ease compliance.

On the compliance front, all registered persons have to file monthly returns in Form GSTR-3B (containing a summary of outward and inward supplies) by the 20th of the succeeding month. Additionally, an invoice-wise return of outward supplies needs to be submitted in Form GSTR-1 by the 10th of the succeeding month. Taxpayers with turnover upto INR 1.5 crores can file Form GSTR-1 on quarterly basis. The Government has suspended the requirement of filing Form GSTR-2 (containing details of inward supplies) and GSTR-3 (a consolidated statement of inward and outward supplies).

The GST Council has approved a simplified GST return format wherein the taxpayers will be required to file only one monthly return. Input tax credit will be available based on invoice details of outward supplies uploaded by the supplier. Taxpayers having turnover below INR 5 crores will have an option to file return on quarterly basis.

Under GST, there is a provision for the person in charge of a conveyance to carry electronic way bill (e-way bill) if the consignment value exceeds INR50,000. E-way bill can be generated through various modes such as web (online), Android app, SMS using Bulk Upload Tool and API-based site-to-site integration. The e-way bill system has become effective for inter-state as well as intra-state movement of goods.

GST has been a major transition in the Indian tax framework. It has evolved significantly from the time of its inception. It is expected that Government's pro-active measures and industry's active participation, will make it a truly "Good and Simple Tax" in the times to come.

Meaning of GST

Goods and Services Tax (**GST**) is an indirect tax (or consumption tax) imposed in India on the supply of goods and services. GST is imposed at every step in the production process, but is meant to be refunded to all parties in the various stages of production other than the final consumer.

Goods and services are divided into five tax slabs for collection of tax - 0%, 5%, 12%, 18% and 28%. 32% However, Petroleum products, alcoholic drinks, electricity, are not taxed under GST and instead are taxed separately by the individual state governments, as per the previous tax regime.[There is a special rate of 0.25% on rough precious and semi-precious stones and 3% on gold.[1] In addition a cess of 22% or other rates on top of 28% GST applies on few items like aerated drinks, luxury cars and tobacco products.[2] Pre-GST, the statutory tax rate for most goods was about 26.5%, Post-GST, most goods are expected to be in the 18% tax range

The tax came into effect from July 1, 2017 through the implementation of One Hundred and First Amendment of the Constitution of India by the Indian government. The tax replaced existing multiple flowing taxes levied by the central and state governments.

The tax rates, rules and regulations are governed by the GST Council which consists of the finance ministers of center and all the states. GST is meant to replace a slew of indirect taxes with a federated tax and is therefore expected to reshape the country's 2.4 trillion dollar economy, but not without criticism.[3] Trucks' travel time in interstate movement dropped by 20%, because of no interstate check posts.[4]

Goods and Services Tax (**GST**) is an indirect tax (or consumption tax) imposed in India on the supply of goods and services. GST is imposed at every step in the production process, but is meant to be refunded to all parties in the various stages of production other than the final consumer.

Goods and services are divided into five tax slabs for collection of tax - 0%, 5%, 12%, 18% and 28%. 32% However, Petroleum products, alcoholic drinks, electricity, are not taxed under GST and instead are taxed separately by the individual state governments, as per the previous tax regime There is a special rate of 0.25% on rough precious and semi-precious stones and 3% on gold In addition a cess of 22% or other rates on top of 28% GST applies on few items like aerated drinks, luxury cars and tobacco products.[2] Pre-GST, the statutory tax rate for most goods was about 26.5%, Post-GST, most goods are expected to be in the 18% tax range

The tax came into effect from July 1, 2017 through the implementation of One Hundred and First Amendment of the Constitution of India by the Indian government. The tax replaced existing multiple flowing taxes levied by the central and state governments.

The tax rates, rules and regulations are governed by the GST Council which consists of the finance ministers of centre and all the states. GST is meant to replace a slew of indirect taxes with a federated tax and is therefore expected to reshape the country's 2.4 trillion dollar economy, but not without criticism.[Trucks' travel time in interstate movement dropped by 20%, because of no interstate check post .

Objectives of GST:

1. Ensuring that the cascading effect of tax on tax will be eliminated.
2. Improving the competitiveness of the original goods and services, thereby improving the GDP rate too.
3. Ensuring the availability of input credit across the value chain.
4. Reducing the complications in tax administration and compliance.
5. Making a unified law involving all the tax bases, laws and administration procedures across the country.
6. Decreasing the unhealthy competition among the states due to taxes and revenues.
7. Reducing the tax slab rates to avoid further clarification issues.

With all of these being very significant objectives of GST, it is still facing a lot of implementation issues. Some of them are:

1. Complete lack of adaptation mechanisms and trained staff.
2. In some cases, the double registration might annoy people. Also, these registrations result in increased compliances and cost.
3. Unclear estimate of the exact impact of GST.
4. No clear mechanisms to control tax evasion.

Advantages of GST:

1. GST is a transparent tax and also reduce number of indirect taxes.
2. GST will not be a cost to registered retailers therefore there will be no hidden taxes and and the cost of doing business will be lower.
3. Benefit people as prices will come down which in turn will help companies as consumption will increase.
4. There is no doubt that in production and distribution of goods, services are increasingly used or consumed and vice versa.
5. Separate taxes for goods and services, which is the present taxation system, requires division of transaction values into value of goods and services for taxation, leading to greater complications, administration, including compliances costs.
6. In the GST system, when all the taxes are integrated, it would make possible the taxation burden to be split equitably between manufacturing and services.
7. GST will be levied only at the final destination of consumption based on VAT principle and not at various points (from manufacturing to retail outlets). This will help in removing economic distortions and bring about development of a common national market.
8. GST will also help to build a transparent and corruption free tax administration.
9. Presently, a tax is levied on when a finished product moves out from a factory, which is paid by the manufacturer, and it is again levied at the retail outlet when sold.

10. GST is backed by the GSTN, which is a fully integrated tax platform to deal with all aspects of GST.

Disadvantages of GST:

1. Experts feel GST (CGST, SGST, and IGST) is just a new name for old taxes

2· Telecom, airlines and banking affected as the old services tax was at 15%, whereas under GST it is now 18%, raising costs for the industries.

3· Binding business by-laws in the control of the central and state governments.

4· Earlier goods used by disabled people such as braille paper, hearing aids, motorized wheelchairs etc. were tax free, however under GST these items are taxable.

5· Higher tax for banking and insurance services

6· Due to complexities of GST many rewards programs have been suspended

7· Launched during mid-financial year resulting in complications and confusions.

8· Seller must register in every state he/she does business in.

Salient features of GST
The salient features of GST are as under:

- (i)GST is applicable on 'supply' of goods or services as against the present concept on the manufacture of goods or on sale of goods or on provision of services.
- (ii) GST is based on the principle of destination-based consumption taxation as against the present principle of origin-based taxation.
- (iii) It is a dual GST with the Centre and the States simultaneously levying tax on a common base. GST to be levied by the Centre would be called Central GST(CGST) and that to be levied by the States would be called State GST (SGST).
- (iv) An Integrated GST (IGST) would be levied an inter-state supply (including stock transfers) of goods or services. This shall be levied and collected by the Government of India and such tax shall be apportioned between the Union and the States in the manner as may be provided by Parliament by Law on the recommendation of the GST Council.
- (v) Import of goods or services would be treated as inter-state supplies and would be subject to IGST in addition to the applicable customs duties.
- (vi) CGST, SGST & IGST would be levied at rates to be mutually agreed upon by the Centre and the States. The rates would be notified on the recommendation of the GST Council. In a recent meeting, the GST Council has decided that GST would be levied at four rates viz. 5%, 12%, 16% and 28%. The schedule or list of items that would fall under each of these slabs has been worked out. In addition to these rates, a cess would be imposed on "demerit" goods to raise resources for providing compensation to States as States may lose revenue owing to the implementation of GST.
- (vii) GST would replace the following taxes currently levied and collected by the Centre:-
  - a) Central Excise Duty
  - b) Duties of Excise (Medicinal and Toilet Preparations)
  - c) Additional Duties of Excise (Goods of Special Importance)

- d) Additional Duties of Excise (Textiles and Textile Products)
- e) Additional Duties of Customs (commonly known as CVD)
- f) Special Additional Duty of Customs(SAD)
- g) Service Tax
- h) Cesses and surcharge in so far as they relate to supply of goods and services.

- (viii) State taxes that would be subsumed within the GST are:-
  - a) State VAT
  - b) Central Sates Tax
  - c) Purchase Tax
  - d) Luxury Tax
  - e) Entry Tax (All forms)
  - f) Entertainment Tax and Amusement Tax (except those levied by the local bodies)
  - g) Taxes on advertisements
  - h) Taxes on lotteries, betting and gambling
  - i) State cesses and surcharges in so far as they relate to supply of goods and services.
- (ix) GST would apply on all goods and services except Alcohol for human consumption.
- (x) GST on five specified petroleum products (Crude, Petrol, Diesel, ATF & Natural Gas) would by applicable from a date to be recommended by the GSTC.
- (xi) Tobacco and tobacco products would be subject to GST. In addition, the Centre would have the power to levy Central Excise duty on these products.
- (xii) A common threshold exemption would apply to both CGST and SGST. Tax payers with an annual turnover not exceeding Rs.20 lakh (Rs.10 Lakh for special category States) would be exempt from GST. For small taxpayers with an aggregate turnover in a financial year upto 50 lakhs, a composition scheme is available. Under the scheme a taxpayer shall pay tax as a percentage of his turnover in a State during the year without benefit of Input Tax Credit. This scheme will be optional.
- (xiii) The list of exempted goods and services would be kept to a minimum and it would be harmonized for the Centre and the States as well as across States as far as possible.
- (xiv) Exports would be zero-rated supplies. Thus, goods or services that are exported would not suffer input taxes or taxes on finished products.
- (xv) Credit of CGST paid on inputs may be used only for paying CGST on the output and the credit of SGST paid on inputs may be used only for paying SGST. Input Tax Credit (ITC) of CGST cannot be used for payment of SGST and vice versa. In other words, the two streams of Input Tax Credit (ITC) cannot be cross-utilised, except in specified circumstances of inter-state supplies for payment of IGST. The credit would be permitted to be utilised in the following manner:-
  - a) ITC of CGST allowed for payment of CGST & IGST in that order;
  - b) ITC of SGST allowed for payment of SGST & IGST in that order;
  - c) ITC of IGST allowed for payment of IGST, CGST & SGST in that order.
- (xvi) Accounts would be settled periodically between the Centre and the States to ensure that the credit of SGST used for payment of IGST is transferred by the Exporting State to the Centre. Similarly, IGST used for payment of SGST would be transferred by the Centre to the Importing State. Further, the SGST portion of IGST collected on B2C supplies would also be

transferred by the Centre to the destination State. The transfer of funds would be carried out on the basis of information contained in the returns filed by the taxpayers.

- (xvii) The laws, regulations and procedures for levy and collection of CGST and SGST would be harmonized to the extent possible.

The whole GST system will be backed by a robust IT system. In this regard, Goods and Services Tax Network (GSTN) has been set up by the Government. It will provide front end services and will also develop back end IT modules for States who opted for the same.

HISTORY OF GST:

ST or Goods and Services Tax came into use from July 1, 2017 replacing number of other taxes that was applied till June 30, 2018. The discussions of GST Bill has been in process process for more than two decades and the bill was passed to implement GST from July 1, 2017 by the Prime Minister of India and his Finance Minister Arun Jaitley. GST was launched on the midnight of July 1, 2017. The single GST replaced several taxes and levies which included: central excise duty, services tax, additional customs duty, surcharges, state-level value added tax and Ontario. We follow the dual GST system i.e. GST for State and Central named SGST and CGST, respectively. Let us have an overview on the history of GST from the content below as an eye-opener.

Overview on History of GST

- 2006 - First announcement of GST was made by the Union Minister during the 2006-2007 budget, that it would be introduced on April 1, 2010.
- 2009 - Empowered Committee released the first Discussion Paper.
- 2011 - 115th Amendment Bill was introduced and subsequently lapsed
- 2014 - 122nd Amendment Bill was introduced in Lok Sabha
- August 2016 - One Hundred and First Amendment Act was enacted
- September 2016 - The first GST Council Meeting was conducted
- March 2017 - CGST, SGST, IGST, UTGST and Compensation Cess Act was recommended by GST Council.
- April 2017 - CGST, SGST, IGST, UTGST and Compensation Cess Act were passed
- 1 July 2017 - GST laws, Goods and Services Tax was launched all over India.
- 7 July 2017 - Jammu and Kashmir state legislature passed its GST

What were the Taxes available Before the Implementation of GST?
State Value Added Tax (VAT), Central Excise Tax, Services Tax, Central Sales Tax, etc are all replaced by the single entity called GST (Goods and Services Tax). Value Added Tax was mainly for the taxes at State level across all states in India. Now on introduction of GST, VAT is replaced by State GST or SGST and the State VAT department will be simply converted to SGST Departments. More details on SGST are given below. Similarly, Central Excise Tax that is the central tax for the goods and services are now replaced with Central GST or CGST.

What was the GST Rates as on July 1, 2017?
As said in the Introduction, GST was implemented in the year 2017 on July 1st. When Gst was first introduced, the charges were broadly divided for State and Central GST. When compared to the earlier taxing system, newly introduced GST rates were higher. When GST was first introduced it had five tax slabs and the goods and services were spread across these tax slabs. This GST rates were followed till an amendment to lower the GST rates on selected

goods and services were made on 18th January 2018 at 25th GST Council Meet. After which amendments were made on 29 Goods and 53 Services which came to effect from 25 January 2018. GST rates major goods till January 25, 2018 are listed below.

0% GST Rate	fresh meat, fish chicken, Eggs, Milk, butter milk, Curd, natural honey, fresh fruits and vegetables, flour, besan, bread, prasad, Salt, BindiSindoor, Stamps, judicial papers, printed books, Newspapers, Bangles, handloom etc.
5% GST Rate	Fish fillet, Cream, skimmed milk powder, branded paneer, frozen vegetables, Coffee, Tea, Spices, pizza bread, Rusk, Sabudana, Kerosene, Coal, Medicines, Stent, lifeboats

12% GST Rate	Frozen meat products, Butter, Cheese, Ghee, dry fruits in packaged form, animal fat, Sausage, fruit juices, Bhutia, Namkeen, Ayurvedic medicines, tooth powder, Agarbatti, colouring books, picture books, Umbrella, sewing machine, and cellphones
18% GST Rate	Flavored refined sugar, Pasta, Cornflakes, pastries and cakes, preserved vegetables, jams, sauces, Soups, ice cream, instant food mixes, mineral water, Tissues, Envelopes, Tampons, notebooks, steel products, printed circuits, Camera, speakers and monitors.
28% GST Rate	Chewing gum, Molasses, chocolate not containing cocoa, waffles and wafers coated with chocolate, pan masala, aerated water, Paint, Deodorants, shaving creams, after shave, hair shampoo, Dye, Sunscreen, Wallpaper, ceramic tiles, water heater, Dishwasher, weighing machine, washing machine, ATM, vending machines, vacuum cleaner, Shavers, hair clippers, Automobiles, Motorcycles, aircraft for personal use, and yachts

Meaning of CGST:

Under GST, CGST is a tax levied on Intra State supplies of both goods and services by the Central Government and will be governed by the CGST Act. SGST will also be levied on the same Intra State supply but will be governed by the State Government.

This implies that both the Central and the State governments will agree on combining their levies with an appropriate proportion for revenue sharing between them. However, it is clearly mentioned in Section 8 of the GST Act that the taxes be levied on all Intra-State supplies of goods and/or services but the rate of tax shall not be exceeding 14%, each.

Meaning of SGST:

Under GST, SGST is a tax levied on Intra State supplies of both goods and services by the State Government and will be governed by the SGST Act. As explained above, CGST will also be levied on the same Intra State supply but will be governed by the Central Government.

Note: Any tax liability obtained under SGST can be set off against SGST or IGST input tax credit only.

An example for CGST and SGST**:**

Let's suppose Rajesh is a dealer in Maharashtra who sold goods to Anand in Maharashtra worth Rs. 10,000. The GST rate is 18% comprising of CGST rate of 9% and SGST rate of 9%. In such case, the dealer collects Rs. 1800 of which Rs. 900 will go to the Central Government and Rs. 900 will go to the Maharashtra Government.

Meaning of IGST:

Under GST, IGST is a tax levied on all Inter-State supplies of goods and/or services and will be governed by the IGST Act. IGST will be applicable on any supply of goods and/or services in both cases of import into India and export from India.

Note: Under IGST,

- Exports would be zero-rated.
- Tax will be shared between the Central and State Government.

An example for IGST:

Consider that a businessman Rajesh from Maharashtra had sold goods to Anand from Gujarat worth Rs. 1,00,000. The GST rate is 18% comprised of 18% IGST. In such case, the dealer has to charge Rs. 18,000 as IGST. This IGST will go to the Centre.

Levy and collection of GST:

1. here shall be levied a tax called the Central/State Goods and Services Tax (CGST/SGST) on all intra-State supplies of goods and/or services on the value determined under section 15 and at such rates as may be notified by the Central/State Government in this behalf, but not exceeding fourteen percent, on the recommendation of the Council and collected in such manner as may be prescribed.
2. The CGST/SGST shall be paid by every taxable person in accordance with the provisions of this Act.
3. The Central or a State Government may, on the recommendation of the Council, by notification, specify categories of supply of goods and/or services the tax on which is payable on reverse charge basis and the tax thereon shall be paid by the recipient of such goods and/or services and all the provisions of this Act shall apply to such person as if he is the person liable for paying the tax in relation to the supply of such goods and/or services.
4. The Central or a State Government may, on the recommendation of the Council, by notification, specify categories of services the tax on which shall be paid by the electronic commerce operator if such services are supplied through it, and all the provisions of this Act shall apply to such electronic commerce operator as if he is the person liable for paying the tax in relation to the supply of such services: PROVIDED that where an electronic commerce operator does not have a physical presence in the taxable territory, any person representing such electronic commerce operator for any purpose in the taxable territory shall be liable to pay tax: PROVIDED FURTHER that where an electronic commerce operator does not have a physical presence in the taxable territory and also he does not have a representative in the said territory, such electronic commerce operator shall appoint a person in the taxable territory for the purpose of paying tax and such person shall be liable to pay tax.

Input Tax Credit under GST – Conditions to Claim

A registered person will be eligible to claim Input Tax Credit (ITC) on the fulfillment of the following conditions:

1. Possession of a tax invoice or debit note or document evidencing payment

2. Receipt of goods and/or services

3. Goods delivered by supplier to other person on the direction of a registered person against a document of transfer of title of goods

4. Furnishing of a return

5. Where goods are received in lots or installments ITC will be allowed to be availed when the last lot or installment is received.

6. Failure of the supplier towards supply of goods and/or services within 180 days from the date of invoice, ITC already claimed by recipient will be added to output tax liability and interest to paid on such tax involved. On payment to supplier, ITC will be again allowed to be claimed

7. No ITC will be allowed if depreciation has been claimed on tax component of a capital good

8. Time limit to claim ITC against an Invoice or Debit Note is earlier of below dates:

The due date of filing GST Return for September of next financial year

OR
Date of filing the Annual Returns relevant for that financial year

For instance, XY Corp, a buyer has a Purchase Invoice was dated 8th July 2017(FY 2017-18), wants to claim GST paid on that purchase. As per the criteria laid down to reckon the time limit:

The Due date of filing GST return for September 2018(FY 2018-19) is 20th October 2018 and the Date of filing GST Annual Return for FY 2017-18 is 31st December 2018, whichever is earlier will be the time period within which XY Corp has to claim ITC. Therefore, the date is 20th October 2018 and XY Corp can claim this ITC in any of the months between July 2017 to September 2018.

Note: For Debit Notes, above condition must be considered with respect to Original Invoice Date.

9. Common credit of ITC used commonly for

- Effecting exempt and taxable supplies
- Business and non-business activity.

Short Questions:
1. Meaning of SGST,CGST,IGST
2. History of GST.
3. Input tax credit

Essay Questions:

1. Write about objectives of GST.
2. What are the Advantages and Disadvantages of GST
3. Write about features of GST.
4. How to Levy and Collection of GST.

Ψ

UNIT 8

Goods and service tax -II

Learning Objectives

- After studying this unit, the student will be able to
- Understand about Reverse charge mechanism
- Understand about Registration procedure under GST
- Learn about persons liable and not liable for registration
- Understand about monthly returns under GST.

Reverse Charge in GST

It is a new concept that is introduced in GST in India, to increase tax revenues, coverage and compliance from partly or unorganized sectors.

Earlier goods were exempt from this scheme, now the collection of GST will increase tremendously.

In GST, the supplier will be liable to collect tax on goods and services provided. But the central government has the power to notify categories of supplies against which service recipient has to discharge the tax liability. Hence, all the provisions of the Act will now be applicable to the recipient of such goods or services as if he is the supplier of such goods or services.

When a person becomes liable to pay tax on the reverse charge, certain provisions like threshold exemption, time of supply, availing of input credit changes. There is a threshold limit for turnover aggregating to Rs.20 Lakhs for registration for normal tax payers but under reverse charge, there is no such limit. The person has to be registered under GST irrespective of the aggregate limit.

Situations Where the Reverse Charge Will Apply

1. If the registered dealer is buying goods or services from an unregistered dealer then, the registered dealer will be liable to pay tax on supply.
2. All other categories of supplies will be notified by Central or State government that will fall under reverse charge.

Time of Supply for Goods Under Reverse Charge

Provisions are different under reverse charge than normal scenario. Time of supply will be the earliest of the below dates:

- When the goods are received i.e. the date of receipt.
- When the amount is paid i.e. the date of payment.
- Date of payment shall be earliest of *'The date on which payment has been debited from supplier's bank account'* Or *'When the recipient records the payment in his books of account'*
- The date immediately after 30 days from the date the supplier issues invoice.

If the assessee fails to determine the time of supply from the above-mentioned clauses, then the time of supply shall be the date on which recipient enters in his books of account.

For Example:
Date of receipt of goods – 16^{th} May 2017
Date of Payment – 16^{th} July 2017
Date of Invoice – 1^{st} June 2017
Date of Entry in books by recipient – 18^{th} May 2017
Thus, Time of supply will be – 16^{th} May 2017. If by any chance time of supply could not be determined under mentioned clauses then it will be 18th May 2017, i.e. Date of entry.

Time of Supply for Services under Reverse Charge

Similarly, provisions are different for services under reverse charge. Time of supply will be the earliest of the below dates:

- When the amount is paid i.e. the date of payment OR
- Date of payment shall be earliest of – *'The date on which payment has been debited from supplier's bank account'* Or *'When the recipient records the payment in his books of account'.*
- The date immediately after 30 days from the date the supplier issues invoice.

If the assesse fails to determine the time of supply from the above-mentioned clauses, then the time of supply shall be the date on which recipient of service enters in his books of account.

For Example:
Date of Payment – 16^{th} June 2017
Date of Invoice – 1^{st}July 2017
Date of Entry in books by recipient – 18^{th} June 2017
Thus, Time of supply will be – 16^{th} June 2017. If by any chance, time of supply could not be determined under mentioned clauses then it will be 18^{th} June 2017, i.e. Date of entry.

If the supplier is located outside India, then the time of supply shall be the earliest of – 'When the amount is paid i.e. the date of payment' OR 'When the recipient records the payment in his books of account'.

GST Registration

Provisions relating to persons liable for obtaining GST registration and provisions relating to compulsory GST registration are contained under section 22 and section 24, respectively, of the **Central Goods and Service Tax (CGST) Act, 2017**. The current article explains both the aforesaid provisions.

Person Liable For Obtaining **GST Registration** –

As per section 22 of the Central Goods and Service Tax (CGST) Act, 2017 following list of persons are liable for obtaining **GST registration** –

1. Supplier engaged in providing a taxable supply of goods or services or both is required to obtain GST registration in the State or Union territory from where the supply is initiated, in case the aggregate turnover exceeds INR 20 Lakhs in a financial year.

2. In case of special category states, supplier engaged in providing a taxable supply of goods or services or both are required to obtain **GST registration** in case the aggregate turnover exceeds INR 10 Lakhs in a financial year.

3. Persons who are registered under the erstwhile law, on the day immediately preceding the appointment date, is liable to obtain GST registration.

4. Every person who is registered under an earlier law (i.e., Excise, VAT, Service Tax etc.) Needs to register under GST, too.

5. When a business which is registered has been transferred to someone/demerged, the transferee shall take registration with effect from the date of transfer.

6. Anyone who drives inter-state supply of goods

7.Casual taxable person (see below)

8. Non-Resident taxable person (see below)

9. Agents of a supplier

10. Those paying tax under the reverse charge mechanism

11. Input service distributor (see below)

12.E-commerce operator or aggregator*

13. Person who supplies via e-commerce aggregator

14. Person supplying online information and database access or retrieval services from a place outside India to a person in India, other than a registered taxable person

e-commerce sellers/aggregators need not register if total sales is less than Rs. 20 lakh

Persons not liable for registration

list Of Persons Exempted From Obtaining GST Registration –

Following categories of person are exempted from obtaining Goods and Service Tax (GST) registration –

1. The person engaged exclusively in providing business of supplying goods or services or both that are not liable to tax or are wholly exempted from tax under Central Goods and Service Tax Act, 2017 or under **Integrated Goods and Services Tax Act, 2017**.

2. An agriculturist. However, the exemption is only to the extent of supply of produce out of cultivation of land.

3. Individual advocates, including senior advocates.

4. Individual sponsorship service providers, including players.

5. The person engaged in making inter-state supplies of taxable services and having an aggregate turnover of less than INR 20 Lakhs, INR 10 Lakhs in case of special category states, in a financial year

6. The person engaged in the supply of services and having an aggregate turnover of less than INR 20 Lakhs, INR 10 Lakhs in case of special category states, in a financial year.

However above exemption is not available to the person who is engaged in supplies, specified under sub-section (5) of section 9 of the Act, through an e-commerce operator who is required to collect tax at source (TCS) under section 52 of the Act.

7. The person engaged in supplying taxable goods or services or both and the total tax on such supplies is required to be paid by the recipient of goods or services or both under reverse charge mechanism

COMPULSORY GST REGISTRATION

As per the section 24 of CGST Act 2017 there are certain cases when **GST registration** is required to be taken by the supplier of goods or services or both. In this section supplier has to get itself registered irrespective of the fact that it has aggregate turnover of 20 lakhs (10 lakhs in case of special category of states) or above. There have been certain notifications through which certain persons have been given relief by the government from compulsory GST registration.

1. Persons making any inter-State taxable supply

Summary: As per the above provision if any person making inter-state "taxable" supplies then irrespective of the amount of supply the person has to get itself registered.

Exemption from compulsory GST registration

- Inter- state supply of service up to 20 lakhs- As per **notification no 10/2017,** any person making interstate taxable supply of service and having an aggregate turnover to be computed on all India basis not exceeding an amount of 20 Lakhs (10 Lakhs for special category of states except J&K) in an financial year then he is not required to get itself registered. It also means that there is not exemption to supplier of inter-state supply of goods.
- Exemption to "Job worker"- As per **notification no 07/2017,**the job worker engaged in making inter-state "supply of services" to a "registered person" as the category of person exempted from obtaining registration, however this notification is not so relevant due to schedule-II job work will always be considered as supply of service and exemption for supply of service has already been given through **notification no 10/2017.**

2. Casual taxable persons making taxable supply

Summary: As per section 24 of **CGST Act 2017**, a casual taxable person is required to obtain compulsory registration irrespective of the aggregate turnover in the previous year. However exemption has been given to person engaged in the supply of "Handicraft goods". A casual taxable person making taxable supplies of handicraft goods is exempted from obtaining registration if aggregate turnover to be computed on all India basis not exceeding an amount of 20 Lakhs.

Casual taxable person meaning- As per sec 2(20) of CGST Act means a person who occasionally undertakes transactions involving supply of goods or services or both in the course or furtherance of business, whether as principal, agent or in any other capacity, in a State or a Union territory where he has no fixed place of business

3. Persons who are required to pay tax under reverse charge

Summary: As per the above provision a person who is required to pay tax under reverse charge has to take compulsory registration as he has to take registration to submit tax under reverse charge. **However this important point should be taken into consideration that Section 24 overrides sec 22 only so any person who is exclusively in the business under section 23 i.e. any person engaged exclusively in the business of supplying goods or services not liable to tax or wholly exempt from tax then he is not required to get himself registered.**

4. Person who are required to pay tax under sub-section (5) of section 9

Summary: As per the above provision any person who is required to submit tax under section 9(5). As per section 9(5) specific categories of intra-state services through e-commerce operators then e-commerce operators are required to pay GST hence they are compulsorily required to get registered. As they have to pay tax under reverse charge mechanism

5. Non-resident taxable persons making taxable supply

Summary: As per the above provision a nonresident person who is making any kind of taxable supply in the taxable territory then he has to take compulsory registration.

As per section 2(77) of CGST Act 2017,"Non-resident taxable person" means any person who occasionally undertakes transactions involving supply of goods or services or both, whether as principal or agent or in any other capacity, but who has no fixed place of business or residence in India;

6. Persons who are required to deduct tax under section 51, whether or not separately registered under this Act

Summary: A person who is required to deduct TDS the authorities as notified a department or establishment of the Central Government or State Government; or local authority; or Governmental agencies; or

such persons or category of persons as may be notified by the Government are required to get itself registered under GST compulsorily

7. Persons who make taxable supply of goods or services or both on behalf of other taxable persons whether as an agent or otherwise

Summary: A person who is working as an agent or otherwise and also making taxable supply then as per section 24 of CGST Act 2017 he has to compulsorily get registered so any kind of agent who is making taxable supply needs to get registered under GST immediately. As per section 2(5) of CGST Act 2017 "agent" means a person, including a factor, broker, commission agent, arhatia, delcredere agent, an auctioneer or any other mercantile agent, by whatever name called, who carries on the business of supply or receipt of goods or services or both on behalf of another;

8. Input Service Distributor, whether or not separately registered under this Act

Summary: As per the above provision input service distributor has to get compulsory registration under GST. As per 2(61) of CGST Act 2017 "Input Service Distributor" means an office of the supplier of goods or services or both which receives tax invoices issued under section 31 towards the receipt of input services and issues a prescribed document for the purposes of distributing the credit of central tax, State tax, integrated tax or Union territory tax paid on the said services to a supplier of taxable goods or services or both having the same Permanent Account Number as that of the said office;

9. Persons who supply goods or services or both, other than supplies specified under sub-section (5) of section 9, through such electronic commerce operator who is required to collect tax at source under section 52

Summary: As per the above provision if a person makes supplies through electronic commerce operator other than 9(5) then the supplier is also required to get compulsorily registered under GST.

10. Every electronic commerce operator

Summary: As per the above provision electronic commerce operator has to get GST registration irrespective of the turnover in previous year. "Electronic commerce" means the supply of goods or services or both, including digital products over digital or electronic network. "Electronic commerce operator" means any person who owns, operates or manages digital or electronic facility or platform for electronic commerce

11. Every person supplying online information and data base access or retrieval services from a place outside India to a person in India, other than a registered person

Summary: As per the above provision if a person is supplying online information and data base access or retrieval from outside India then that person has to get itself registered under GST irrespective of the turnover in the previous year. E.g. Netflix providing services outside India then Netflix has to get itself-registered and pay taxes under normal charge.
Such other person or class of persons as may be notified by the Government on the recommendations of the Council.

Types of GST Returns:

S.No	***Return***	***Particulars***
1.	GSTR-1	Details of outward supplies of taxable goods or services or both effected
2.	GSTR-2	Details of inward supplies of taxable goods or services or both claiming input tax credit
3	GSTR-3	Monthly return on the basis of finalization of details of outward supplies and inward supplies along with the payment of amount of tax
4	GSTR-4	Quarterly Return for compounding taxable persons
5	GSTR-5	Return for Non-Resident foreign taxable persons
6	GSTR-6	Input Service Distributor return
7	GSTR-7	Return for authorities deducting tax at source
8	GSTR-8	Details of supplies effected through e-commerce operator and the amount of tax collected as required under sub-section (52)
9	GSTR-9	Annual Return
10	GSTR-9A	Simplified Annual return by Compounding taxable persons registered under section 10

Details of GST return forms:

this information shows the details of all GST return forms & details of returns which are required to be filed under the GST Law:

1. <u>Who is required to furnish the return</u>?

GSTR 1: Registered person shall be required to submit details of outward supplies other than the following registered person

i. Input Service Distributor

ii. Non-Resident Taxable Person

iii. Person paying tax under section 10 i.e. person opting for Composition Levy

iv. Person required to deduct tax at source i.e. Person paying tax under section 51

v. Person required to collect tax at source i.e. Person paying tax under section 52

GSTR 2: Registered person shall be required to submit details of Inward supplies other than the following registered persons:
i. Input service distributor
ii. Non-Resident Taxable person
iii. Person paying tax under section 10 i.e. person opting for Composition Levy
iv. Person required to deduct tax at source i.e. person paying tax under section 51.

v. Person required to collect tax at source i.e. person paying tax under section 52
GSTR 3: Registered person shall be required to submit return in from GSTR-3, barring the following registered persons
i. Input service distributor
ii. Non-Resident Taxable person
iii. Person paying tax under section 10 i.e. person opting for Composition Levy
iv. Person required to deduct tax at source i.e. person paying tax under section51.

v. Person required to collect tax at source i.e. person paying tax under section 52
GSTR 4: Registered person paying tax under section 10 i.e. person paying composition levy in lieu of tax
GSTR 5: Registered Non-Resident Taxable person

GSTR 6: Taxable person registered as Input Service Distributor

GSTR 7: Registered person required to deduct tax under section 51

GSTR 9: Registered person shall be required to submit Annual return other than the following registered person

i. Input Service Distributor

ii. Non-Resident Taxable person

iii. Person required to deduct tax at source i.e. Person paying tax under section 51

iv. Person required to collect tax at source i.e. person paying

3. Periodicity of Filing of Return:
GSTR 1, GSTR 2 & GSTR 7GSTR 3, GSTR 5 & GSTR 6: Monthly
GSTR 4: Each quarter or part thereof

GSTR 9: Yearly

4. Due Date for Submission of Return:
GSTR 1: On or before the 10th day of the month succeeding the said tax period

GSTR 2: After the tenth but on or before the fifteenth day of the month succeeding the tax period

GSTR 3: On or before twentieth day of the month succeeding such calendar month or part thereof

GSTR 4: Eighteen days after the end of such quarter

GSTR 5: Twenty days after the end of a calendar month or within seven days after the last day of the period of registration, whichever is earlier

GSTR 6: Thirteen days after the end of such month

GSTR 7: Ten days after the end of such month

GSTR 9: On or before the thirty first day of December following the end of such financial year

Essay Questions
1. What is Registration under GST ?Explain persons Liable for Registration.
2. Write persons not liable for GST Registration.
3. Write about Types of Returns under GST.

Short Questions
1. What is Time of Supply?
2. What is Place of Supply?
3. Explain Reverse charge Mechanism.

Ψ

ACCOUNTING & TAXATION (A & T)

II YEAR

PART-B, VOCATIONAL COURSE

PAPER-I THEORY

Auditing

Periods/Week :05 **Periods/Year:110**

Time Schedule Weightage And Blue Print

S.No	Name of Unit	No.Of Periods	Weightage In Marks	Short Answer Questions	Essay type Questions
1	Introduction of Auditing ,	10	10	2	1
2	Objects of Audit	10	8	1	1
3	Types of Audit	10	8	1	1
4	Qualification and disqualification of Auditor - Appointment and removal of Auditor	20	10	2	1
5	Remuneration, Rights & Duties of auditor	15	8	1	1
6	Vouching, Errors and Frauds	15	8	1	1
7	Audit Programmee	15	8	1	1
8	Audit Report	15	8	1	1
	Total	**110**	**68**	**10**	**8**

ACCOUNTING & TAXATION (A & T)

II YEAR

PART-B, VOCATIONAL COURSE

PAPER-II THEORY

Accountancy And Tally

Periods/Week :04 **Periods/Year:110**

Time Schedule Weightage And Blue Print

S.No	Name of Unit	No.Of Periods	Weightage In Marks	Short Answer Questions	Essay type Questions
1	Depreciation	10	8	1	1
2	Accounts of Non-Trading Concerns	10	10	2	1
3	Partnership Accounts-I	20	8	1	1
4	Partnership Accounts-II	15	8	1	1
5	Company Accounts – I	15	8	1	1
6	Company Accounts – II	15	8	1	1
7	Accounting Packages-I(Tally)	10	8	1	1
8	Accounting Packages-II(Tally)	10	10	2	1
	Total	**110**	**68**	**10**	**08**

ACCOUNTING & TAXATION (A & T)

II YEAR

PART-B, VOCATIONAL COURSE

PAPER-III THEORY

Taxation - II

Periods/Week :05 **Periods/Year:110**

Time Schedule Weightage And Blue Print

S.No	Name of Unit	No.Of Periods	Weightage In Marks	Short Answer Questions	Essay type Questions
1	Income From Business	15	8	1	1
2	Income From Profession	15	8	1	1
3	Income From Capital Gains	15	8	1	1
4	Income From Other Sources	15	10	2	1
5	Deductions From Gross Total Income	15	8	1	1
6	Assessment of Individual	15	8	1	1
7	Goods and Service Tax-I	10	8	1	1
8	Goods and Service Tax-II	10	10	2	1
	Total	**110**	**68**	**10**	**08**

ACCOUNTING & TAXATION (A & T)
II YEAR
PAPER I Auditing

TIME: 3 Hours **Max. Marks: 50**

SECTION-A

Note: i) Answer all questions **10 x 2 =20**
ii)Each question carries two marks

01. Define Auditing
02. What is Investigation
03. What is Interim audit
04. What is Statutory audit
05. Who appoints first auditor
06. What are disqualification of auditor
07. Who will fix the remuneration of auditor
08. What is vouching
09. Clean report
10. Define Investigation

SECTION-B

Note: i) Answer any five questions **5 x 6 = 30**
ii) Each question carries Six marks

11. What are the advantages of auditing
12. What is error, Write different types of error
13. Explain the differences between periodical and continuous audit
14. What are the qualifications of an Auditor
15. Explain the rights of an auditor
16. Explain the precautions taken when vouching different vouchers.
17. What are the steps to be taken by the auditor for Audit Programmee
18. What are the differences different types of audit report

Ψ

ACCOUNTING & TAXATION (A & T)
II YEAR
PAPER II Accountancy And Tally

TIME: 3 Hours **Max. Marks:50**

SECTION-A

Note: i) Answer all questions **10 x 2 =20**
ii) Each question carries two marks

1. What is Depreciation
2. Write any two examples for capital expenditure
3. Donations
4. Gaining ratio
5. What is goodwill
6. Discount on issue of shares
7. Out standing Expenditure
8. Features of inventory
9. Groups under Tally
10. Functional keys for Sales and Purchase

SECTION-B

Note: i) Answer any five questions **5 x 6 = 30**
ii) Each question carries Six marks

11 Mr. Raman purchased a machine for Rs.50,000 on 1st January 2017. It is decided to depreciate the asset on Straight line method at 10% p.a. Prepare Depreciation account for three years in the books of Mr. Ramana .

12. Problems from Income and Expenditure Account with minimum 3 adjustments
13. Problem on good will calculation under simple and weighted average methods
14. Problems on Admission of the partner – Revaluation Account, Partners Capital A/c, Cash A/c, New Balance sheet with minimum 5 adjustments.
15. Problems on issue of share .
16. Problem on Company final Accounts as per companies act 2013
17. Explain the features of accounting packages Tally.
18. What are different types ledger groups ?

Ψ

ACCOUNTING & TAXATION (A & T)
II YEAR
PAPER III Taxation - II

TIME:3 Hours **Max. Marks:50**

SECTION-A

Note: i) Answer all questions **10 x 2 =20**
ii) Each question carries two marks

1. What is Business income
2. Define Profession
3. Long term capital gain
4. What are securities
5. What is meant by casual income
6. What is Deduction 80 D
7. Rebate on tax
8. IGST
9. Reverse charge
10. GST council

SECTION-B

Note: i) Answer any five questions **5 x 6 = 30**
ii) Each question carries Six marks

11. Simple Problem from Income from Business
12. Simple Problem on Income from Profession (C.A., Doctor or lawyer)
13. Sri Harsha sold his Residential House for Rs.8,22,000 on 10th March, 2017. (Cost of inflation index 711) which he purchased on June 2005 for Rs. 3,00,000. (Cost of inflation Index 351) and he paid selling expenses Rs.22,000. Compute Income from Capital gains.
14. Simple Problem on Income from interest on securities under the head of income from other sources
15. Write about any two deductions out of 80 C , 80 CCD, 80 D, 80 E, 80 GGA
16. Compute the total income of Mrs. Narayana Rao for the current Assessment year:
    1. Income from Salary Rs. 2,00,000
    2. Income from Let house Rs. 1,20,000
    3. Loss from self occupied house Rs. 35,000
    4. Income from other sources Rs. 25,000
    5. She contributed to LIC Rs.10,000 on Policy value Rs.1,50,000 and paid medical insurance by cheque Rs. 10,000
17. Explain meaning and objectives of GST
18. Explain the Registration procedure under GST

Ψ