UPSC EPFO · EO/AO · APFC

The Compact Book for UPSC EPFO

ACCOUNTANCY

36 Chapters · Every EPFO PYQ · DEALER Rule for Every Entry

The complete accountancy syllabus of UPSC EPFO in plain, connected language: concepts, worked illustrations, every journal entry explained with the DEALER rule, and every previous-year question with its answer.

Foundations · Recording & Books · Financial Statements · Company Accounts · Analysis · Partnership & Special · Costing, Insurance & Auditing

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CHAPTER 1

Basic Accounting: Meaning, Definitions & Process

CHAPTER AT A GLANCE

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1 Meaning and Definitions of Accounting

Part I · Foundations

Weightage in UPSC EPFO: No question asked directly (EO/AO and APFC, 2015-2025), but it is the base of General Accounting Principles; its terms appear in options on concepts and conventions (Chapter 3).

➤ Meaning

Accounting carries the financial message of a business - how much it earned, what it owns, what it owes - to those who need to know.

➤ Standard Definitions

Authority	Definition (substance)
AICPA, 1941	The art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof.
AAA, 1966	The process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information.
APB, 1970 (Statement No. 4)	A service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions.

➤ Working Definition

NCERT: Accounting is the process of identifying, measuring, recording and communicating the required information relating to the economic events of an organisation to the interested users of such information.

2 Economic Events: the Raw Material of Accounting

Part I · Foundations

➤ Event and Transaction

- **Economic event:** a happening of consequence to a business, consisting of transactions and measurable in money.
- **Transaction:** an exchange of value between two or more parties, for cash or on credit.
- Every transaction is an event; every event is not a transaction (fall in value of stock: event, no exchange).

➤ External and Internal Events

External events (with outsiders)	Internal events (within the organisation)
Sale of goods to customers; purchase of materials from suppliers; rent paid to the landlord	Raw materials issued to the factory; wages paid; depreciation charged; goods transferred between departments

3 The Accounting Process

Part I · Foundations

➤ Stages of the Process

- **NCERT:** four attributes - identifying, measuring, recording, communicating.
- **Traditional texts, eight steps:** Identifying → Measuring → Recording → Classifying → Summarising → Analysing → Interpreting → Communicating.
- **Flow within the books:** Journal → Ledger → Trial balance → Financial statements.

➤ Steps 1-2: Identification and Measurement

- **Identification:** decides which events are recorded; events without money value and owner's personal events are left out.
- **Measurement:** assigns money value; where no exact figure exists, a reliable estimate is used (e.g. depreciation).

➤ Steps 3-5: Recording, Classifying and Summarising

- **Recording:** date-wise in the **journal**, the book of original entry.
- **Classifying:** items of similar nature grouped under one head in the **ledger**.
- **Summarising:** trial balance first; then Statement of Profit and Loss and Balance Sheet.

Step 3 - Journal of Anita: goods bought on credit from Sharma Traders

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
1 Apr	Purchases A/c **Dr.**	60,000		Expense (Purchases) ↑ → Debit
	To Sharma Traders (Creditor)		60,000	Liability (Sharma Traders) ↑ → Credit
	(Being goods purchased on credit)			

➤ Steps 6-8: Analysing, Interpreting and Communicating

Step	Work done
Analysing	Establish relationships between summarised items - comparisons, trends, ratios
Interpreting	Explain the meaning and significance of the analysis
Communicating	Convey information to users in a suitable form at the right time

4 Objectives, Role and Qualitative Characteristics

Part I · Foundations

➤ Qualitative Characteristics

They make accounting information useful for decision-making. NCERT, following the ICAI Framework, names four: reliability, relevance, understandability, comparability.

Characteristic	Meaning	Components
Reliability	Free from material error and bias; faithfully represents what it claims to	Verifiability · Neutrality · Faithful representation · Consistent methods
Relevance	Capable of making a difference to a user's decision	Timeliness · Predictive value · Feedback (confirmatory) value
Understandability	Receiver understands it in the sense the sender intended	Clear classification and presentation; users have reasonable knowledge; complex but relevant items not left out
Comparability	Users can compare across periods (intra-firm) and firms (inter-firm)	Common period, unit, format and consistent policies

➤ Newer Conceptual Framework (IASB 2018; Ind AS)

- **Fundamental:** relevance (with materiality) and faithful representation (replaces the term reliability).
- **Enhancing:** comparability, verifiability, timeliness, understandability.
- Conservatism is a convention (Chapter 3), not a characteristic.

5 Branches, History and Limitations of Accounting

Part I · Foundations

➤ Branches of Accounting

- NCERT names three main branches: financial accounting, cost accounting, management accounting.

Key Terms

Auditing	Independent examination of books and statements to express an opinion on a true and fair view
Human resource accounting	Identifying and measuring the cost and value of employees as an asset
Responsibility accounting	Accumulating costs and revenues by responsibility centres so each manager is accountable for what he or she controls

➤ History of Accounting and the Profession in India

- **India (about 23 centuries ago): Kautilya**, minister of Chandragupta Maurya, described how accounting records should be kept in the Arthashastra.
- **Venice, 1494: Luca Pacioli**, a Franciscan friar, published Summa de Arithmetica, Geometria, Proportioni et Proportionalita - the first printed book to explain double entry; father of modern accounting.
- **ICAI** (Chartered Accountants Act, 1949); **ICMAI** (Cost and Works Accountants Act, 1959); **ICSI** (Company Secretaries Act, 1980).

➤ Limitations of Accounting

- NCERT names three: accounting is historical, quantitative and financial only, and ignores items not measurable in money.

Limitation	Explanation and example
Only money-measurable items	Skill of staff, customer loyalty, a capable manager are not recorded.
Historical cost basis	Machine bought for ₹10 lakh in 2018 shown at cost less depreciation even if market value is ₹20 lakh.
Choice of methods	Straight line vs written down value: profits not strictly comparable.

CHAPTER 2

Book-keeping and Users of Accounting Information

CHAPTER AT A GLANCE

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    - Revenue, Expense, Expenditure, Gain and Loss
    - Trade Discount and Cash Discount

1 Book-keeping

Part I · Foundations

Weightage in UPSC EPFO: No question asked directly (2015-2025), but its terms are used in almost every accounting question - trade and cash discount (APFC 2015 cash-discount numericals), capital and drawings, revenue vs gain.

➤ Meaning and Definition

- **Book-keeping** is the recording phase of accounting: recording financial transactions in the appropriate books of account in a regular, systematic and chronological manner.
- **R.N. Carter:** the science and art of correctly recording in the books of account all those business transactions that result in the transfer of money or money's worth.

➤ Stages Covered

- **Flow:** Transaction identified → Journalising (original entry) → Posting to ledger → Balancing accounts → Trial balance (boundary).
- Book-keeping covers journalising, posting and balancing.
- Trial balance: some texts treat it as the last step of book-keeping, others as the first step of accounting.
- Final accounts, their analysis and interpretation belong wholly to accounting.
- 'Book-keeping ends with' - expected answer is usually preparation of the trial balance.

2 Book-keeping, Accounting and Accountancy

Part I · Foundations

➤ Book-keeping vs Accounting

Basis	Book-keeping	Accounting
Meaning	Systematic recording of financial transactions	Recording, classifying, summarising, analysing, interpreting and communicating
Scope	Narrow - recording phase only	Wide - includes book-keeping and goes beyond
Stage	Primary stage	Secondary stage; begins where book-keeping ends
Nature	Routine and clerical	Analytical and professional
Done by	Book-keeper	Accountant

➤ Accountancy

- **Accountancy:** the whole body of knowledge - theory, principles and standards.
- **Accounting:** practice of applying that knowledge. **Book-keeping:** recording part of accounting.
- Accountancy ⊃ Accounting ⊃ Book-keeping.

➤ Example

Sales ₹15,00,000; purchases ₹9,00,000; rent ₹1,20,000; salaries ₹2,40,000; closing stock ₹1,00,000. Book-keeping records these; accounting goes further:

Result	Working	₹
Gross profit	15,00,000 - (9,00,000 - 1,00,000)	7,00,000
Net profit	7,00,000 - 1,20,000 - 2,40,000	3,40,000

3 Users of Accounting Information

Part I · Foundations

➤ Internal and External Users

- **Internal users:** inside the organisation; manage and control it.
- **External users:** outside, with present or potential interest; depend mainly on published general-purpose financial statements.
- Owners are internal users, although their claim (capital) is shown as a liability.
- Shareholders of a company are generally external users (no day-to-day management).

➤ Information Needs of Users

User	Information needed	Typical decisions
Owners / partners (internal)	Profit, return on capital, safety of capital, comparison with other firms	Continue, expand or close; bring in more capital
Management (internal)	Cost of sales, profitability of products and departments, budgets, cash position	Planning, pricing, cost control, product line
Investors (external)	Risk and return; profitability and dividend capacity	Buy, hold or sell shares
Lenders and creditors	Creditworthiness, liquidity, ability to pay interest and repay principal	Grant a loan; amount, rate, security

User	Information needed	Typical decisions
Government and tax authorities	Income, turnover for income tax, GST and customs duty	Assessment of tax; economic policy

4 Basic Accounting Terms

Part I · Foundations

➤ Entity, Transaction and Voucher

Key Terms

Entity	Specifically identifiable business enterprise for which accounts are kept, separate from its owners.
Transaction	Event involving exchange of value between two or more entities, for cash or on credit.
Voucher	Documentary evidence of a transaction - cash memo, invoice, bill, receipt. Every journal entry needs one. A price list or quotation is not a voucher (records an offer, not a transaction).

➤ Assets, Liabilities and Capital

Key Terms

Assets	Economic resources owned or controlled by the business, expressible in money, expected to give future benefit. Non-current: land, building, machinery, patents. Current (realised within 12 months or operating cycle): cash, debtors, stock, bills receivable, prepaid expenses.
Liabilities	Obligations to outsiders, payable in future. Non-current: long-term loan, debentures. Current: creditors, bills payable, outstanding expenses.
Capital	Amount invested by the owner: Capital = Assets - Liabilities (owner's equity). Shown on the liabilities side, as the business owes it to the owner.
Drawings	Cash or goods withdrawn by the owner for personal use; reduce capital.

➤ Debtors, Creditors, Purchases and Stock

Key Terms

Debtors	Persons who owe money for goods or services supplied on credit; current asset.
Creditors	Persons to whom the business owes money for goods or services bought on credit; current liability.
Purchases	Goods bought for resale or production, for cash or credit. A computer bought by a grocer is an asset, not purchases.
Stock (inventory)	Goods unsold on a given date; valued at cost or net realisable value, whichever is lower.

➤ Revenue, Expense, Expenditure, Gain and Loss

Key Terms

Revenue	Amount earned from regular activities - sales, commission, interest, dividend, royalty, rent received.
Expenses	Costs incurred in earning revenue in a period - rent, wages, salaries, depreciation, interest.
Expenditure	Revenue expenditure: benefit within the year. Capital expenditure: benefit for more than a year (creates an asset).
Gain	Profit of an irregular, incidental nature - profit on sale of a fixed asset.
Loss	Excess of expenses over revenues; or money lost without benefit - goods destroyed by fire, theft.

Case	Result
Machinery ₹5,00,000, life 5 years	Expenditure ₹5,00,000 (capital); yearly expense = depreciation ₹1,00,000
Machine of book value ₹40,000 sold for ₹45,000	Gain ₹5,000, not sales

➤ Trade Discount and Cash Discount

- Cash discount is always computed on the amount after trade discount.
- For the seller it is discount allowed; for the buyer, discount received.

Step	Working	₹
List price		1,00,000
Invoice value	1,00,000 less 20% trade discount	80,000
Cash discount	2% of 80,000	1,600
Cash paid within 15 days	80,000 - 1,600	78,400

CHAPTER 3

Accounting Concepts, Conventions & Accounting Policies

CHAPTER AT A GLANCE



1 GAAP and Fundamental Accounting Assumptions (AS-1)

Part I · Foundations

Weightage in UPSC EPFO (2017-2025): 11 questions - EO/AO 2017 (2), EO/AO 2021 (2), EO/AO 2023 (1), APFC 2023 (4), 2025 combined (2). Most tested: Conservatism (4).

➤ Generally Accepted Accounting Principles (GAAP)

GAAP are the rules and guidelines for recording and reporting business transactions, so that financial statements are uniform and comparable.

➤ The Three Fundamental Assumptions (AS-1)

- AS-1 (Disclosure of Accounting Policies) names only three:
  - **Going concern:** business will continue for the foreseeable future.
  - **Consistency:** policies applied the same way from one period to the next.
  - **Accrual:** revenues and costs recorded when earned or incurred, not when cash moves.
- All three followed: no disclosure needed (presumed). Any one not followed: that fact must be disclosed.
- Matching, accounting period, money measurement and conservatism are not fundamental assumptions; option 'Going Concern, Accounting Period, Accrual' is incorrect (APFC 2023; 2025).

➤ Going Concern

- Business assumed to run for a long time, not to be liquidated in the foreseeable future.
- Fixed assets shown at cost less depreciation, not at sale value.

➤ Consistency

- A chosen policy (FIFO or weighted average) is followed year after year.
- Change allowed only when: a statute requires it; a new or revised Accounting Standard requires it; the new policy gives a more appropriate presentation.
- Change, its reasons and its effect on profit must be disclosed.

➤ Accrual

- Companies must keep books on the accrual basis (Companies Act, 2013).
- Cash basis is simple but breaks the matching concept.

2 Basic Accounting Concepts

Part I · Foundations

➤ Business Entity

- Business and owner are two separate persons in accounting.
- **Capital:** money or assets brought in by the owner; a liability of the business to the owner. **Drawings** reduce capital.
- Owner's personal transactions are not recorded unless business money is involved.

Illustration: Rahul's shop - entries under the business entity concept

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
(a)	Cash A/c	**Dr.**	5,00,000		Asset (Cash) ↑ → Debit
	To Rahul's Capital A/c *(Being Rahul brought ₹5,00,000 from savings)*			5,00,000	Equity (Capital) ↑ → Credit
(b)	Drawings A/c	**Dr.**	25,000		Drawings ↑ → Debit
	To Bank A/c *(Being school fees of Rahul's child paid by shop's cheque (personal use, not an expense))*			25,000	Asset (Bank) ↓ → Credit

➤ Money Measurement

- Only transactions and events expressible in money are recorded.
- Not only cash: credit purchases, cheques and bank transfers are recorded.
- Honest staff, a brilliant manager, a new competitor, customer satisfaction are not recorded (EO/AO 2021).

➤ Accounting Period

- Life divided into equal artificial periods, normally one year (financial year, 1 April - 31 March).
- A separate profit and loss account and balance sheet for each period.

➤ Historical Cost

- Asset recorded at cost of acquisition = price paid + all costs to bring it to working condition.
- Later rises or falls in market value ignored; only depreciation reduces the figure.

➤ Dual Aspect

- Every transaction has two equal effects; recorded in at least two accounts.
- Base of double entry and of the equation Assets = Liabilities + Capital.

➤ Revenue Recognition (Realisation)

- Revenue recorded when realised - when a legal right to receive it arises (goods sold or service rendered), not when cash is received.
- **Exceptions:** long-term contracts - revenue in proportion to work completed; hire purchase - instalments collected treated as realised; gold and precious metals - may be recognised at production (mining) stage.

Situation	Revenue belongs to
Credit sale on 25 March 2026; cash on 10 April 2026	FY 2025-26 (date of sale)

➤ Matching

- Expenses of a period are set against revenues of the same period.
- Expense recognised when the asset or service is used to earn revenue, not when paid for.
- Matching is a concept, not a fundamental assumption (2025).

➤ Full Disclosure and Objectivity

- **Full disclosure:** all material and relevant facts disclosed in statements or notes to accounts - significant accounting policies (AS-1), contingent liabilities, events after the balance-sheet date.
- A contingent liability is not in the totals, but the reader must know of it (EO/AO 2023).
- **Objectivity:** records free from personal bias, supported by verifiable evidence - cash memo, invoice, receipt.

3 Conservatism and Materiality

Part I · Foundations

➤ Conservatism (Prudence)

- 'Anticipate no profit, but provide for all possible losses.'
- Do not overstate profit or assets; do not understate losses or liabilities.

Practice	How it shows prudence
Closing stock at cost or NRV, whichever is lower (AS-2)	Fall in value recognised; rise ignored until sold (2025)
Provision for fluctuation in value of investments	Possible loss provided before it happens (APFC 2023)

Practice	How it shows prudence
Provision for doubtful debts / discount on debtors	Expected losses charged in advance

➤ Materiality

- An item is material if knowing it (or not) would influence an informed user's decision.
- Depends on amount and nature.
- Pencils and staplers: written off as expense in the year of purchase.
- By nature, even a small bribe or fraud is material.

4 Accounting Policies, Systems and Standards

Part I · Foundations

➤ Accounting Policies (AS-1)

- Specific accounting principles and methods of applying them adopted by an enterprise.
- Areas: depreciation method, valuation of inventories, goodwill, investments, retirement benefits, foreign currency conversion, profit on long-term contracts.
- **Three major considerations in selecting policies:**
  - **Prudence:** provide for losses, do not anticipate profits.
  - **Substance over form:** record economic reality, not just legal form.
  - **Materiality:** disclose all items that can influence decisions.
- Consistency is not one of the three - it is a fundamental assumption (APFC 2023).

➤ Accounting Standards

- Written policy documents issued by the ICAI on recognition, measurement, treatment, presentation and disclosure.

5 Previous Year Questions: UPSC EPFO

Part I · Foundations

1. Appending notes on contingent liability is pursuant to: EO/AO 2023

(a) Convention of consistency
(b) Money measurement concept
(c) Convention of conservatism
(d) Convention of full disclosure

Answer: (d) Convention of full disclosure — A contingent liability is not added to liabilities, but the reader must know of it, so it is shown as a note.

2. In case of gold, revenue is recognized in the accounting period in which the gold is: EO/AO 2017

(a) delivered
(b) sold
(c) mined
(d) identified to be mined

Answer: (c) mined — Exception to the sale rule: gold has an assured market at a known price, so revenue is recognised at production.

3. As per the traditional approach, the expense to be matched with revenue is based on: EO/AO 2017

(a) original cost
(b) opportunity cost
(c) replacement cost
(d) cash cost

Answer: (a) original cost — Traditional (historical cost) accounting matches the original cost of what was used.

4. What is the underlying accounting concept that supports no anticipation of profits but provision for all possible losses? EO/AO 2021

(a) Matching
(b) Materiality
(c) Consistency
(d) Conservatism

Answer: (d) Conservatism — This sentence is the textbook definition of conservatism (prudence).

5. Which accounting concept is applied when events such as new competitors entering the market and a rift between production and marketing departments are not disclosed in the books of accounts? EO/AO 2021

(a) Matching
(b) Money measurement
(c) Revenue recognition
(d) Cost

Answer: (b) Money measurement — Both events matter but cannot be measured in rupees, so they stay out of the books.

6. In a business firm, assets are valued on the basis of their intrinsic value rather than realizable value. This accounting is based on: APFC 2023

(a) money measurement concept
(b) matching concept
(c) going concern assumption
(d) consistency principle

Answer: (c) going concern assumption — Realisable value matters only if the firm will close; as it continues, assets are shown at cost less depreciation.

7. Which of the following is not a major consideration in the selection and application of accounting policies? APFC 2023

(a) Prudence
(b) Consistency
(c) Substance over form
(d) Materiality

Answer: (b) Consistency — AS-1 lists prudence, substance over form and materiality; consistency is a fundamental assumption.

8. The value of long-term investment in shares is subject to wide fluctuations. A provision created against fluctuation in value of investments is based on the convention of: APFC 2023

(a) conservatism
(b) full disclosure
(c) materiality
(d) consistency

Answer: (a) conservatism — Providing for a possible fall before it happens means providing for all possible losses.

9. Which one of the following combinations represents the fundamental accounting assumptions? APFC 2023

(a) Going Concern, Consistency, Accrual
(b) Going Concern, Money Measurement, Conservatism
(c) Going Concern, Consistency, Conservatism
(d) Going Concern, Accounting Period, Accrual

Answer: (a) Going Concern, Consistency, Accrual — G-C-A under AS-1; every other option includes a concept or convention.

10. The principle of inventory valuation 'cost or net realisable value, whichever is lower' is based on: 2025

(a) Accrual concept
(b) Matching concept
(c) Money measurement concept
(d) Convention of conservatism

Answer: (d) Convention of conservatism — A fall below cost is recognised at once; a rise above cost is ignored until sold.

11. Which one of the following is not a 'fundamental accounting assumption' in the preparation of financial statements? 2025

(a) Matching concept
(b) Going concern
(c) Accrual
(d) Consistency

Answer: (a) Matching concept — The G-C-A list again from the opposite side; matching is a concept.

CHAPTER 4

The Accounting Equation

CHAPTER AT A GLANCE

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1 Meaning of the Accounting Equation

Part I · Foundations

Weightage in UPSC EPFO: No question asked about the equation by name (EO/AO 2017-2023, APFC 2015, 2016, 2023, 2025), but it is the base of almost every numerical - finding capital, profit or a missing balance, classifying items as assets or liabilities.

➤ Equation

- At any point of time, assets equal liabilities plus capital: **Assets (A) = Liabilities (L) + Capital (C)**.
- Also called the **Balance Sheet Equation** (balance sheet is a detailed statement of this equality).
- Arithmetic form of the dual aspect concept (Chapter 3).

➤ Two Kinds of Claims

- **Outsiders' claims:** liabilities (creditors, lenders), also called outsiders' equity.
- **Owner's claim:** capital, also called owner's equity or net worth.

➤ Formulas

- **Total assets** A = L + C
- **Capital (net worth)** C = A - L
- **Outside liabilities** L = A - C

➤ Example: First Transaction (NCERT)

Transaction	Assets	=	Liabilities	+	Capital
Rohit starts business with cash	Cash ₹5,00,000	=	0	+	Capital (Rohit) ₹5,00,000

- However many transactions follow, the two sides stay equal.

2 Components and Classification

Part I · Foundations

➤ Assets

- **Asset:** resource controlled by the business as a result of past events, from which future economic benefits are expected.
- **Three tests:** business controls it (ownership not essential, as in hire purchase); arises from a past event; promises a future benefit.

Type	Meaning	Examples
Non-current assets	Held for long-term use; not for sale in normal course	Land, building, plant and machinery, goodwill, patents
Current assets	Cash, or expected to be converted into cash or used up within operating cycle or 12 months	Stock, debtors, bills receivable, cash, bank, prepaid expenses
Tangible / intangible	Physical existence / no physical existence but has value	Machinery, stock / goodwill, trademark, copyright, software

➤ Liabilities

- **Liability:** present obligation from past events; settlement expected to result in outflow of resources.
- Owed to outsiders; payable on due date irrespective of profit or loss.
- **Non-current:** payable after operating cycle or 12 months - long-term loan, debentures.
- **Current:** payable within it - creditors, bills payable, bank overdraft, outstanding expenses, income received in advance.

➤ Capital (Owner's Equity)

- Residual interest of the owner in assets after deducting all liabilities: **Capital = Assets - Liabilities**.
- Treated as a liability of the business to its owner (business entity concept).
- Increases with fresh capital and profits; decreases with losses and drawings.

➤ Liabilities vs Capital

Basis	Liabilities (outsiders' equity)	Capital (owner's equity)
Repayment	On a fixed or agreed date	Normally only when business is closed
Return	Fixed interest, payable even in a loss year	Depends on profit
On closure	Paid first	Gets what remains

3 The Expanded Accounting Equation

Part I · Foundations

➤ Expanded Equation

- Profits increase capital; losses and amounts withdrawn reduce it. Profit = revenue - expenses.
- **Assets = Liabilities + Opening Capital + Additional Capital + Revenues - Expenses - Drawings**
- Short form: A = L + C + R - E (C net of drawings).
- Expenses are incurred to earn revenue and pass through the profit and loss account; drawings are deducted directly from capital.

➤ Formulas

- **Closing capital** = Opening capital + Additional capital + Profit - Drawings
- **Profit** = Closing capital - Opening capital + Drawings - Additional capital
- A loss is a negative profit.

➤ Finding Missing Figures

Data given	Working	Answer (₹)
Assets ₹12,00,000; liabilities ₹4,50,000; find capital	C = A - L	7,50,000
Opening capital ₹4,00,000; additional ₹50,000; drawings ₹60,000; closing ₹5,10,000; find profit	5,10,000 - 4,00,000 + 60,000 - 50,000	1,20,000

- **Method:** find closing capital as A - L at closing date, then apply the profit formula.
- This is the basis of the statement of affairs method for incomplete records.

4 Effect of Transactions on the Equation

Part I · Foundations

➤ Types of Transactions

Combination	Example	Effect on total
Asset ↑, Asset ↓	Machinery bought for cash	No change
Asset ↑, Liability ↑	Goods bought on credit	Both sides ↑
Asset ↑, Capital ↑	Owner brings cash; commission received	Both sides ↑
Asset ↓, Liability ↓	Creditor paid; loan repaid	Both sides ↓
Asset ↓, Capital ↓	Salary paid; drawings; goods lost by fire	Both sides ↓

➤ Points to Remember

- 'Asset ↑ with Liability ↓' (or reverse) with nothing else changing is impossible: one side rises, the other falls.
- Transactions changing only the form of assets (machinery bought for cash) do not change totals.
- A profit (₹10,000 on goods costing ₹25,000 sold for ₹35,000) is added to capital.

5 Comprehensive Illustration and Debit-Credit Link

Part I · Foundations

➤ Equation and the Rules of Debit and Credit

- Rules of debit and credit (Chapter 7) come from each item's position in the equation: left side increases by debit, right side by credit.
- **DEALER: D**ividends/Drawings, **E**xpenses/Losses, **A**ssets increase by Debit; **L**iabilities, **E**quity/Capital, **R**evenue/Gains increase by Credit. A decrease goes the opposite way.

Item	Position	Increase on	Decrease on
Assets	Left	Debit	Credit
Liabilities	Right	Credit	Debit
Capital	Right	Credit	Debit
Revenues / gains	Increase capital	Credit	Debit
Expenses / losses	Decrease capital	Debit	Credit

- A debit does not always mean an increase: a debit to a liability or capital account is a decrease.

➤ Capitalisation of Costs

- All costs to bring an asset to working condition are capitalised, not charged to profit and loss.

Item	₹
Machine	9,00,000
Freight	25,000
Installation	35,000
Added to Machinery	9,60,000

CHAPTER 5

Accounting Standards AS 1 to AS 29

CHAPTER AT A GLANCE

- Accounting Standards AS 1 to AS 29
  - 1 Meaning, Objectives and Benefits of Accounting Standards
    - Weightage in UPSC EPFO
    - Meaning and Nature
    - Objectives and Need
    - Benefits and Limitations (NCERT)
  - 2 Standard-Setting Bodies and Formulation Procedure
    - Standard-Setting Bodies in India
    - Procedure for Formulating a Standard
  - 3 Enforcement, Legal Status and Applicability
    - Enforcement and Legal Status
    - Applicability: Companies
    - Applicability: Non-company Entities (ICAI Scheme from 1 April 2020)
  - 4 List of Accounting Standards: AS 1 to AS 29
    - The Standards
    - Withdrawn and Superseded Standards

1 Meaning, Objectives and Benefits of Accounting Standards

Part I · Foundations

➤ Weightage in UPSC EPFO

No direct question on the standard-setting process in 2017–2025 EO/AO and APFC papers. Standards asked: AS-1 (APFC 2023, 2025), AS-2 (EO/AO 2023), contingent liabilities (EO/AO 2023).

➤ Meaning and Nature

Accounting Standards are written policy documents issued by an expert accounting body, or by the government or another regulatory body, covering recognition, measurement, treatment, presentation and disclosure of accounting transactions in financial statements.

- **Issued by (India):** Institute of Chartered Accountants of India (ICAI).
- **Companies:** mandatory once notified by the Central Government under the Companies Act, 2013.
- **Conflict:** if a standard and a statute conflict, the statute prevails.

➤ Objectives and Need

NCERT objectives: uniformity in accounting policies, less non-comparability of financial statements, greater reliability.

Objective	Explanation
Uniformity	Similar transactions are accounted for on the same principles by all enterprises
Comparability	Statements of different enterprises and years can be compared

➤ Benefits and Limitations (NCERT)

Benefits	Limitations
They eliminate or reduce variations in the treatment of items	Choosing between alternative treatments can still be difficult

2 Standard-Setting Bodies and Formulation Procedure

Part I · Foundations

➤ Standard-Setting Bodies in India

Two-tier: ICAI formulates the standards; the Central Government prescribes them for companies after review by a statutory authority.

Body	Role
ICAI (est. 1949 under the Chartered Accountants Act, 1949)	Formulates and issues Accounting Standards and recommends them to the Central Government
ASB - Accounting Standards Board of ICAI (constituted 21 April 1977)	Prepares drafts and Exposure Drafts for the ICAI Council
NFRA - National Financial Reporting Authority (Section 132, Companies Act 2013; constituted 1 October 2018)	Examines ICAI's recommendations and recommends standards to the Central Government
MCA - Ministry of Corporate Affairs	Prescribes (notifies) standards for companies under Section 133 through Rules

➤ Procedure for Formulating a Standard

The ASB follows a consultative procedure.

Step	Stage	What happens
1	Identification of areas	ASB identifies broad areas needing standardisation
2	Constitution of study groups	Expert study groups prepare preliminary drafts
3	Consideration by the ASB	ASB discusses the draft in light of laws, customs and international standards
4	Circulation to outside bodies	Draft sent to MCA, SEBI, CAG, CBDT, RBI, industry associations for views
5	Meeting with representatives	ASB meets these bodies to discuss their views
6	Exposure Draft	Exposure Draft (ED) issued for public comment
7	Finalisation by the ASB	Comments examined and draft revised
8	Approval by ICAI Council	Council issues the standard

- **Chain:** ASB (drafts, ED) → ICAI Council (approves) → NFRA (examines) → MCA (notifies) → companies comply.
- **Before NFRA (2018):** review was done by NACAS under Section 210A of the 1956 Act.

3 Enforcement, Legal Status and Applicability

Part I · Foundations

➤ Enforcement and Legal Status

- **Companies:** legally binding only after the Central Government notifies under **Section 133**, as recommended by ICAI after examining NFRA's recommendations.
- **Other entities:** ICAI standards bind ICAI members; an auditor must report non-compliance in the audit report.

Provision (Companies Act, 2013)	What it lays down
Section 129(1)	Financial statements shall give a true and fair view, comply with standards notified under Section 133, and be in Schedule III form
Section 129(5)	If statements do not comply with a standard, the company shall disclose the deviation, the reasons and its financial effect

➤ Applicability: Companies

Companies not following Ind AS apply the Companies (Accounting Standards) Rules, 2021, which divide them into Small and Medium-sized Companies (SMCs) and others.

- **SMC conditions (all):** securities not listed (or being listed); not a bank, financial institution or insurance company.
- **SMC limits (preceding year):** turnover (excluding other income) not above ₹250 crore; borrowings not above ₹50 crore.
- **SMC group:** not a holding or subsidiary of a company that is not an SMC.
- **Main exemptions:** AS 3 (Cash Flow Statements) and AS 17 (Segment Reporting).

➤ Applicability: Non-company Entities (ICAI Scheme from 1 April 2020)

Level	Criteria (any one)	Standards not applicable
I	Listed or being listed; banks, financial institutions, insurance entities; turnover above ₹250 crore; borrowings above ₹50 crore	None - all apply
II	Turnover ₹50-250 crore; or borrowings ₹10-50 crore	AS 3, 17, 20, 21, 23, 25, 27
III	Turnover ₹10-50 crore; or borrowings ₹2-10 crore	AS 3, 17, 18, 20, 21, 23, 24, 25, 27
IV	All other non-company entities (MSMEs)	AS 3, 14, 17, 18, 20, 21, 23, 24, 25, 27, 28

4 List of Accounting Standards: AS 1 to AS 29

Part I · Foundations

➤ The Standards

- **Issued:** 29 standards; AS 6 and AS 8 withdrawn, so **27 are in force**.
- Last column gives the corresponding Ind AS (Chapter 6).

AS	Title	Ind AS
1	Disclosure of Accounting Policies	1

AS	Title	Ind AS
2	Valuation of Inventories	2
3	Cash Flow Statements	7
4	Contingencies and Events after the Balance Sheet Date	10
5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	8
6	Depreciation Accounting	-
7	Construction Contracts	115
8	Accounting for Research and Development	-
9	Revenue Recognition	115
10	Property, Plant and Equipment	16
11	Effects of Changes in Foreign Exchange Rates	21
12	Accounting for Government Grants	20
13	Accounting for Investments	109
14	Accounting for Amalgamations	103
15	Employee Benefits	19
16	Borrowing Costs	23
17	Segment Reporting	108
18	Related Party Disclosures	24
19	Leases	116
20	Earnings Per Share	33
21	Consolidated Financial Statements	110
22	Accounting for Taxes on Income	12
23	Accounting for Investments in Associates in Consolidated FS	28
24	Discontinuing Operations	105
25	Interim Financial Reporting	34
26	Intangible Assets	38
27	Financial Reporting of Interests in Joint Ventures	111
28	Impairment of Assets	36
29	Provisions, Contingent Liabilities and Contingent Assets	37

➤ Withdrawn and Superseded Standards

- **AS 6** (Depreciation) - withdrawn on the revision of AS 10 as Property, Plant and Equipment (2016).
- **AS 8** (Research and Development) - withdrawn when AS 26 became mandatory (2003).
- **AS 4** - the part on contingencies was superseded by AS 29; it now covers only events after the balance sheet date.

CHAPTER 6

IFRS, Ind AS and Convergence

CHAPTER AT A GLANCE

- IFRS, Ind AS and Convergence
  - 1 IFRS and the IASB
    - Weightage in UPSC EPFO
    - International Financial Reporting Standards
    - Standard-Setting Bodies and Series
    - Adoption versus Convergence
  - 2 Indian Accounting Standards (Ind AS) and the Phased Roadmap
    - What Ind AS Are
    - Applicability: Phased Roadmap
  - 3 Carve-outs, Carve-ins and Key Ind AS
    - Carve-outs and Carve-ins
    - Key Ind AS and Corresponding Standards
  - 4 Ind AS 115 and Ind AS 116 Illustrated
    - Ind AS 115: Revenue from Contracts with Customers
    - Ind AS 116: Leases
  - 5 Previous Year Questions: UPSC EPFO

1 IFRS and the IASB

Part I · Foundations

➤ Weightage in UPSC EPFO

One question in 2017–2025 (EO/AO 2017: full form of IFRS).

➤ International Financial Reporting Standards

IFRS are a single set of high-quality, globally accepted accounting standards laying down how transactions and events are recognised, measured, presented and disclosed.

- **Issued by:** International Accounting Standards Board (IASB).
- **Status:** independent body, headquartered in London.
- **Parent:** not-for-profit IFRS Foundation.

➤ Standard-Setting Bodies and Series

Body / item	Key facts
IASC - International Accounting Standards Committee	Formed in 1973; issued International Accounting Standards (IAS) 1 to 41
IASB	Replaced the IASC in 2001; issues IFRS; adopted the existing IAS, many still in force
ISSB - International Sustainability Standards Board	Set up November 2021; issued IFRS S1 and S2 in June 2023

- **IAS 1 to 41:** issued by the IASC; those not replaced still apply (e.g. IAS 2 Inventories).

- **IFRS 1 to 19:** issued by the IASB (e.g. IFRS 9 Financial Instruments, IFRS 15 Revenue, IFRS 16 Leases).

➤ Adoption versus Convergence

- **Adopt:** apply IFRS as issued by the IASB.
- **Converge:** issue own standards based on IFRS, modified where national law or conditions require.
- **India chose convergence.**

Basis	Adoption	Convergence
Meaning	IFRS applied as issued by the IASB	National standards brought in line with IFRS
Modifications	None (or negligible)	Specified changes permitted - carve-outs and carve-ins
Issued under	IASB, endorsed locally	National law - in India, Section 133 of the Companies Act, 2013

2 Indian Accounting Standards (Ind AS) and the Phased Roadmap

➤ What Ind AS Are

Ind AS are accounting standards converged with IFRS.

- **Formulated by:** ASB of ICAI; **examined by:** NFRA.
- **Notified by:** Ministry of Corporate Affairs, Section 133, Companies Act, 2013, through the **Companies (Indian Accounting Standards) Rules, 2015**.
- **Other companies:** continue with AS under the Companies (Accounting Standards) Rules, 2021.
- **Ind AS 1 to 41:** same number as the corresponding IAS - e.g. Ind AS 2 = IAS 2 Inventories, Ind AS 16 = IAS 16 PPE.
- **Ind AS 101 onwards:** IFRS number + 100 - e.g. Ind AS 109 = IFRS 9, Ind AS 115 = IFRS 15, Ind AS 116 = IFRS 16.

➤ Applicability: Phased Roadmap

- Phased, starting with the largest companies.
- Entry depends on listing status and net worth.
- Once applied, Ind AS covers standalone and consolidated statements; the company **cannot go back to AS**.

Phase	Periods beginning on or after	Companies covered
Phase I	1 April 2016 (FY 2016-17)	Listed or unlisted companies with net worth of ₹500 crore or more; their holding, subsidiary, joint venture and associate companies
Phase II	1 April 2017 (FY 2017-18)	All companies listed or being listed (other than on SME exchanges) not in Phase I; unlisted companies with net worth ₹250 crore or more but below ₹500 crore

Phase	Periods beginning on or after	Companies covered
Banks	Deferred	Scheduled commercial banks - deferred until further notice
Insurers	Deferred	Awaiting IRDAI notification (Ind AS 117 notified by MCA in August 2024)

3 Carve-outs, Carve-ins and Key Ind AS

Part I · Foundations

➤ Carve-outs and Carve-ins

- **Carve-out:** removes, restricts or changes an IFRS requirement.
- **Carve-in:** adds a requirement or guidance not in the IFRS.
- **Result:** an Indian company following Ind AS cannot state full compliance with IFRS as issued by the IASB.

Ind AS	IFRS position	Ind AS position	Type
Ind AS 40 Investment Property	IAS 40 permits cost or fair value model	Only the cost model; fair value is disclosed	Carve-out
Ind AS 103 Business Combinations	Bargain purchase gain in profit or loss	Recognised in capital reserve (equity)	Carve-out
Ind AS 103, Appendix C	IFRS 3 does not deal with common-control combinations	Pooling of interests method added	Carve-in

➤ Key Ind AS and Corresponding Standards

Ind AS based on IAS (same number):

Ind AS	Title	Old AS
2	Inventories	AS 2
7	Statement of Cash Flows	AS 3
16	Property, Plant and Equipment	AS 10
19	Employee Benefits	AS 15

Ind AS based on IFRS (number + 100):

Ind AS	Title	Old AS
103	Business Combinations	AS 14
109	Financial Instruments	AS 13 (part)
110	Consolidated Financial Statements	AS 21
115	Revenue from Contracts with Customers (from 1 April 2018)	AS 7, AS 9
116	Leases (from 1 April 2019)	AS 19

4 Ind AS 115 and Ind AS 116 Illustrated

Part I · Foundations

➤ Ind AS 115: Revenue from Contracts with Customers

Revenue is recognised when (or as) control of promised goods or services passes to the customer. Five-step model:

- Identify the contract.

- Identify the separate performance obligations.
- Determine the transaction price.
- Allocate the price in proportion to standalone selling prices.
- Recognise revenue when (or as) each obligation is satisfied.

Illustration: laptop with one year's support sold on 1 January 2026 for ₹1,20,000 (standalone: laptop ₹1,00,000; support ₹25,000); year ends 31 March 2026.

Performance obligation	Allocation (₹)	Recognised in 2025-26 (₹)
Laptop: 1,20,000 × 1,00,000/1,25,000	96,000	96,000 (on delivery)
Support: 1,20,000 × 25,000/1,25,000	24,000	24,000 × 3/12 = 6,000

Revenue in 2025-26 is ₹1,02,000; the balance ₹18,000 is a contract liability.

➤ Ind AS 116: Leases

- **Lessee:** recognises almost every lease in the balance sheet - a right-of-use (ROU) asset and a lease liability equal to the present value of lease payments.
- **AS 19:** operating/finance distinction removed for lessees.

Illustration: machine leased for 3 years at ₹1,00,000 payable at year end; discount rate 10%.

Item	Working	₹
Lease liability = ROU asset	1,00,000 × (0.9091 + 0.8264 + 0.7513) = 1,00,000 × 2.4869	2,48,685
Year 1 interest on liability	2,48,685 × 10%	24,869
Year 1 depreciation on ROU asset	2,48,685 ÷ 3	82,895

5 Previous Year Questions: UPSC EPFO

Part I · Foundations

1. In the context of accounting, the term IFRS stands for: EO/AO 2017

(a) International Financial Reporting Standards
(b) Indian Financial Reporting Standards
(c) Indian Financial Reporting System
(d) International Financial Reporting System

Answer: (a) International Financial Reporting Standards — Issued by the IASB; Indian converged standards are called Ind AS, not Indian Financial Reporting Standards.

CHAPTER 7

Double Entry System, Kinds of Accounts & Golden Rules

CHAPTER AT A GLANCE

- Double Entry System, Kinds of Accounts & Golden Rules
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    - Weightage in UPSC EPFO
    - Meaning and Origin
    - Double Entry and the Accounting Equation
  - 2 Account, Debit and Credit; Modern Approach
    - Account, Debit and Credit
    - Rules of Debit and Credit: Accounting Equation (Modern) Approach
    - Priya's Transactions as Journal Entries
  - 3 The DEALER Rule
    - What DEALER Means
    - How to Use It
    - DEALER and the Golden Rules
  - 4 Traditional Classification and the Golden Rules
    - Three Kinds of Accounts
    - Personal Accounts
    - Real Accounts
    - Nominal Accounts
    - Common Errors in Classification
  - 5 Previous Year Questions: UPSC EPFO

1 Double Entry System

Part II · Recording and Books of Account

➤ Weightage in UPSC EPFO

Direct: EO/AO 2023 (outstanding rent is a representative personal account); APFC 2023 (goodwill account is a real account). Related: 2025 (rent outstanding is personal; capital account has a debit balance, Chapter 12); EO/AO 2017 and 2021 (Income and Expenditure Account is nominal, Chapter 23).

➤ Meaning and Origin

Double entry bookkeeping records both aspects of every transaction - something received and something given - with an equal amount on the debit side of one account and the credit side of another.

- **Origin:** first explained in print by **Luca Pacioli in 1494**, the Italian mathematician called the father of modern accounting.
- Every transaction affects at least two accounts; total debits = total credits.
- **Limitation:** trial balance agreement is not conclusive proof of accuracy - errors of omission, principle and compensating errors remain undetected.

➤ Double Entry and the Accounting Equation

- Two equal effects per transaction keep Assets = Liabilities + Capital in balance.

- Revenue increases capital; expenses and drawings reduce it.
- **Expanded equation:** Assets + Expenses + Drawings = Liabilities + Capital + Revenue

2 Account, Debit and Credit; Modern Approach

Part II · Recording and Books of Account

➤ Account, Debit and Credit

An **account** is a summarised record of all transactions relating to one item - a person, asset, liability, expense or income.

- Left side = debit (Dr.); right side = credit (Cr.).
- Debit and credit are only positions: a debit is not always bad, a credit not always good.

➤ Rules of Debit and Credit: Accounting Equation (Modern) Approach

Each account is placed in a group (drawings reduce capital); the rule depends only on increase or decrease.

Type of account	Increase	Decrease	Normal balance
Assets	Debit	Credit	Debit
Liabilities	Credit	Debit	Credit
Capital	Credit	Debit	Credit
Revenues / Gains	Credit	Debit	Credit
Expenses / Losses	Debit	Credit	Debit
Drawings	Debit	Credit	Debit

➤ Priya's Transactions as Journal Entries

Priya's transactions recorded by the accounting equation approach

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Cash A/c	**Dr.**	5,00,000		Asset (Cash) ↑ → Debit
	To Priya's Capital A/c *(Being business started with cash)*			5,00,000	Equity (Capital) ↑ → Credit
	Arun A/c	**Dr.**	50,000		Liability (Creditor) ↓ → Debit
	To Cash A/c *(Being Arun paid in cash)*			50,000	Asset (Cash) ↓ → Credit

3 The DEALER Rule

Part II · Recording and Books of Account

➤ What DEALER Means

- **Memory trick** for debit and credit in every journal entry.
- **D**ividends/Drawings, **E**xpenses/Losses, **A**ssets: increase by **Debit**.
- **L**iabilities, **E**quity/Capital, **R**evenue/Gains: increase by **Credit**.
- A decrease always goes the opposite way.

Letter	Account group	Increase	Decrease
D	Dividends / Drawings	Debit	Credit
E	Expenses / Losses	Debit	Credit

Letter	Account group	Increase	Decrease
A	Assets	Debit	Credit
L	Liabilities	Credit	Debit
E	Equity / Capital	Credit	Debit
R	Revenue / Gains	Credit	Debit

➤ How to Use It

Illustration: DEALER applied to a credit purchase of machinery

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Machinery A/c **Dr.**	2,00,000		Asset (Machinery) ↑ → Debit
	To Kiran Engineering A/c *(Being machinery bought on credit)*		2,00,000	Liability (Creditor) ↑ → Credit

➤ DEALER and the Golden Rules

- **DEALER:** modern (accounting equation) approach; **Golden Rules:** traditional approach.
- Both give the same entry; every account is classified in one system or the other.
- Golden Rules name the type of account; DEALER names the effect on the equation, so it also shows how to record a decrease.

Golden Rule (traditional)	Same in DEALER terms
Personal: debit the receiver, credit the giver	Debtor (Asset) ↑ = Debit; Creditor (Liability) ↑ = Credit; Capital (Equity) ↑ = Credit; Drawings = Debit
Real: debit what comes in, credit what goes out	Assets: increase (comes in) = Debit; decrease (goes out) = Credit
Nominal: debit expenses and losses, credit incomes and gains	Expenses/Losses (E) = Debit; Revenue/Gains (R) = Credit

4 Traditional Classification and the Golden Rules

Part II · Recording and Books of Account

➤ Three Kinds of Accounts

Under the traditional (British) approach every account is **Personal**, **Real** or **Nominal**; each has its own golden rule.

➤ Personal Accounts

Accounts of persons the business deals with, and amounts that stand for persons.

Type	Meaning	Examples
Natural personal	Human beings	Ram, Meena; proprietor's Capital and Drawings accounts
Artificial (legal) personal	Bodies that exist in law, not physically	ABC Ltd, State Bank of India, a firm, a co-operative society
Representative personal	Stand for a person or group to whom an amount is owed or from whom it is due, arising from an expense or income	Outstanding rent or salary, prepaid insurance, accrued interest, commission received in advance

Capital and Drawings are personal accounts - they represent the proprietor.

➤ Real Accounts

Accounts of assets and properties owned by the business, other than amounts due from persons.

- **Tangible:** can be seen and touched (cash, land, building, machinery, furniture, stock).
- **Intangible:** no physical form but money value (goodwill, patents, trademarks, copyrights).

➤ Nominal Accounts

Accounts of expenses, losses, incomes and gains; closed at year end by transfer to the Trading or Profit and Loss Account.

Examples of entries (golden rule + DEALER)

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Ram A/c	**Dr.**	12,000		Receiver (Ram) → Debit; Asset (Debtor) ↑ → Debit
	To Sales A/c *(Being goods sold on credit to Ram)*			12,000	Revenue (Sales) ↑ → Credit; income → Credit
	Machinery A/c	**Dr.**	50,000		Comes in → Debit; Asset (Machinery) ↑ → Debit
	To Cash A/c *(Being machinery bought for cash)*			50,000	Goes out → Credit; Asset (Cash) ↓ → Credit

➤ Common Errors in Classification

- **Bank A/c** is personal (artificial), not real; Cash A/c is real.
- **Rent A/c** is nominal; Outstanding Rent and Prepaid Rent are representative personal.
- **Interest Received** is nominal; Accrued Interest and Interest Received in Advance are representative personal.

5 Previous Year Questions: UPSC EPFO

Part II · Recording and Books of Account

1. 'Outstanding rent' may be classified as: EO/AO 2023

(a) Natural personal account
(b) Representative personal account
(c) Real account
(d) Nominal account

Answer: (b) Representative personal account — Rent due but unpaid stands for the landlord to whom money is owed; Rent A/c itself is nominal, outstanding rent is not.

2. Goodwill Account is a/an: APFC 2023

(a) Personal Account
(b) Real Account
(c) Nominal Account
(d) Expense Account

Answer: (b) Real Account — Goodwill has money value but no physical form: an intangible real account (a debit-balance asset in the modern approach).

CHAPTER 8

Recording of Transactions: Journal and Ledger

CHAPTER AT A GLANCE

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    - The Recording Process
    - Source Documents
    - Accounting Vouchers
  - 2 Journal: Book of Original Entry
    - Meaning and Format
    - Illustration: Journal of Rahul Traders (April 2026)
    - Opening Entry
  - 3 Special Journal Entries
    - Goods and Loss Entries
    - Capital Items that Look Like Expenses
  - 4 Accounting for GST
    - Structure of GST
  - 5 Ledger: Principal Book of Accounts
    - Meaning, Posting and Balancing
    - Permanent and Temporary Accounts
  - 6 Previous Year Questions: UPSC EPFO

1 Source Documents and Accounting Vouchers

Part II · Recording and Books of Account

➤ Weightage in UPSC EPFO

EO/AO 2021: account debited for wages on installation of machinery; first book of record. 2025: ledger as principal book; closing of nominal accounts (Chapter 12).

➤ The Recording Process

A transaction is written in the journal from a source document, then posted to the ledger.

- **Sequence:** business transaction → source document → accounting voucher → journal (first entry) → ledger (posting) → trial balance → financial statements.

➤ Source Documents

A **source document** is written evidence of a transaction - nature, date, amount and parties; it applies the objectivity concept.

Document	Evidence of	Prepared by
Cash memo	Cash sale or purchase	Seller, given to buyer

Document	Evidence of	Prepared by
Debit note	Goods returned to supplier, or overcharge - supplier's account debited	Buyer, sent to seller
Credit note	Goods returned by customer - customer's account credited	Seller, sent to buyer

➤ Accounting Vouchers

An **accounting voucher** is prepared by the accountant from a source document and shows the account debited and credited.

Type	Used for
Transaction voucher	One debit and one credit; cash voucher or transfer (non-cash) voucher
Compound voucher	One debit with several credits, or several debits with one credit
Journal voucher	Several debits and several credits

2 Journal: Book of Original Entry

Part II · Recording and Books of Account

➤ Meaning and Format

The **journal** (French "jour", a day) is the book of original (prime) entry: transactions recorded first, in chronological order, from vouchers.

- **Particulars column:** account debited first with "Dr"; credited account next, preceded by "To"; then narration beginning "Being...".
- **Simple entry:** one debit and one credit.
- **Compound entry:** two or more debits, or credits, or both, for transactions of the same date and nature; total debits still equal total credits.

➤ Illustration: Journal of Rahul Traders (April 2026)

Rahul Traders: simple and compound entries

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
Apr 1	Cash A/c	**Dr.**	3,00,000		Asset (Cash) ↑ → Debit
	To Rahul's Capital A/c *(Being business started with cash)*			3,00,000	Equity (Capital) ↑ → Credit
Apr 15	Sunil Traders	**Dr.**	80,000		Liability (Creditor) ↓ → Debit
	To Bank A/c			78,000	Asset (Bank) ↓ → Credit
	To Discount Received A/c *(Being full settlement by cheque; discount received)*			2,000	Gain/Revenue ↑ → Credit

➤ Opening Entry

- Passed at the start of a new year to bring in closing balances.
- Assets are debited; liabilities and capital are credited.

3 Special Journal Entries

Part II · Recording and Books of Account

➤ Goods and Loss Entries

- The account debited is not the obvious one.

- Goods taken out of the business are credited to Purchases A/c at cost - bought for resale, never sold.

Goods and loss entries

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Insurance Company A/c **Dr.** *(Goods costing 50,000 destroyed by fire; claim admitted 35,000)*	35,000		Asset (claim receivable) ↑ → Debit
	Loss by Fire A/c **Dr.**	15,000		Loss ↑ → Debit
	To Purchases A/c *(Being goods destroyed by fire)*		50,000	Expense (Purchases) ↓ → Credit

Bad debts and capital items

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Cash A/c **Dr.** *(Mohan, debtor for 10,000, insolvent; 60 paise in the rupee received)*	6,000		Asset (Cash) ↑ → Debit
	Bad Debts A/c **Dr.**	4,000		Loss ↑ → Debit
	To Mohan *(Being amount not recoverable written off)*		10,000	Asset (Debtor) ↓ → Credit

➤ Capital Items that Look Like Expenses

Payment	Account debited
Wages for installation of machinery; freight and cartage on machinery	Machinery A/c
Carriage on goods purchased (for resale)	Carriage Inwards A/c (revenue expense, not capital)

- **EO/AO 2021:** wages paid for installation of machinery are debited to Machinery Account.

4 Accounting for GST

Part II · Recording and Books of Account

➤ Structure of GST

- **GST (from 1 July 2017):** destination-based tax on supply of goods and services.
- **Set-off:** input tax on purchases against output tax on sales; only the difference is paid - **input tax credit (ITC)**.

Supply	Tax charged	Collected by
Intra-state	CGST + SGST (UTGST in Union Territories), each at half the rate	Centre and State respectively
Inter-state and imports	IGST at the full rate	Centre (State's share settled later)

- **Input CGST, SGST, IGST:** debited on purchases and expenses; assets (tax recoverable).
- **Output CGST, SGST, IGST:** credited on sales; liabilities (tax payable).

Credit of	Used first against	Then against	Never against
Input IGST	IGST	CGST, then SGST	-
Input CGST	CGST	IGST	SGST
Input SGST	SGST	IGST	CGST

- IGST credit must be used up completely before CGST or SGST credit (Section 49A, CGST Act).

5 Ledger: Principal Book of Accounts

Part II · Recording and Books of Account

➤ Meaning, Posting and Balancing

The **ledger** contains all accounts of a business, each on a separate page (folio). Final accounts come from ledger balances, so it is the **principal book** (book of final entry).

- Left (debit) side entries begin with "To"; right (credit) side entries begin with "By".
- **Posting:** transfer from journal to ledger; debit side shows "To" + account credited; credit side shows "By" + account debited.
- Folios (J.F. and L.F.) complete the audit trail.
- **Balancing:** find the difference between the two sides and carry it forward.
- Write the difference on the shorter side as "Balance c/d"; bring it down on the opposite side next period as "Balance b/d".
- Debit side larger → debit balance; credit side larger → credit balance.

➤ Permanent and Temporary Accounts

Basis	Permanent accounts	Temporary accounts
Accounts	Assets, liabilities, capital	Revenues (incomes, gains) and expenses (losses)
Year-end treatment	Balanced and carried forward	Closed by transfer to the Trading or Profit and Loss Account

- Nominal accounts are closed at year end, not balanced.
- The statement "at the year end all nominal accounts of the ledger are balanced" (2025) is incorrect.

6 Previous Year Questions: UPSC EPFO

Part II · Recording and Books of Account

1. Wages paid for installation of machinery is debited to: EO/AO 2021

(a) Wages Account
(b) Machinery Account
(c) Installation Account
(d) Profit and Loss Account

Answer: (b) Machinery Account — Installation is a cost of bringing the asset to working condition, so it is capital expenditure added to machine cost (AS 10).

2. Which is the first book in which the transactions of a business unit are recorded? EO/AO 2021

(a) Balance Sheet
(b) Cash Book
(c) Ledger
(d) Journal

Answer: (d) Journal — The journal is the book of original entry; the ledger is second entry; the balance sheet is a statement, not a book.

CHAPTER 9

Cash Book, Bank Transactions & Petty Cash Book

CHAPTER AT A GLANCE

- Cash Book, Bank Transactions & Petty Cash Book
  - 1 Meaning and Nature of the Cash Book
    - Weightage in UPSC EPFO
    - 9.1 Meaning and Nature of the Cash Book
  - 2 Kinds of Cash Book and Bank Instruments
    - 9.2 Kinds of Cash Book
    - 9.4 Bank Transactions and Instruments
  - 3 Double Column Cash Book and Contra Entry
    - 9.5 Double Column and Three Column Cash Book
    - Contra Entry
  - 4 Discount Column and Dishonour of Cheques
    - Discount Column and Cash Discount
    - Dishonour of a Cheque
  - 5 Posting and Petty Cash Book
    - 9.6 Posting the Cash Book
    - 9.7 Petty Cash Book

1 Meaning and Nature of the Cash Book

Part II · Recording and Books of Account

➤ Weightage in UPSC EPFO

No question has been set directly on the cash book in 2015–2025. The 2025 paper used the statement "Discount column of cash book records cash discount" (correct) inside a question on ledger and books (see Chapter 12).

➤ 9.1 Meaning and Nature of the Cash Book

The **Cash Book** is a special-purpose subsidiary book in which all cash receipts and payments (and, where a bank column is kept, all bank receipts and payments) are recorded in chronological order. It is ruled like a ledger account: **receipts on the debit (left) side and payments on the credit (right) side**.

Role	Explanation
Book of original entry	Cash transactions are entered here first, directly from vouchers.
Principal book (ledger)	Because it is ruled like an account and balanced, it replaces the Cash Account and Bank Account.

- Credit transactions never enter the cash book.
- The cash column can never show a credit balance; the bank column may (an overdraft).

2 Kinds of Cash Book and Bank Instruments

Part II · Recording and Books of Account

➤ 9.2 Kinds of Cash Book

Kind	Money columns on each side	Used when
Single column	Amount (cash) only	Business deals only in cash
Double column	Cash and Bank	Business has a bank account
Three column	Discount, Cash and Bank	Bank account plus regular cash discounts
Petty cash book	Total + analysis columns	Numerous small payments (imprest system)

The discount column is a memorandum column. It is not balanced; it is only totalled and the totals are posted to the ledger.

➤ 9.4 Bank Transactions and Instruments

Under Section 6 of the Negotiable Instruments Act, 1881, a cheque is a bill of exchange drawn on a specified banker and payable on demand. The **drawer** is the account holder who signs it, the **drawee** is the bank on which it is drawn, and the **payee** is the person to whom the amount is payable. A cheque is valid for three months from its date (RBI directive, effective 1 April 2012); after that it is stale.

A **bearer cheque** is paid to whoever presents it; an **order cheque** to the named payee or his endorsee; a **crossed cheque** is only credited to a bank account.

Type of crossing	How it is made	Effect
General	Two parallel lines, with or without "& Co."	Payable only through any bank account
Account payee	"A/c Payee" written between the lines	Credited only to the payee's own account
Special	Name of a bank written between the lines	Paid only through that bank

3 Double Column Cash Book and Contra Entry

Part II · Recording and Books of Account

➤ 9.5 Double Column and Three Column Cash Book

A double column cash book has a Cash column and a Bank column on each side and replaces both the Cash Account and the Bank Account.

Transaction	Side and column
Cheque received and deposited the same day	Debit – Bank
Payment by cheque; bank charges	Credit – Bank
Cash withdrawn from bank for owner's private use	Credit – Bank (By Drawings)

➤ Contra Entry

A **contra entry** is an entry whose both aspects are recorded in the cash book itself, one in the cash column and the other in the bank column. The letter "C" is written in the L.F. column of both sides, which means no posting to the ledger is required.

Contra entry: cash ₹20,000 deposited into bank

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Bank A/c	**Dr.**	20,000		Asset (Bank) ↑ → Debit
	To Cash A/c *(Being cash deposited into bank)*			20,000	Asset (Cash) ↓ → Credit

Cash withdrawn from the bank for the proprietor's personal use is **not** a contra entry; it is recorded only as "By Drawings A/c" in the bank column.

4 Discount Column and Dishonour of Cheques

Part II · Recording and Books of Account

➤ Discount Column and Cash Discount

Cash discount is the allowance given for prompt payment. It is a loss to the receiver of cash and a gain to the payer, so it is recorded. Trade discount is never entered in the cash book (see Chapter 10).

Side	Represents	Posting of column total
Debit	Discount allowed to customers	Debited to Discount Allowed A/c (expense/loss)
Credit	Discount received from suppliers	Credited to Discount Received A/c (income/gain)

➤ Dishonour of a Cheque

A cheque is dishonoured when the drawee bank refuses payment,. The amount is entered on the credit side of the bank column and the party's account is debited again. If a cheque accepted after discount is dishonoured, the discount is also cancelled.

Dishonour of Arun's cheque ₹9,800 (received in full settlement of ₹10,000)

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Arun A/c	**Dr.**	10,000		Asset (Debtor) ↑ → Debit
	To Bank A/c			9,800	Asset (Bank) ↓ → Credit
	To Discount Allowed A/c *(Being cheque dishonoured and discount cancelled)*			200	Expense (discount) ↓ → Credit

5 Posting and Petty Cash Book

Part II · Recording and Books of Account

➤ 9.6 Posting the Cash Book

Item in cash book	Posted to
Each debit entry (To X)	Credit side of account X, "By Cash" or "By Bank"
Each credit entry (By Y)	Debit side of account Y, "To Cash" or "To Bank"
Contra entries marked C	Not posted
Total of debit / credit discount column	Debit of Discount Allowed A/c / Credit of Discount Received A/c

➤ 9.7 Petty Cash Book

Small recurring payments such as postage, stationery and taxi fares are **petty expenses**, handled by a petty cashier. Under the **imprest system** the main cashier gives the petty cashier a fixed sum (the imprest) at the start of a period and reimburses ex-

actly the amount spent at the end, so the petty cashier again starts with the full imprest.

- Imprest = cash in hand with petty cashier + reimbursement due.

An analytical petty cash book has a Total column and one analysis column per expense head; the analysis columns together equal the total column.

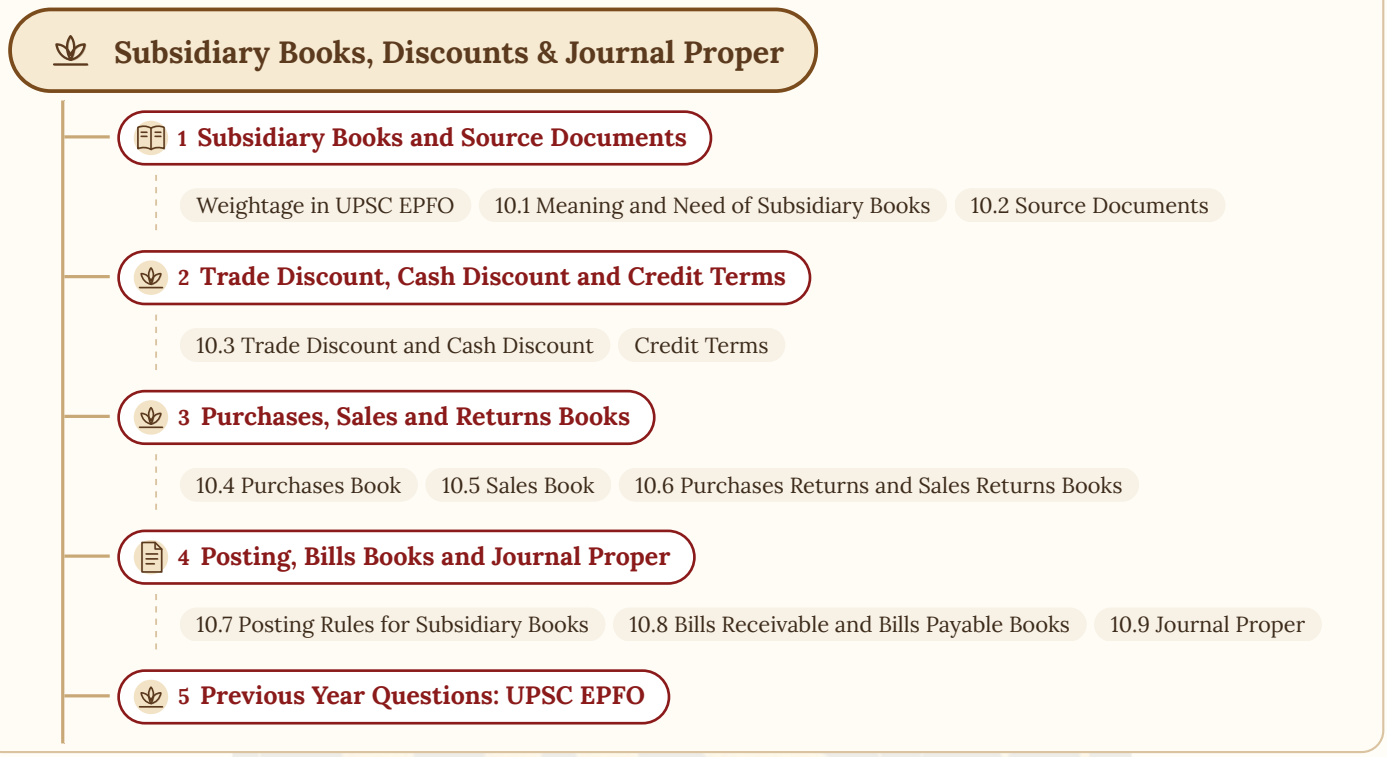
Posting petty cash analysis totals (payments ₹3,330)

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Postage, Stationery, Conveyance and other expense A/cs **Dr.**	3,330		Expense ↑ → Debit
	To Petty Cash A/c *(Being petty expenses analysed and posted)*		3,330	Asset (Petty Cash) ↓ → Credit

CHAPTER 10

Subsidiary Books, Discounts & Journal Proper

CHAPTER AT A GLANCE



1 Subsidiary Books and Source Documents

Part II · Recording and Books of Account

➤ Weightage in UPSC EPFO

One question in 2015–2025 (APFC 2015): a numerical on credit terms and cash discount. The 2025 statements on the sales day book and the 2023 error-of-principle question also draw on this chapter.

➤ 10.1 Meaning and Need of Subsidiary Books

As volume grows, the journal is divided into **subsidiary books** (special journals, day books or books of prime entry). Each is totalled periodically; only the total is posted to the relevant nominal account, while individual amounts are posted to personal accounts.

Subsidiary book	Records	Source document
Cash Book	All cash and bank receipts and payments	Cash memo, receipts
Purchases Book	Credit purchases of goods only	Invoice received
Sales Book	Credit sales of goods only	Copy of invoice issued
Purchases Returns Book	Goods returned to suppliers	Debit note issued
Sales Returns Book	Goods returned by customers	Credit note issued
Journal Proper	Transactions fitting no other book	Journal voucher

- "Goods" means items the firm deals in: furniture is goods for a furniture dealer but an asset for a cloth merchant.

- Cash purchases and sales go to the cash book; credit purchase or sale of assets goes to the journal proper.

➤ 10.2 Source Documents

An **invoice** is prepared by the seller for a credit sale; a **cash memo** is the voucher for the cash book.

Basis	Debit Note	Credit Note
Prepared by	Buyer (returning goods)	Seller (accepting returned goods)
Book recorded in	Purchases Returns Book	Sales Returns Book

2 Trade Discount, Cash Discount and Credit Terms

➤ 10.3 Trade Discount and Cash Discount

Basis	Trade Discount	Cash Discount
Purpose	To promote sales; given on bulk or resale	To encourage prompt payment
When allowed	At the time of sale, on list price	At the time of payment, on amount due
Shown in	Invoice only	Cash book discount column
Recorded in accounts	No – goods recorded at net price	Yes – Discount Allowed / Received A/c

Illustration: list price ₹1,00,000, 20% trade discount, 2% cash discount if paid within 15 days; buyer pays on the 10th day. Invoice value = ₹80,000; cash discount = 2% of 80,000 = ₹1,600; cash received ₹78,400. Cash discount is calculated on the invoice value after trade discount, not on the list price.

Seller's books: cash received and discount allowed

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Bank A/c	**Dr.**	78,400		Asset (Bank) ↑ → Debit
	Discount Allowed A/c	**Dr.**	1,600		Expense (Discount) ↑ → Debit
	To Buyer A/c *(Being cash received and discount allowed)*			80,000	Asset (Debtor) ↓ → Credit

➤ Credit Terms

Credit terms are written x/n, y/m, net t: x% discount if paid within n days; y% if paid after n days but within m days; and the full amount due within t days. Example: ₹2,50,000, terms 2/10, 1/30, net 45.

Day of payment	Band	Discount ₹	Amount payable ₹
8th	Within 10 days → 2%	5,000	2,45,000
25th	After 10, within 30 days → 1%	2,500	2,47,500
40th	After 30, within 45 days → net	nil	2,50,000

Apply only the rate of the band in which the payment day falls; the higher early-payment rate cannot be claimed once its day limit has passed.

3 Purchases, Sales and Returns Books

Part II · Recording and Books of Account

➤ 10.4 Purchases Book

The purchases book records only credit purchases of goods meant for resale, from invoices received, at the net amount after trade discount. The monthly total is debited to Purchases A/c and each supplier is credited on the date of purchase.

Where GST applies, separate columns show net value and CGST and SGST (intra-state) or IGST (inter-state). The tax paid is debited to Input CGST / SGST / IGST accounts, because it can be set off as input tax credit.

➤ 10.5 Sales Book

The sales book records only credit sales of goods, from copies of invoices issued, at the net amount after trade discount; cash sales and sale of assets are excluded.

Journal proper: old computer sold on credit to Dev

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Dev A/c	**Dr.**	8,000		Asset (Debtor) ↑ → Debit
	To Computer A/c *(Being old computer sold on credit)*			8,000	Asset (Computer) ↓ → Credit

➤ 10.6 Purchases Returns and Sales Returns Books

The purchases returns book is written from debit notes and the sales returns book from credit notes, at the price charged (net of the same trade discount).

4 Posting, Bills Books and Journal Proper

Part II · Recording and Books of Account

➤ 10.7 Posting Rules for Subsidiary Books

Book	Individual items posted to	Periodic total posted to
Purchases Book	Credit of each supplier	Debit of Purchases A/c
Sales Book	Debit of each customer	Credit of Sales A/c
Purchases Returns Book	Debit of each supplier	Credit of Purchases Returns A/c
Sales Returns Book	Credit of each customer	Debit of Sales Returns A/c
Bills Receivable Book	Credit of each acceptor	Debit of Bills Receivable A/c
Bills Payable Book	Debit of each drawer	Credit of Bills Payable A/c

➤ 10.8 Bills Receivable and Bills Payable Books

The Bills Receivable Book records bills received from debtors (Bills Receivable A/c Dr, To Debtor A/c); the Bills Payable Book records bills accepted in favour of creditors (Creditor A/c Dr, To Bills Payable A/c). Dishonour, endorsement and renewal of bills go to the journal proper or cash book.

➤ 10.9 Journal Proper

The **journal proper** (general journal) is the residual book of original entry. It records transactions that cannot be entered in the cash book or in any other subsidiary book.

Use	Example
Credit purchase/sale of assets	Machinery A/c Dr, To Singer Agencies
Adjustment, rectification, transfer and closing entries	Depreciation A/c Dr, To Machinery A/c; Profit and Loss A/c Dr, To Salary A/c

Machinery bought on credit from Singer Agencies

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Machinery A/c	**Dr.**	30,000		Asset (Machinery) ↑ → Debit
	To Singer Agencies *(Being machinery bought on credit)*			30,000	Liability (Creditor) ↑ → Credit

Credit purchase of machinery entered in the purchases book instead of the journal proper treats a capital item as a revenue item, an error of principle (EO/AO 2023; Chapter 13).

5 Previous Year Questions: UPSC EPFO

Part II · Recording and Books of Account

1. A firm is purchasing two items, both on credit on the same day. The credit terms offered for the first item are 2½/10, 1/20, net 30; and for the second item, 3/5, 2/15, net 30. The purchase costs are ₹60,000 and ₹1,40,000 respectively. If both credits are settled on the 14th day, what is the total amount payable? APFC 2015

(a) ₹1,97,200
(b) ₹1,97,500
(c) ₹1,96,600
(d) ₹1,98,400

Answer: (c) ₹1,96,600 — Day 14: item 1 falls in the 1% band (600 off), item 2 in the 2% band (2,800 off): 59,400 + 1,37,200.

CHAPTER 11

Bank Reconciliation Statement

CHAPTER AT A GLANCE

- Bank Reconciliation Statement
  - 1 Meaning and Causes of Difference
    - Weightage in UPSC EPFO
    - 11.1 Meaning of Bank Reconciliation Statement
    - 11.2 Causes of Difference
  - 2 Rules of Adjustment and Steps of Preparation
    - 11.3 Rules of Adjustment
    - Steps of Preparation
  - 3 Illustrations and Comparison
    - 11.4 Illustrations
    - 11.6 Finding the Reconciling Items by Comparison
  - 4 Errors and Amended Cash Book
    - 11.7 Treatment of Errors
    - 11.8 Amended Cash Book Method
    - 11.9 Quick Reference

1 Meaning and Causes of Difference

Part II · Recording and Books of Account

➤ Weightage in UPSC EPFO

No question on bank reconciliation has been set in 2015–2025, but the topic links to the cash book discount column (Chapter 9) and to errors the trial balance cannot reveal (Chapter 13).

➤ 11.1 Meaning of Bank Reconciliation Statement

A **Bank Reconciliation Statement (BRS)** is a statement prepared by the account holder, on a given date, to reconcile the bank balance shown by the cash book (bank column) with the balance shown by the pass book (bank statement), by listing the items that cause the difference. It is a statement, not an account; no posting is made from it.

Transaction	Cash book (firm's record)	Pass book (bank's record)
Money deposited	Debit	Credit
Money withdrawn / cheque paid	Credit	Debit
Favourable balance	Debit balance	Credit balance
Overdraft	Credit balance	Debit balance

The two records are mirror images. Only the bank column is reconciled, not cash in hand.

➤ 11.2 Causes of Difference

Differences arise from **timing differences** (the same transaction recorded on different dates) and **errors** (a transaction recorded wrongly by one party).

Recorded by the firm, not yet by the bank	Recorded by the bank, not yet by the firm
Cheques issued but not yet presented for payment	Bank charges, commission, interest on overdraft
Cheques deposited but not yet collected	Interest, dividends or bills collected by bank; direct deposits by customers
Cheques recorded in cash book but not sent to bank	Payments under standing instructions or ECS; dishonour of a cheque deposited earlier

A firm's own error is finally corrected in the cash book; a bank error is reported to the bank. Both are reconciling items in the BRS.

2 Rules of Adjustment and Steps of Preparation

➤ 11.3 Rules of Adjustment

Start with one balance and ask: has this item made the other balance higher or lower? If higher, add; if lower, less. When starting with an overdraft, treat it as a negative figure.

Item	Start: CB favourable → PB	Start: CB overdraft → PB	Start: PB favourable → CB	Start: PB overdraft → CB
Cheques issued, not presented	Add	Less from overdraft	Less	Add to overdraft
Cheques deposited, not collected (or not sent)	Less	Add to overdraft	Add	Less from overdraft
Bank charges, interest on overdraft, direct payments, dishonour (PB only)	Less	Add to overdraft	Add	Less from overdraft
Interest, dividend, bill collected, direct deposit (PB only)	Add	Less from overdraft	Less	Add to overdraft

➤ Steps of Preparation

- Head the statement "Bank Reconciliation Statement as on 31 March 2026" with two columns, Plus and Minus.
- Write the starting balance: a favourable balance in the plus column, an overdraft in the minus column.
- Enter each reconciling item in the plus or minus column using the rules above.
- Total both columns; the difference is the other balance. Excess of plus items = favourable balance; excess of minus items = overdraft.

3 Illustrations and Comparison

Part II · Recording and Books of Account

➤ 11.4 Illustrations

Illustration 1. Cash book shows ₹50,000. Cheques issued but not presented ₹6,000; dividend collected by bank ₹8,000; bank charges ₹400; cheques deposited but not collected ₹6,000.

Particulars	Plus ₹	Minus ₹
Balance as per cash book (Dr)	50,000	
Add: cheques issued but not presented	6,000	
Add: dividend collected by bank	8,000	
Less: bank charges		400
Less: cheques deposited but not collected		6,000
Balance as per pass book (Cr)	57,600	

Illustration 2 (overdraft). Cash book overdraft ₹8,000. Cheques paid in but not collected ₹2,000; cheques issued not presented ₹800; interest on overdraft ₹60 and bank charges ₹100 debited in the pass book only.

Particulars	Plus ₹	Minus ₹
Overdraft as per cash book		8,000
Cheques paid in but not collected		2,000
Interest on overdraft; bank charges		160
Cheques issued but not presented	800	
Overdraft as per pass book = 10,160 − 800		9,360

An overdraft in the firm's books can turn favourable in the pass book when large cheques issued have not yet been presented.

➤ 11.6 Finding the Reconciling Items by Comparison

When the cash book and the pass book themselves are given, each entry in one is ticked against the matching entry in the other. The unticked items on either side are the reconciling items.

4 Errors and Amended Cash Book

Part II · Recording and Books of Account

➤ 11.7 Treatment of Errors

Ask whether the error has made the starting balance too high or too low compared with the other record. If the cash book balance is overstated, deduct the excess; if understated, add the shortfall. A wrong debit by the bank lowers the pass book balance; a wrong credit raises it. Examples: a cheque of ₹8,000 issued but recorded as ₹800 → less ₹7,200; bank wrongly credits ₹3,000 of another customer → add.

➤ 11.8 Amended Cash Book Method

Items known only to the bank (charges, interest, direct receipts and payments, dishonoured cheques) and the firm's own errors must be entered in the cash book in any

case. Under this method an **amended cash book** is prepared first; its corrected balance is the figure shown in the balance sheet. The BRS then starts from the amended balance and contains only cheques not presented, cheques not collected and bank errors.

Illustration: cash book balance ₹42,000 Dr; interest credited ₹1,200 and dividend ₹3,800 not entered; charges ₹500, dishonour ₹2,500, insurance ₹1,800 not entered; cheques not presented ₹9,000; cheques not credited ₹6,000. Amended balance = 42,000 + 5,000 − 4,800 = ₹42,200; pass book balance = 42,200 + 9,000 − 6,000 = ₹45,200.

The balance sheet shows ₹42,200, not the pass book ₹45,200.

➤ 11.9 Quick Reference

- No difference arises from a cheque issued and presented, or deposited and collected, in the same period, or from any cash-in-hand transaction.

CHAPTER 12

Trial Balance

CHAPTER AT A GLANCE

- Trial Balance
  - 1 Meaning, Nature and Objectives of a Trial Balance
    - Weightage in UPSC EPFO (Chapters 12 and 13 together)
    - 12.1 Meaning and Nature
    - 12.2 Objectives
  - 2 Placing of Balances and Methods of Preparation
    - 12.3 Debit and Credit Balances: Where Each Item Goes
    - 12.4 Methods of Preparing a Trial Balance
  - 3 Agreement of the Trial Balance and Its Limitations
    - 12.6 Agreement and Limitations
    - Are the Debit and Credit Totals Always Equal?
    - 12.7 Trial Balance Compared with Other Statements
  - 4 Previous Year Questions: UPSC EPFO

1 Meaning, Nature and Objectives of a Trial Balance

➤ Weightage in UPSC EPFO (Chapters 12 and 13 together)

Part II · Recording and Books of Account

Eight questions in 2015–2025 (EO/AO 2021: 2; EO/AO 2023: 1; APFC 2023: 2; 2025: 3), asked in every recent paper; four belong to this chapter.

➤ 12.1 Meaning and Nature

A **trial balance** is a statement showing the debit and credit balances (or totals) of all ledger accounts, including cash and bank balances, on a particular date. It is prepared to test the arithmetical accuracy of posting and balancing. Under double entry every debit has an equal credit, so total debit balances must equal total credit balances.

Features	What a trial balance is not
A statement, not an account; it has only Dr and Cr amount columns	Not a book of account (the ledger is the principal book)
Prepared on a date, not for a period	Not the balance sheet, since it contains nominal accounts as well
An internal working statement; not a legal requirement	Not proof of freedom from all errors

The EO/AO 2021 correct description: "a statement containing the various ledger balances of an entity on a particular date". The flow is Transactions → Journal → Ledger → Trial Balance → Final Accounts.

➤ 12.2 Objectives

- Arithmetical accuracy: equal totals show that for every debit posted an equal credit has been posted.
- Locating errors: a difference signals an error, and its amount gives clues (half the difference, or divisible by 9).
- Base for financial statements: the Trading and Profit and Loss Account and the Balance Sheet can be prepared from it.

2 Placing of Balances and Methods of Preparation

➤ 12.3 Debit and Credit Balances: Where Each Item Goes

Debit column	Credit column
Assets (debtors, cash, bank, stock, machinery, furniture, land, goodwill, investments, bills receivable)	Capital
Expenses and losses (opening stock, purchases, returns inward, wages, rent, discount allowed, bad debts, depreciation)	Liabilities (creditors, bills payable, bank overdraft, loans taken)
Drawings; prepaid expenses; accrued income	Incomes and gains (sales, returns outward, discount received, commission)
	Provisions and reserves; outstanding expenses; income received in advance

Recall aid "ADEL": Assets, Drawings, Expenses, Losses are debits.

- Closing stock normally appears outside the trial balance (as an adjustment); it appears inside only when purchases have already been adjusted for it, as a debit item.
- Capital normally shows a credit balance; "Capital account has a debit balance" is not correct as a general statement (2025).
- Common errors: bank overdraft is a liability, Cr; returns inward are Dr; provision for doubtful debts is Cr; outstanding wages Cr, prepaid insurance Dr.

➤ 12.4 Methods of Preparing a Trial Balance

Basis	Totals method	Balances method	Totals-cum-balances
Amount entered	Both side totals of each account	Net balance only	Totals and balances
Nil-balance accounts	Included	Omitted	Included
Use in practice	Rare	Most common	Rare, lengthy

The totals-method statement is sometimes called a Gross Trial Balance and the balances-method statement a Net Trial Balance. In examinations a list of balances is given; place each on its correct side and, where asked, find the missing figure (often capital) as the balancing amount: Capital = total debits − credits other than capital.

3 Agreement of the Trial Balance and Its Limitations

➤ 12.6 Agreement and Limitations

When the two totals agree, equal debits and credits have been posted and balanced. This is **prima facie** (first-sight) evidence of arithmetical accuracy, not conclusive proof that the books are correct. Errors that affect both sides equally leave the totals in agreement.

Errors not disclosed (TB still agrees)	Errors disclosed (TB disagrees)
Complete omission of a transaction	Posting only one side (partial omission)
Error of principle (capital item treated as revenue or vice versa)	Posting a wrong amount on one side
Wrong amount in the book of original entry	Posting to the wrong side of an account
Posting to a wrong account on the correct side	Wrong totalling (casting) of a subsidiary book or an account
Compensating errors; duplication of an entry	Wrong balancing or extraction into the TB

➤ Are the Debit and Credit Totals Always Equal?

In a correctly kept double entry system they should be equal, but they may differ when a one-sided error has occurred. The difference is temporarily placed in a **Suspense Account** until the error is found. The EO/AO 2021 official key accepted "No, there are sometimes good reasons why they differ". Suspense A/c is a temporary account, never a permanent account (2025).

Rectification: Rahul's credit (₹5,000 cash received) omitted; Suspense shown on credit side of TB

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Suspense A/c	**Dr.**	5,000		Suspense (temporary balancing account) ↑ → Debit; closes the credit balance
	To Rahul's A/c *(Being omitted credit to Rahul's account posted)*			5,000	Asset (Debtor) ↓ → Credit

➤ 12.7 Trial Balance Compared with Other Statements

Basis	Trial Balance	Balance Sheet
Purpose	Check arithmetical accuracy	Show assets, liabilities and capital
Accounts	Real, personal and nominal	Only real and personal
Closing stock	Usually outside	Always shown as an asset
Legal status	Internal; not required by law	Required; published

Nominal account balances go to the Trading and Profit and Loss Account; real and personal balances go to the Balance Sheet. The journal is the book of original entry; the ledger is the principal book because the TB and final accounts are drawn from it (correct in the 2025 paper).

4 Previous Year Questions: UPSC EPFO

Part II · Recording and Books of Account

1. Which one of the following statements about 'Trial Balance' is correct? EO/AO 2021

(a) It is a book containing different accounts of an entity

(b) It is a statement containing balances of debtors

(c) It is a statement containing balances of debtors and creditors

(d) It is a statement containing the various ledger balances of an entity on a particular date

Answer: (d) It is a statement containing the various ledger balances of an entity on a particular date — A trial balance is a statement, not a book, listing every ledger balance on a given date; (b) and (c) cover only personal accounts.

2. Is the total of the debit side and credit side of the trial balance the same? EO/AO 2021

(a) No, there are sometimes good reasons why they differ

(b) Yes, always

(c) Yes, except where the trial balance is extracted at the year end

(d) No, because it is not a balance sheet

Answer: (a) No, there are sometimes good reasons why they differ (official key) — One-sided errors make totals differ; the gap goes to a suspense account. Date of extraction is irrelevant.

3. Which one of the following statements is correct? (A) Agreement of trial balance is conclusive proof of accuracy (B) Suspense account opened in trial balance is a permanent account (C) At the end of the year all nominal accounts of ledger are balanced (D) A ledger is known as the principal book of accounts 2025

(A)

(B)

(C)

(D)

Answer: (D) — Agreement is only prima facie proof; suspense is temporary; nominal accounts are closed to Trading/P&L, not balanced.

4. Which one of the following statements is not correct? (A) Capital account has a debit balance (B) Discount column of cash book records cash discount (C) Under traditional approach, rent outstanding is a personal account (D) Cash sales are not recorded in sales day book 2025

(A)

(B)

(C)

(D)

Answer: (A) — Capital is the owner's claim and normally has a credit balance; the other statements are correct.

CHAPTER 13

Errors, Rectification & Suspense Account

CHAPTER AT A GLANCE



1 Meaning and Classification of Errors

Part II · Recording and Books of Account

Weightage in UPSC EPFO (2021–2025): 4 questions; most tested is the **error of principle**. Questions on the trial balance and suspense account are in Chapter 12.

➤ 13.1 Meaning and Classification of Errors

Errors are unintentional mistakes in recording, classifying, posting, totalling (casting), balancing, carrying forward or summarising transactions. An intentional misstatement made to deceive is a **fraud**, not an error.

- Four types: **commission, omission, principle, compensating**.
- Commission, omission and compensating errors are **clerical errors**.
- Error of principle arises from wrong knowledge of accounting rules.

➤ 1. Errors of Commission

Committed while recording, posting, totalling or balancing (wrong amount, account or side) without violating any principle.

Form	Example	Effect on TB
Wrong account, correct side	Cash from Ramesh credited to Rakesh	No effect
Wrong amount / side in posting; wrong casting, balancing or carry forward	Gopal credited ₹1,200 instead of ₹12,000; Sales Book overcast ₹1,000	Disagrees

➤ 2. Errors of Omission

- **Complete omission:** nothing recorded in the book of original entry; trial balance **agrees**.
- **Partial omission:** transaction recorded but one side not posted; trial balance **disagrees**.

➤ 3. Errors of Principle

- Fundamental principles not followed, most often a wrong distinction between capital and revenue items, or a personal item treated as a business item.
- Trial balance agrees; profit and asset values are misstated.

Example	Wrongly treated as	Should be
Credit purchase of machinery in Purchases Book (EO/AO 2023)	Goods (revenue)	Machinery (Journal Proper)
Furniture for owner's home debited to Furniture A/c	Business asset	Drawings

➤ 4. Compensating Errors

Two or more errors whose effects on debit and credit totals cancel, so the trial balance agrees (Rent debited ₹8,000 instead of ₹9,500 and Sales Book undercast by ₹1,500).

➤ 5. Other Two-sided Errors

- **Error of original entry**, **duplication** and **complete reversal of entry** keep debits equal to credits.
- A complete reversal needs **double** the amount: once to cancel the wrong entry, once to record the right one.

2 Effect on Trial Balance and Locating Errors

Part II · Recording and Books of Account

➤ 13.2 Effect on Trial Balance and Locating Errors

One-sided errors (TB disagrees)	Two-sided errors (TB agrees)
Wrong casting, balancing, amount or side in posting, omission to post one side.	Complete omission, error of principle, wrong amount in original entry, wrong account on correct side, compensating errors.
Rectified through the **Suspense Account** after the TB.	Rectified by an ordinary journal entry between the accounts concerned.

➤ Locating Errors

- Recast both columns.
- Check ledger balances.

- Apply arithmetic tests on the difference.
- Recheck subsidiary books and postings.

Test on the difference	What to look for
Equal to an item	A single posting of that amount omitted on one side
Divide by 2	An item equal to half the difference
Divisible by 9	Transposition (₹459 as ₹954) or a misplaced decimal

3 Rectification of Errors and Guiding Principles

➤ 13.3 Rectification of Errors

Rectification means correcting an error by an appropriate entry.

- Find the entry actually made.
- Find the entry that should have been made.
- Pass the entry that cancels the wrong part and records the right part.

Stage at which error is found	Two-sided error	One-sided error
1. Before the TB	Rectifying journal entry	No journal entry; correct on the proper side of the account
2. After the TB, before final accounts	Rectifying journal entry	Journal entry with other side to Suspense A/c
3. After final accounts (next year)	Journal entry; nominal accounts replaced by P&L Adjustment A/c	Same, with Suspense A/c brought forward

➤ 13.4 Guiding Principles for Rectification

When the question is silent, assume:

- An error in a book of original entry was posted exactly as recorded; an error in posting means the original entry is correct.
- In a wrongly posted cash or bank transaction, the Cash Book side is correct.
- A journal entry "not posted" means neither account was posted.

Illustration: credit purchase from Raghu ₹20,000 – selected cases

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
(vii) Debited to Raghu	Suspense A/c	**Dr.**	40,000		Credit side was short → Debit
	To Raghu's A/c			40,000	Liability ↑ (cancel debit, record credit) → Credit
(ix) In Sales Book	Sales A/c	**Dr.**	20,000		Revenue ↓ → Debit
	Purchases A/c	**Dr.**	20,000		Expense ↑ → Debit
	To Raghu's A/c			40,000	Liability ↑ → Credit

4 Suspense Account and Effect on Profit

Part II · Recording and Books of Account

➤ 13.5 Suspense Account

The difference in the trial balance is placed in the **Suspense Account** so that final accounts can be prepared.

- It goes on the **shorter side**: debit total greater → Suspense on credit side; credit total greater → on debit side.
- It is a **temporary account** (2025); it only holds the difference and corrects no error.
- Two-sided errors never pass through it.
- If not cleared by year end, a debit balance is shown on the assets side and a credit balance on the liabilities side.

Kavita Stores: TB debit exceeded credit by ₹6,100 (credited to Suspense)

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
1	Suspense A/c	**Dr.**	1,500		Credit side was short → Debit
	To Sales A/c *(Sales Book undercast)*			1,500	Revenue ↑ → Credit

With the other errors, corrected profit = **₹58,300**.

➤ 13.6 Effect of Rectification on Profit

Rectifying entry involves	Effect on net profit
Expense/loss account debited, or income account debited	Profit decreases
Income/gain account credited, or expense account credited	Profit increases
Only real and personal accounts (and Suspense)	No effect

5 Rectification in the Next Accounting Period

Part II · Recording and Books of Account

➤ 13.7 Rectification in the Next Accounting Period

- Final accounts close the nominal accounts, so an error found next year is not corrected through them.
- Every nominal account in the rectifying entry is replaced by a **Profit and Loss Adjustment Account** (Prior Period Adjustment Account); its balance is transferred to capital.

Nikhil (books closed 31 March 2026): repairs ₹5,000 debited to Machinery; credit sale ₹6,000 to Jyoti not recorded

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
(ii)	P&L Adjustment A/c	**Dr.**	5,000		Expense ↑ → Debit
	To Machinery A/c			5,000	Asset ↓ → Credit
(iv)	Jyoti's A/c	**Dr.**	6,000		Asset ↑ → Debit
	To P&L Adjustment A/c			6,000	Revenue ↑ → Credit

- A credit balance in P&L Adjustment A/c means last year's profit was understated; transfer to Capital.

- **Companies:** earlier-year errors are prior period items, disclosed separately under AS 5 or corrected retrospectively under Ind AS 8.

6 Previous Year Questions: UPSC EPFO

Part II · Recording and Books of Account

1. Credit purchase of machinery recorded in Purchase Book instead of Journal Proper is an example of: EO/AO 2023

(a) Compensating errors
(b) Errors of commission
(c) Errors of principle
(d) Errors of omission

Answer: (c) Errors of principle — Machinery is a capital asset, not goods for resale; capital/revenue confusion is an error of principle. TB still agrees.

2. When purchase of an asset is treated as an expense, it is called: 2025

(A) Error of principle
(B) Error of omission
(C) Error of commission
(D) Compensating error

Answer: (A) Error of principle — Capital expenditure charged to revenue violates the capital–revenue principle; profit and assets are understated.

3. Which one of the following is not an error of commission? APFC 2023

(a) Overcasting of sales book
(b) Credit sales to Ramesh ₹5,000 credited to his account
(c) Wrong balancing of machinery account
(d) Cash sales not recorded in cash book

Answer: (d) Cash sales not recorded in cash book — (a), (b), (c) are casting, wrong-side and balancing errors; not entering a transaction at all is complete omission.

4. Which one of the following errors is NOT detected by the Trial Balance? APFC 2023

(a) Credit purchase of ₹1,000 from Mr. Singh credited wrongly to Mr. Akash
(b) Credit purchase of ₹20,000 from Mr. Sandhu recorded in the day book as ₹2,000
(c) Conversion of temporary shed into permanent building recorded as repairs
(d) Error in posting from subsidiary book to ledger

Answer: (a) (official key) — Right amount, correct side, wrong personal account keeps TB agreeing. Strictly (b) and (c) are also two-sided; only (d) normally disturbs the TB.

CHAPTER 14

Computerised Accounting Systems

CHAPTER AT A GLANCE

- Computerised Accounting Systems
  - 1 Meaning and Working of a Computerised Accounting System
    - 14.1 Meaning of a Computerised Accounting System
    - Illustration: Vouchers in Software
  - 2 Features, Manual vs Computerised, Advantages and Limitations
    - 14.2 Features of Computerised Accounting
    - 14.3 Manual and Computerised Accounting Compared
    - 14.4 Advantages and Limitations
  - 3 Accounting Software, ERP and Choosing Software
    - 14.5 Accounting Software
    - Factors in Choosing Software
    - Enterprise Resource Planning (ERP) and Cloud Accounting
  - 4 Codification, Database Basics and Legal Requirements
    - 14.6 Codification and Grouping of Accounts
    - 14.7 Database Basics for Accounting
    - Legal Position for Companies

1 Meaning and Working of a Computerised Accounting System

Weightage in UPSC EPFO: no direct question yet in EO/AO or APFC papers; the chapter supports the general accounting principles section and the computer applications in the syllabus. Part II · Recording and Books of Account

➤ 14.1 Meaning of a Computerised Accounting System

A **computerised accounting system (CAS)** is an accounting information system that records, stores, processes and reports financial transactions with the help of computer hardware and accounting software.

- Accounting rules remain the same whether books are kept by hand or on a computer.
- Works on the concept of a **database**: each transaction is entered once as a **voucher**; every report is drawn from the same stored data.
- **Components:** procedure (logical steps), data (transactions and master records), people (users), hardware (computer, storage, printer, network) and software (operating system and accounting package).
- **Flow:** source document (bill, receipt) → voucher entry (input once) → database → ledger and trial balance (automatic) → reports (P&L, Balance Sheet).

➤ Illustration: Vouchers in Software

Raj's vouchers (software posts ledgers and trial balance automatically)

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
Receipt	Cash A/c	**Dr.**	1,00,000		Asset (Cash) ↑ → Debit
	To Capital A/c *(Being capital brought in)*			1,00,000	Equity (Capital) ↑ → Credit
Sales	Rahul A/c	**Dr.**	15,000		Asset (Debtor) ↑ → Debit
	To Sales A/c *(Being credit sale to Rahul)*			15,000	Revenue ↑ → Credit

- Adjustments (outstanding and prepaid expenses, depreciation) must still be entered by the accountant as journal vouchers.

2 Features, Manual vs Computerised, Advantages and Limitations

Part II · Recording and Books of Account

➤ 14.2 Features of Computerised Accounting

- **Single entry of data:** posting, balancing and totalling are automatic.
- **Online, real-time information** and automatic production of invoices, receipts, payslips and cheques.
- **Security** through passwords and user rights; **audit trail** of who entered or changed each transaction and when; **scalability**.

➤ 14.3 Manual and Computerised Accounting Compared

Basis	Manual	Computerised
Recording and classification	Journal and subsidiary books; ledger posted by hand, data written twice	Vouchers stored in a database; no separate posting; ledgers are generated reports
Summarising	Trial balance prepared by hand	Produced instantly; always agrees arithmetically
Financial statements and closing	Time-consuming; closing entries by hand	Generated any time for any period; year-end closing automatic
Errors	Arithmetic and posting errors common	Arithmetic errors removed; input errors and errors of principle remain

- **Link with Chapter 13:** the software posts both sides of a voucher with the same amount, so one-sided errors (partial omission, wrong-side posting, casting errors) practically disappear.
- Two-sided errors (complete omission, wrong account, errors of principle, compensating errors) can still occur: "garbage in, garbage out".

➤ 14.4 Advantages and Limitations

Advantages	Limitations
Speed and accuracy; no arithmetic or posting mistakes	Cost of training staff, software and hardware

Advantages	Limitations
Reliability, legibility, up-to-date information at any time	Staff opposition from fear of job loss; disruption while the system is changed over
Real-time access for many users at different places; quality MIS reports	System failure (crash, virus) – backups essential; inability to check unanticipated errors

3 Accounting Software, ERP and Choosing Software

Part II · Recording and Books of Account

➤ 14.5 Accounting Software

Accounting software is a set of programs that records transactions and produces accounting reports. Three types:

Basis	Ready-to-use	Customised	Tailor-made
Meaning	Standard package for general use	Standard package modified to suit the user	Developed specially for one organisation
Suited to	Small and medium businesses	Medium and large businesses	Large, complex organisations
Cost and training	Low cost; little training	Moderate; some training	High cost; specialised training
Examples	TallyPrime, Busy, QuickBooks, Zoho Books	Packages adapted for a store chain or hospital	ERP built for banks, PSUs (SAP, Oracle)

➤ Factors in Choosing Software

- Flexibility
- Cost
- Size of organisation
- Ease of training
- Range of MIS reports
- Secrecy of data
- Vendor reputation

➤ Enterprise Resource Planning (ERP) and Cloud Accounting

- **ERP:** integrated software; accounting is one module among purchase, inventory, production, sales, payroll and human resources.
- All departments share one database: a sale entered once updates stock, debtors and the ledger together.
- **Cloud accounting:** software and data kept on remote servers, accessed through the internet.

4 Codification, Database Basics and Legal Requirements

Part II · Recording and Books of Account

➤ 14.6 Codification and Grouping of Accounts

Codification gives each account a unique code (number, letters or both) so that the computer can identify, sort and group it.

- The complete list of accounts with codes is the **chart of accounts**.

Type of code	Meaning	Example
Sequential	Numbers in serial order, usually to documents	Invoice 0001, 0002, 0003
Block	A range reserved for each group	1000–1999 Assets; 2000–2999 Liabilities; 3000–3999 Capital; 4000–4999 Income; 5000–5999 Expenses
Mnemonic	Letters or symbols that aid memory	CSH – Cash; BNK – Bank; SLS – Sales

- Accounts are grouped in a hierarchy: Balance Sheet → Assets (non-current and current) and Equity and Liabilities.
- For companies the grouping follows Schedule III of the Companies Act, 2013.

➤ 14.7 Database Basics for Accounting

A **database** is an organised collection of related data; a **Database Management System (DBMS)** is the software that creates and maintains it and controls access. Accounting software is a database application.

🕮 Key Terms

Table (relation)	Data in rows and columns, e.g. Accounts table, Vouchers table
Record (row)	One complete entry, such as one voucher
Primary key	A field that identifies each record uniquely (account code, voucher number)
Foreign key	A field that refers to the primary key of another table
SQL	Standard query language to request specific data

➤ Legal Position for Companies

- **Section 128**, Companies Act, 2013: books of account may be kept in electronic form.
- **Rule 3**, Companies (Accounts) Rules, 2014: electronic books accessible in India at all times; backed up on servers in India daily.
- From 1 April 2023: accounting software must have an **audit trail (edit log)** that cannot be disabled.

CHAPTER 15

Capital and Revenue: Expenditure and Receipts

CHAPTER AT A GLANCE

- Capital and Revenue: Expenditure and Receipts
  - 1 Need for the Distinction and Capital Expenditure
    - 15.1 Need for the Distinction
    - 15.2 Capital Expenditure
    - Cost of a Fixed Asset (AS 10)
    - Tests for Classification
  - 2 Revenue Expenditure, Repairs and Overhauls
    - 15.3 Revenue Expenditure
    - 15.4 Repairs, Overhauls, Replacements and Improvements
    - Quick Reference for Other Items
  - 3 Deferred Revenue Expenditure
    - 15.5 Deferred Revenue Expenditure
  - 4 Capital and Revenue Receipts, Profits and Losses
    - 15.6 Capital Receipts and Revenue Receipts
    - Insurance Claims
    - Other Receipts
    - 15.7 Capital and Revenue Profits and Losses
  - 5 Previous Year Questions: UPSC EPFO

1 Need for the Distinction and Capital Expenditure

Weightage in UPSC EPFO (2017–2025): 5 questions (EO/AO 2017, EO/AO 2023, APFC 2023 ×2, 2025). Most tested: repairs, overhauls and replacements (3). Linked: wages for installing machinery (EO/AO 2021, Ch 8) and errors of principle (Ch 13).

Part III · Measurement and Financial Statements

➤ 15.1 Need for the Distinction

A capital item benefits many years; a revenue item belongs to the current year. The first goes to the Balance Sheet, the second to the Statement of Profit and Loss.

Error	Effect on profit	Effect on Balance Sheet
Capital expenditure treated as revenue (machine debited to Repairs)	Profit understated	Fixed assets understated
Revenue expenditure treated as capital (repairs debited to Machinery)	Profit overstated	Fixed assets overstated
Capital receipt treated as revenue	Profit overstated	Fixed assets overstated

All three are **errors of principle**.

➤ 15.2 Capital Expenditure

Capital expenditure is incurred to acquire a fixed asset, or to add to or improve an existing one, so that the business benefits for more than one accounting period.

- Shown as an asset; written off through depreciation (Chapter 16).
- **Examples:** land, building, machinery, goodwill, patents, an improvement that increases capacity, efficiency or life.

➤ Cost of a Fixed Asset (AS 10)

- Cost = purchase price + all directly attributable costs of bringing the asset to its location and working condition.
- **Included:** freight, customs duty, installation, wages of own workers used for installation, trial runs, stamp duty, legal fees, initial repairs of a second-hand asset.
- **Not added:** recoverable GST, annual maintenance contract (AMC), routine repairs, general overheads, training.

Machine cost ₹8,90,000; installation wages ₹15,000 transferred from Wages A/c (EO/AO 2021)

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
Apr 1	Machinery A/c **Dr.**	8,90,000		Asset ↑ → Debit
	To Bank A/c		8,75,000	Asset (Bank) ↓ → Credit
	To Wages A/c *(Being machine capitalised)*		15,000	Expense ↓ (capitalised) → Credit

➤ Tests for Classification

Test	Capital expenditure	Revenue expenditure
Purpose	Acquire, construct or improve a fixed asset	Run the business or maintain an asset
Period of benefit	More than one year	Current year

- No single test is decisive.
- Neither the **size** nor the **name** of the account decides the class; the purpose does.

2 Revenue Expenditure, Repairs and Overhauls

Part III · Measurement and Financial Statements

➤ 15.3 Revenue Expenditure

Revenue expenditure is incurred to earn the current period's revenue or maintain fixed assets in working condition.

- Creates no asset; charged in full to the Trading Account (direct expenses) or Profit and Loss Account (indirect expenses).
- **Examples:** purchase of goods for resale, wages, rent, routine repairs, insurance, depreciation, interest on loans.

➤ 15.4 Repairs, Overhauls, Replacements and Improvements

- **Restoring** an asset to its original condition: revenue.

- **Bringing it to working condition**, or improving it beyond its original condition: capital.

Expenditure	Class	Reason
Overhaul/repair of a second-hand machine before first use (2025; APFC 2023)	Capital	Cost of making the asset usable
Overhaul of a car engine for better fuel efficiency (EO/AO 2023)	Capital	Improves efficiency beyond original level
Replacement of a worn-out portion of a machine (2025)	Revenue	Restores the old condition
Cost of removing a worn-out part before a new engine is fitted (APFC 2023)	Revenue	Adds nothing to the asset
Shed converted into permanent building	Capital	Improvement or extension

- **AS 10 (Revised):** replacement of a significant component with a separate useful life is capitalised; otherwise apply the traditional rule.

➤ Quick Reference for Other Items

Item	Class
Patents, trademarks; licence to run a cinema hall (2025)	Capital
Foreign tour expenses to select and buy a machine; freight and customs duty on new machinery (APFC 2023)	Capital
Interest on loan during construction (AS 16); after use begins	Capital; revenue
Annual maintenance contract; annual insurance premium	Revenue
Depreciation (EO/AO 2017)	Revenue

3 Deferred Revenue Expenditure

Part III · Measurement and Financial Statements

➤ 15.5 Deferred Revenue Expenditure

Deferred revenue expenditure is revenue in nature (creates no saleable asset) but unusually large, with benefit extending over more than one year.

- Only a part is written off each year; the balance is a **fictitious asset**.
- **Examples: preliminary expenses**, heavy advertising to launch a product, shifting of business, discount on issue of shares or debentures.
- **Illustration:** ₹9,00,000 launch advertising benefiting three years: ₹3,00,000 written off each year; ₹6,00,000 remains in the Balance Sheet after year 1.
- **Present position:** AS 26 requires start-up activities (preliminary expenses), training and advertising to be expensed when incurred.
- For examination questions the expected answer is still **deferred revenue expenditure** (EO/AO 2017).
- **Depreciation is not deferred revenue expenditure:** it is the yearly allocation of a capital cost already incurred, an ordinary revenue expense of each year (EO/AO 2017).

4 Capital and Revenue Receipts, Profits and Losses

➤ 15.6 Capital Receipts and Revenue Receipts

Capital receipts are not from normal operations; **revenue receipts** arise from normal operations.

Capital receipts	Revenue receipts
Owners' contributions, borrowings, sale of fixed assets and investments	Sales, rent, interest, dividend, commission
Appear in the Balance Sheet	Credited to the Trading or Profit and Loss Account; only these increase profit available for dividend

➤ Insurance Claims

- The nature of an insurance claim follows the nature of the asset lost.
- Claim for machinery, building or vehicle destroyed by fire: **capital receipt** (APFC 2023); any shortfall is a capital loss.
- Claim for stock destroyed by fire: **revenue receipt**.

Machinery of book value ₹3,20,000 destroyed by fire; claim admitted ₹2,50,000

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
Fire	Insurance Company A/c	**Dr.**	2,50,000		Asset (claim receivable) ↑ → Debit
	Loss by Fire A/c	**Dr.**	70,000		Loss ↑ → Debit
	To Machinery A/c *(Being machinery destroyed)*			3,20,000	Asset ↓ → Credit

➤ Other Receipts

- **Sale of a fixed asset:** machine of book value ₹75,000 sold for ₹60,000 gives a capital loss of ₹15,000.
- **Government grants (AS 12):** grant for a specific fixed asset is a capital receipt; grant to meet revenue expenses (export subsidy) is a revenue receipt.

➤ 15.7 Capital and Revenue Profits and Losses

Capital profits	Revenue profits	Capital losses	Revenue losses
Profit on sale of fixed asset; premium on shares	Gross profit; commission, rent, interest earned	Loss on sale of fixed asset; uninsured fixed asset lost by fire	Bad debts; loss of stock by theft; depreciation

- Capital profits go to capital reserve or securities premium; generally not distributed as dividend.

5 Previous Year Questions: UPSC EPFO

1. Overhauling expenses of ₹25,000 for the engine of a motor car to get better fuel efficiency is: EO/AO 2023

(a) Deferred revenue expenditure
(b) Revenue receipt
(c) Capital expenditure
(d) Revenue expenditure

Answer: (c) Capital expenditure — The overhaul improves efficiency beyond the original level, so it is capital; (b) is a receipt, not expenditure.

2. Preliminary expenses are examples of: EO/AO 2017

(a) capital expenditure
(b) capital gain
(c) deferred revenue expenditure
(d) revenue expenditure

Answer: (c) deferred revenue expenditure — They create no saleable asset but benefit many years; under AS 26 they are now expensed when incurred.

3. Which one of the following is a revenue expenditure? 2025

(A) Overhaul of second-hand machinery purchased
(B) Legal fees to acquire property
(C) Amount spent for replacement of worn-out portion of a machine
(D) Expenses for obtaining licence to run cinema hall

Answer: (C) Amount spent for replacement of worn-out portion of a machine — Replacing a worn-out part only restores the machine; the others are costs of acquiring an asset or right.

4. Which one of the following is NOT a capital expenditure? APFC 2023

(a) ₹5,000 spent to remove a worn-out part that needs replacement with a new engine
(b) Foreign tour expenses for purchasing a new machine
(c) Freight and insurance of purchased machinery
(d) Repairing a second-hand machine before use

Answer: (a) ₹5,000 spent to remove a worn-out part — Removal adds nothing to the asset, so it is revenue; (b), (c), (d) are directly attributable acquisition costs.

5. Insurance claim received for machinery completely damaged by fire is: APFC 2023

(a) Capital receipt
(b) Revenue receipt
(c) Capital expenditure
(d) Revenue expenditure

Answer: (a) Capital receipt — The claim replaces a fixed asset, so it takes that asset's nature; (c) and (d) are expenditures, not receipts.

CHAPTER 16

Depreciation and Amortisation

CHAPTER AT A GLANCE

- Depreciation and Amortisation
  - 1 Meaning, Features and Causes of Depreciation
    - 16.1 Meaning and Definitions
    - 16.2 Features of Depreciation
    - 16.3 Causes and Need for Depreciation
  - 2 Factors, Schedule II and Methods of Depreciation
    - 16.4 Factors Affecting Depreciation
    - 16.5 Methods of Depreciation
    - Straight Line Method (SLM)
    - Written Down Value Method (WDV)
    - Units of Production Method
  - 3 Recording Depreciation, Disposal and Additions
    - 16.6 Methods of Recording Depreciation
    - 16.7 Disposal of an Asset
    - 16.8 Additions, Change of Method and Amortisation
    - Amortisation
  - 4 Previous Year Questions: UPSC EPFO

1 Meaning, Features and Causes of Depreciation

Weightage in UPSC EPFO (2017–2025): 2 questions (EO/AO 2017, EO/AO 2023), both on the nature of depreciation. SLM and WDV numericals are natural future questions. Part III · Measurement and Financial Statements

➤ 16.1 Meaning and Definitions

Depreciation is the expired portion of the cost of a fixed asset, charged against the revenue of each period. **Amortisation** does the same for intangible assets.

- **ICMA:** the diminution in intrinsic value of the asset due to use and/or lapse of time.
- **AS 10 (Revised):** the systematic allocation of the depreciable amount of an asset over its useful life.
- AS 6 withdrawn and merged into AS 10 from 1 April 2016.

Key Terms

Cost	Purchase price plus all costs directly attributable to bringing the asset to working condition
Residual value	Estimated amount on disposal at the end of useful life, after disposal costs
Depreciable amount	Cost less residual value
Useful life	Period over which the asset is expected to be used
Carrying amount	Cost less accumulated depreciation; also book value or written down value

- **Depreciation is allocation, not valuation.** Hence "depreciation is the process of valuation of assets" is not correct (EO/AO 2023).

➤ 16.2 Features of Depreciation

- **Non-cash expense:** no cash is paid when it is recorded.
- **Revenue expense** of each year charged to the Statement of Profit and Loss (EO/AO 2017); not capital expenditure, not deferred revenue expenditure, not a capital loss.

Basis	Depreciation	Depletion	Amortisation
Applies to	Tangible fixed assets	Natural resources – mines, oil wells	Intangibles – patents, copyrights, software
Standard	AS 10 / Ind AS 16	–	AS 26 / Ind AS 38

➤ 16.3 Causes and Need for Depreciation

- **Wear and tear** through use or passage of time – the main cause (EO/AO 2023).
- **Expiry of legal rights**.
- **Obsolescence** – new technology even if the asset still works.
- **Abnormal factors** – accidents, fire, flood.
- Needed to match cost with revenue; without it profit is overstated.
- Section 123, Companies Act, 2013 permits dividend only out of profit after providing depreciation under Schedule II.

2 Factors, Schedule II and Methods of Depreciation

➤ 16.4 Factors Affecting Depreciation

- **Cost**
- **Net residual value:** sale value less disposal cost
- **Depreciable cost:** cost less net residual value
- **Useful life:** economic, not physical, life
- **Schedule II, Companies Act, 2013** prescribes useful lives, not rates: factory buildings 30 years, plant and machinery (general) 15, furniture 10, motor cars 8.
- Residual value is ordinarily not more than 5% of original cost.
- **Income-tax Act, Section 32:** depreciation on the WDV of blocks of assets at prescribed rates.

➤ 16.5 Methods of Depreciation

- Two methods in India: Straight Line Method and Written Down Value Method.
- Under AS 10 the method must reflect the pattern in which the asset's benefits are consumed.

➤ Straight Line Method (SLM)

- An equal amount is charged every year.
- **Annual depreciation = (Cost − Net residual value) ÷ Useful life**
- **Rate = (Annual depreciation ÷ Cost) × 100**
- **Example:** cost ₹2,50,000, life 10 years, residual ₹50,000: depreciation ₹20,000, rate 8% on cost.
- **Limitation:** assumes equal benefit each year.

➤ Written Down Value Method (WDV)

- A fixed percentage is charged on the **opening book value**; charge is highest in year 1 and falls every year.
- **Example:** cost ₹2,00,000 at 10%: ₹20,000, ₹18,000, ₹16,200 ...
- **Rate under WDV: r = [1 − (s ÷ c)^(1/n)] × 100**, where s = scrap value, c = cost, n = life in years.
- The formula fails if s = 0, since book value never reaches zero.

Basis	SLM	WDV
Charge based on	Original cost	Opening book value
Annual charge	Same every year	Falls every year
Book value at end	Can reach zero or residual value	Never reaches zero

➤ Units of Production Method

- Depreciation follows actual output.
- **Rate per unit = (Cost − Residual value) ÷ Total estimated units**

3 Recording Depreciation, Disposal and Additions

➤ 16.6 Methods of Recording Depreciation

- **Method A (charging to Asset Account):** the asset account shows the reducing book value.
- **Method B (Provision for Depreciation Account):** asset stays at original cost; depreciation accumulates in the provision account, deducted from the asset in the Balance Sheet.
- Both give the same profit and net book value; Method B is preferred.

Machine ₹2,00,000, 10% SLM on cost, 6 months = ₹10,000

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
Method B	Depreciation A/c	**Dr.**	10,000		Expense ↑ → Debit
	To Provision for Depreciation A/c *(Being depreciation provided)*			10,000	Contra-asset ↑ → Credit

➤ 16.7 Disposal of an Asset

- Cost and accumulated depreciation are removed.
- Difference between book value and amount realised = profit or loss on sale (capital profit or loss, Chapter 15), taken to Profit and Loss.
- An **Asset Disposal Account** collects cost, accumulated depreciation and sale proceeds; its balance is the profit or loss.

Furniture cost ₹20,000 sold for ₹5,000 (accumulated depreciation ₹8,000; loss ₹7,000)

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
Cost	Furniture Disposal A/c	**Dr.**	20,000		Disposal A/c opened → Debit
	To Furniture A/c			20,000	Asset ↓ → Credit
Depreciation	Provision for Depreciation A/c	**Dr.**	8,000		Contra-asset ↓ → Debit
	To Furniture Disposal A/c			8,000	Depreciation removed → Credit
Sale	Bank A/c	**Dr.**	5,000		Asset ↑ → Debit
	To Furniture Disposal A/c			5,000	Sale proceeds → Credit
Loss	Profit and Loss A/c	**Dr.**	7,000		Loss ↑ → Debit
	To Furniture Disposal A/c			7,000	Disposal account closed → Credit

➤ 16.8 Additions, Change of Method and Amortisation

- An addition or extension is capitalised and depreciated.
- If an integral part of the existing asset: over the asset's remaining life at the same rate.
- If it has a separate identity: over its own life.
- Under AS 10 (Revised), method, useful life and residual value are reviewed at least each year end.
- A change in method is a **change in accounting estimate** (AS 5), applied prospectively; under the former AS 6 it was a change in policy.

➤ Amortisation

- **Amortisation:** systematic allocation of the depreciable amount of an intangible asset over its useful life (AS 26).
- Rebuttable presumption: useful life does not exceed ten years; residual value is generally zero.
- Ind AS 38: an intangible with indefinite life is not amortised but tested for impairment.

4 Previous Year Questions: UPSC EPFO

Part III · Measurement and Financial Statements

1. Which one of the following statements is NOT correct? EO/AO 2023

(a) Depreciation is a non-cash expense
(b) Depreciation is the process of valuation of assets
(c) The main cause of depreciation is wear and tear
(d) Depreciation must be charged to ascertain true profit

Answer: (b) Depreciation is the process of valuation of assets — Depreciation allocates cost over useful life; it does not value assets. The other three statements are correct.

2. Depreciation of fixed assets is an example of: EO/AO 2017

(a) deferred revenue expenditure
(b) capital expenditure
(c) capital gain
(d) revenue expenditure (expense)

Answer: (d) revenue expenditure (expense) — The capital cost was incurred at purchase; the expired part is charged yearly to the Statement of Profit and Loss as an ordinary expense.

CHAPTER 17

Inventory Valuation (AS-2)

CHAPTER AT A GLANCE



1 Meaning, Scope and the Measurement Rule

Part III · Measurement and Financial Statements

➤ Weightage in UPSC EPFO (2015–2025)

Five questions in all: three numericals (FIFO and LIFO values) and two on AS-2 cost rules. "Cost or NRV, whichever is lower" is also based on conservatism (2025; see Chapter 3).

➤ 17.1 Meaning and Types of Inventory

Inventories are assets (a) held for sale in the ordinary course of business (finished goods, stock-in-trade); (b) in the process of production for such sale (work-in-progress); or (c) in the form of materials or supplies to be consumed in production (raw materials, stores). They are current assets.

➤ 17.2 Scope of AS-2

AS-2 applies to all inventories prepared on the historical cost basis, except work-in-progress under construction contracts (AS-7), work-in-progress of service providers, and shares, debentures and other financial instruments held as stock-in-trade.

➤ 17.3 The Measurement Rule

Inventories shall be valued at the lower of cost and net realisable value (NRV). Cost is the amount spent to bring goods to their present location and condition. NRV is what the goods are expected to bring in, net of costs still to be incurred to complete and sell them.

If NRV is higher than cost → value at cost. If NRV is lower than cost → write down to NRV. The rule reflects conservatism.

2 Cost of Inventories

➤ 17.4 Cost of Inventories

Cost comprises all costs incurred in bringing inventories to their present location and condition: **cost of purchase + cost of conversion + other costs**.

➤ 1. Cost of Purchase

Included: purchase price, import duties and other taxes (other than those subsequently recoverable from the taxing authorities, such as GST for which input tax credit is available), freight inwards, handling and transit insurance. Deducted: trade discounts, rebates and duty drawbacks.

➤ 2. Cost of Conversion

Applies to manufacturers: direct labour plus a systematic allocation of production overheads. **Variable production overheads** are allocated on actual use of the production facilities. **Fixed production overheads** (factory rent, depreciation of factory building) are allocated on the basis of normal capacity.

➤ 3. Normal Capacity Rule

Normal capacity is the production expected on average over a number of periods under normal circumstances, allowing for planned maintenance.

➤ 4. Other Costs

Borrowing costs are normally excluded; they are included only where AS-16 allows, for inventories that take a substantial period to become ready for sale (for example, whisky or wine kept for ageing).

➤ 5. Costs Excluded from Cost of Inventories

Excluded cost	Note / exception
Abnormal wastage	Normal wastage is part of cost
Storage costs	Included if necessary in production (maturing of cheese)
Administrative overheads	Office rent, audit fees
Selling and distribution costs	No exception

3 Net Realisable Value (NRV)

Part III · Measurement and Financial Statements

➤ 17.5 Net Realisable Value

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

NRV = Estimated selling price − Estimated cost of completion − Estimated cost to sell

➤ 6. Item-by-Item Comparison

Inventories are written down to NRV item by item; similar or related items may be grouped. Comparing totals of a whole class is not appropriate, because a gain on one item would hide a loss on another.

➤ 7. Raw Material Rule

Materials held for use in production are not written down below cost if the finished products are expected to sell at or above cost. Only if the finished product's cost will exceed its NRV are the materials written down; replacement cost may then be the best measure of NRV.

4 Cost Formulas: FIFO, LIFO and Weighted Average

Part III · Measurement and Financial Statements

➤ 17.6 Cost Formulas

Formula	Meaning	When used
Specific identification	Actual cost of each identified item is attached to it	Items not ordinarily interchangeable; goods segregated for specific projects
FIFO (First-In, First-Out)	Items bought first are issued first; closing stock is at the latest prices	All other interchangeable items
Weighted average cost	Cost of each item = weighted average of similar items at the beginning and bought during the period	All other interchangeable items; periodic or after each receipt

LIFO (Last-In, First-Out) issues the latest purchases first, so closing stock is at the oldest prices. LIFO is **not permitted** under AS-2 (revised) or Ind AS 2. It is still taught because UPSC EPFO has asked LIFO numericals (APFC 2023). Standard cost and the retail method are allowed if results approximate cost.

➤ 17.7 Illustration (Kapoor Industries)

Opening 400 @ ₹20; purchase 600 @ ₹22; issue 700; purchase 500 @ ₹26; issue 450. Closing stock: FIFO ₹9,100; LIFO perpetual ₹7,300; weighted average periodic ₹7,980.

Effect	Rising prices	Falling prices
Closing stock	FIFO highest, LIFO lowest	FIFO lowest, LIFO highest

Under the periodic system only purchases are recorded and closing stock comes from a physical count; under the perpetual system every receipt and issue is recorded.

5 Cost of Goods Sold, Inventory Errors and Disclosure

Part III · Measurement and Financial Statements

➤ 17.9 Cost of Goods Sold and Inventory Errors

COGS = Opening stock + Purchases − Purchase returns + Direct expenses − Closing stock. Gross profit = Net sales − COGS. Purchases = COGS + Closing stock − Opening stock.

Closing stock of one year is the opening stock of the next, so an error affects two years in opposite directions and cancels out over the two years together.

Error in closing stock 2025-26	Profit 2025-26	Profit 2026-27	Balance sheet 31.3.2026
Overstated by ₹50,000	Overstated ₹50,000	Understated ₹50,000	Stock and capital overstated
Understated by ₹50,000	Understated ₹50,000	Overstated ₹50,000	Stock and capital understated

➤ Useful Shortcuts

Situation	Working
Profit x% on cost → % on sales	x ÷ (100 + x) × 100; 25% on cost = 20% on sales

➤ 17.10 Disclosure and Ind AS 2

AS-2 requires disclosure of the cost formula and the total carrying amount with its classification. Ind AS 2 follows the same core rules (lower of cost and NRV; FIFO or weighted average; LIFO prohibited) and requires reversal of an earlier write-down when NRV recovers, limited to the original write-down.

6 Previous Year Questions: UPSC EPFO

Part III · Measurement and Financial Statements

1. As per AS-2, which one of the following is included in the cost of inventory? EO/AO 2023

(a) Administrative overheads that do not contribute to bringing inventories to their present location and condition

(b) Storage costs that are necessary in the production process prior to a further production stage

(c) Selling and distribution costs

(d) Duties and taxes subsequently recoverable from taxing authorities

Answer: (b) — Storage is excluded except where necessary in production (seasoning, maturing); the others are exclusions or a receivable.

2. Which cost is generally NOT included in the cost of inventory? 2025

(a) Administration overheads

(b) All costs of purchase

(c) Normal wastage of materials

(d) Storage cost when special storage is part of production

Answer: (a) — Administration overheads do not bring goods to present location and condition; normal wastage and production storage are part of cost.

3. Under the perpetual inventory system using FIFO, what is the value of inventory on 31 January? Jan 1 opening 200 units @ ₹7; Jan 6 issued 100 units; Jan 8 purchased 1,100 units @ ₹8; Jan 9 issued 200 units; Jan 25 purchased 300 units @ ₹9. EO/AO 2023

(a) ₹6,700 (b) ₹8,700
(c) ₹10,700 (d) ₹12,000

Answer: (c) ₹10,700 — 1,300 units remain, the latest: 1,000 @ ₹8 + 300 @ ₹9 = 8,000 + 2,700 = ₹10,700.

4. With the same data as the previous question, what is the value of inventory on 31 January under the perpetual inventory system using LIFO? APFC 2023

(a) ₹6,600 (b) ₹8,600
(c) ₹10,600 (d) ₹12,000

Answer: (c) ₹10,600 — After issues, 100 @ 7 + 900 @ 8 + 300 @ 9 = 700 + 7,200 + 2,700 = ₹10,600; periodic LIFO would differ.

5. Stock of 1,500 units was valued at ₹1,27,500 (₹85 per unit). 300 units were purchased at ₹95 per unit and 600 units were consumed. Using FIFO, the value of the residual stock is: APFC 2015

(a) ₹1,00,000 (b) ₹1,02,500
(c) ₹1,05,000 (d) ₹1,07,500

Answer: (c) ₹1,05,000 — Available 1,56,000 less 600 @ 85 (51,000) = 900 @ 85 (76,500) + 300 @ 95 (28,500) = ₹1,05,000.

CHAPTER 18

Revenue Recognition (AS-9 and Ind AS 115)

CHAPTER AT A GLANCE

- Revenue Recognition (AS-9 and Ind AS 115)
  - 1 Meaning of Revenue and Sale of Goods (AS-9)
    - Weightage in UPSC EPFO
    - 18.1 Meaning and Scope of Revenue (AS-9)
    - 18.2 Sale of Goods
    - Special Cases in the Sale of Goods
  - 2 Rendering of Services; Interest, Royalties and Dividends
    - 18.3 Rendering of Services
    - Specific Service Revenues
    - 18.4 Interest, Royalties and Dividends
  - 3 Ind AS 115: Revenue from Contracts with Customers
    - 18.5 Ind AS 115
    - The Five-Step Model
    - Transfer of Control: Over Time or at a Point in Time
    - Other Key Terms
  - 4 AS-9 versus Ind AS 115 and Point of Recognition
    - 18.6 Comparison of AS-9 and Ind AS 115
    - 18.7 Identifying the Point of Revenue Recognition

1 Meaning of Revenue and Sale of Goods (AS-9)

Part III · Measurement and Financial Statements

➤ Weightage in UPSC EPFO

No question has yet been set directly on AS-9 or Ind AS 115. The related question on timing of revenue for gold (EO/AO 2017: recognised when mined) is covered in Chapter 3.

➤ 18.1 Meaning and Scope of Revenue (AS-9)

Revenue is the gross inflow of cash, receivables or other consideration arising in the course of ordinary activities from (i) the sale of goods; (ii) the rendering of services; and (iii) the use by others of enterprise resources yielding interest, royalties and dividends.

Revenue is measured by the charges made to customers. Amounts collected on behalf of third parties, such as GST, are not revenue. In an agency relationship, revenue is only the commission.

Outside AS-9: construction contracts (AS-7), hire-purchase and lease agreements (AS-19), government grants (AS-12) and insurance contracts.

➤ 18.2 Sale of Goods

Under AS-9, revenue from the sale of goods is recognised when both conditions are met: (i) the seller has transferred to the buyer the property in the goods for a price, or all significant **risks and rewards** of ownership, and retains no effective control of the

goods to a degree usually associated with ownership; and (ii) no significant uncertainty exists regarding the amount of consideration.

Revenue is not linked to cash: goods sold on credit on 28 March 2026 for ₹2,00,000, payable on 30 April 2026, give revenue in FY 2025-26. If a customer becomes doubtful after the sale, revenue is not reversed; a provision for doubtful debts is made.

➤ Special Cases in the Sale of Goods

Situation	Point of recognition under AS-9
Sale on approval	When the buyer formally accepts, or the time for rejection has elapsed
Consignment	When the consignee sells to a third party, not when goods are sent
Cash on delivery	When delivery is made and cash is received
Instalment sales	Sale price excluding interest on the date of sale; interest over the instalment period on time proportion
Trade discounts and volume rebates	Deducted in arriving at revenue

2 Rendering of Services; Interest, Royalties and Dividends

➤ 18.3 Rendering of Services

Under AS-9, performance in a service transaction is measured by the method that relates revenue to the work accomplished.

Basis	Proportionate completion method	Completed service contract method
Revenue recognised	Proportionately, by stage of completion	Only when completed or substantially completed
Example	Annual maintenance contract; year-long training course	Filing a single tax return; a one-day event

Nexus Consultants: fee ₹12,00,000; 60% done by 31.3.2026	FY 2025-26	FY 2026-27
Proportionate completion	7,20,000	4,80,000
Completed service contract	Nil	12,00,000

➤ Specific Service Revenues

Service	Point of recognition
Advertising agency commission (media)	When the advertisement appears before the public
Admission fees (events)	When the event takes place; subscription for several events spread over them

➤ 18.4 Interest, Royalties and Dividends

Revenue from interest, royalties and dividends is recognised when no significant uncertainty as to measurability or collectability exists; the test is earning, not receipt. Interest: time proportion. Royalties: accrual in accordance with the agreement. Di-

vidends: when the shareholder's right to receive payment is established; one merely proposed by the board is not yet income.

3 Ind AS 115: Revenue from Contracts with Customers

➤ 18.5 Ind AS 115

Ind AS 115 applies to companies following Ind AS from 1 April 2018. It replaced Ind AS 18 (Revenue) and Ind AS 11 (Construction Contracts) with a single model for all contracts with customers. AS-9 continues for entities not applying Ind AS. Excluded: leases (Ind AS 116), insurance contracts and financial instruments (Ind AS 109).

➤ The Five-Step Model

Step	What it requires
1. Contract	Agreement creating enforceable rights and obligations
2. Performance obligations	Each promise to transfer a distinct good or service
3. Transaction price	Consideration expected, excluding GST
4. Allocation	In proportion to relative stand-alone selling prices
5. Recognition	Revenue when control passes to the customer, over time or at a point in time

Illustration (TechZone Ltd): laptop with two years of on-site support sold for ₹66,000 on 1 October 2025; stand-alone prices laptop ₹60,000, support ₹12,000. Laptop = 66,000 × 60/72 = ₹55,000 on delivery; support = ₹11,000 over 24 months, ₹2,750 for October–March. Revenue FY 2025-26 = ₹57,750; balance ₹8,250 is a contract liability.

➤ Transfer of Control: Over Time or at a Point in Time

Control is the ability to direct the use of an asset and obtain substantially all of its remaining benefits. A performance obligation is satisfied over time if any one of three criteria is met; otherwise at a point in time.

Over time (any one criterion): the customer simultaneously receives and consumes the benefits; the work enhances an asset the customer controls; or the asset has no alternative use and the entity has an enforceable right to payment for work done to date. Otherwise, point in time: present right to payment, legal title, physical possession, risks and rewards, acceptance.

➤ Other Key Terms

Key Terms

Contract liability	Consideration received before goods or services are transferred – an advance from the customer
Contract asset	Right to consideration for goods or services already transferred, dependent on something other than passage of time
Receivable	Unconditional right to consideration – only passage of time required

4 AS-9 versus Ind AS 115 and Point of Recognition

➤ 18.6 Comparison of AS-9 and Ind AS 115

Basis	AS-9	Ind AS 115
Applies to	Entities not following Ind AS	Ind AS companies (from 1 April 2018)
Core test	Transfer of significant risks and rewards; no significant uncertainty	Transfer of control
Approach	Separate rules for goods, services, interest, royalty, dividend	One five-step model for customer contracts
Services	Proportionate completion or completed service contract	Over time or point in time

➤ 18.7 Identifying the Point of Revenue Recognition

Situation	Revenue recognised
Order with advance in March; goods delivered in May	In May; the advance is a liability in March
Goods sent to a consignee	When the consignee sells them
Sale with agreement to repurchase at a higher price	No revenue; financing arrangement

CHAPTER 19

Final Accounts I: Trading and Profit and Loss Account

CHAPTER AT A GLANCE

Final Accounts I: Trading and Profit and Loss Account
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  - Weightage in UPSC EPFO (2017–2025)
  - 19.1 Financial Statements: Meaning and Objectives
  - 19.2 Capital and Revenue: The Basic Distinction
- 2 Trading Account, COGS and Gross Profit
  - 19.3 Trading Account
  - Direct and Indirect Expenses
  - 19.4 Cost of Goods Sold and Gross Profit
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  - 19.6 Operating Profit
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- 5 Previous Year Questions: UPSC EPFO

1 Financial Statements and Capital versus Revenue

Part III · Measurement and Financial Statements

➤ Weightage in UPSC EPFO (2017–2025)

Three questions: gross profit at 25% on cost (EO/AO 2017), meaning of gross profit (EO/AO 2021), formula for operating profit (2025).

➤ 19.1 Financial Statements: Meaning and Objectives

- Prepared at the close of a period from the trial balance
- **Objective:** true and fair view of financial performance for the period (profit or loss) and financial position on the closing date

Statement	What it shows	Nature
Trading Account	Gross profit or loss from buying, making and selling goods	Account, for a period
Profit and Loss Account	Net profit or loss after indirect expenses and incomes	Account, for a period
Balance Sheet	Assets, liabilities and capital	Statement, on a date
Cash Flow Statement	Inflows and outflows of cash by activity	Statement, for a period (AS-3)

➤ 19.2 Capital and Revenue: The Basic Distinction

Revenue items go to the Trading and P&L Account; capital items go to the Balance Sheet. Test: the period over which the benefit is received.

Basis	Revenue expenditure	Capital expenditure	Deferred revenue expenditure
Benefit	Within the current period	Over several periods	Revenue in nature, benefit extends beyond one period
Treatment	Trading / P&L Account	Balance Sheet; depreciated	Written off over the period of benefit
Examples	Salaries, rent, repairs, carriage	Machinery, furniture; wages and freight for installing a new machine	Heavy advertising to launch a new product

Basis	Capital receipts	Revenue receipts
Nature	Create an obligation to repay, or arise from sale of fixed assets	Arise in normal course of business; no obligation to repay
Goes to	Balance Sheet	Trading / P&L Account

2 Trading Account, COGS and Gross Profit

Part III · Measurement and Financial Statements

➤ 19.3 Trading Account

- Nominal account prepared to find gross profit or gross loss
- **Debit side:** opening stock, net purchases, direct expenses
- **Credit side:** net sales, closing stock
- Balancing figure: gross profit (credit side larger) or gross loss

➤ Direct and Indirect Expenses

- **Direct expenses:** incurred in purchasing goods, bringing them to place of business or converting them into saleable condition → Trading A/c
- **Indirect expenses:** incurred in running the business (office, selling, distribution, financing) → P&L A/c

Direct (Trading A/c)	Indirect (P&L A/c)	Distinction
Carriage inwards	Carriage outwards	On purchases vs on sales
Wages; "wages and salaries"	Salaries; "salaries and wages"	A combined item takes the treatment of its first-named word
Factory rent, factory lighting	Office rent, office lighting	Location of use

Closing stock already in the trial balance: show only in the Balance Sheet, otherwise counted twice.

➤ 19.4 Cost of Goods Sold and Gross Profit

- COGS = Opening Stock + Net Purchases + Direct Expenses − Closing Stock
- Gross Profit = Net Sales − COGS; Net Sales = Sales − Returns Inwards

- COGS exceeds net sales → gross loss

➤ Gross Profit on Cost and on Sales

- Identify the base first
- GP of r% on cost: GP = Sales × r/(100 + r)
- GP of s% on sales: GP = Cost × s/(100 − s)
- Rule of fractions: GP is 1/n of cost → 1/(n+1) of sales

GP on cost	GP on sales
20% (1/5)	16⅔% (1/6)
25% (1/4)	20% (1/5)
33⅓% (1/3)	25% (1/4)
50% (1/2)	33⅓% (1/3)
100%	50%

3 Profit and Loss Account and Operating Profit

➤ 19.5 Profit and Loss Account

- Nominal account; starts with gross profit (or loss) brought down
- Adds other incomes and gains; deducts indirect expenses and losses
- Balance is net profit or loss, transferred to Capital Account

Net Profit = Gross Profit + Other Incomes − Indirect Expenses and Losses

Group	Items (debit side)
Administrative	Office salaries, rent and rates, lighting, insurance, printing, postage, telephone, audit fees, legal charges, repairs
Selling and distribution	Carriage outwards, advertisement, commission on sales, salesmen's salaries, packing for despatch, bad debts, provision for doubtful debts, discount allowed

Illustration: Raman Traders: net profit = 1,90,000 + 6,000 + 9,000 − 1,27,000 = ₹78,000.

➤ 19.6 Operating Profit

- Profit from normal operations, before interest and tax (EBIT)
- Excludes non-operating items (financial items, abnormal gains or losses)
- Operating Profit = Net Profit + Non-operating Expenses − Non-operating Incomes (asked in 2025)
- Non-operating expenses were deducted, so add back; non-operating incomes were added, so take out
- Equivalent: Operating Profit = Gross Profit − Operating Expenses (+ operating incomes such as discount received)

Level	How obtained
Gross profit	Net sales − COGS
Operating profit (EBIT)	Gross profit − operating expenses, including depreciation
EBITDA	EBIT + depreciation and amortisation

Level	How obtained
Profit before tax (PBT)	Operating profit + non-operating incomes − non-operating expenses

4 Closing Entries and Correct Treatment of Items

Part III · Measurement and Financial Statements

➤ 19.7 Closing Entries

- Nominal accounts: closed at year end by transfer to Trading or P&L Account
- Asset, liability and capital accounts: not closed; balances carried forward to Balance Sheet

Illustration: Closing entries for Raman Traders (gross profit and net profit)

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
31 Mar	Trading A/c **Dr.** *(Being gross profit transferred)*	1,90,000		Trading A/c balance (profit) closed → Debit
	To Profit and Loss A/c		1,90,000	Revenue/Gain (gross profit) ↑ → Credit
31 Mar	Profit and Loss A/c **Dr.** *(Being net profit transferred to capital)*	78,000		P&L balance (profit) closed → Debit
	To Capital A/c		78,000	Equity (Capital) ↑ → Credit

➤ 19.8 Identifying the Correct Treatment

Item	Treatment
Carriage outwards; packing for despatch	P&L A/c, debit (selling expense)
Wages for installation of a new machine	Machinery A/c (capitalised)
Closing stock outside the trial balance	Trading A/c credit + Balance Sheet asset
Drawings	Deducted from capital; never an expense

5 Previous Year Questions: UPSC EPFO

Part III · Measurement and Financial Statements

1. The rate of gross profit is 25% on the cost of goods sold and sales are ₹20,00,000. The amount of gross profit is: EO/AO 2017

(a) ₹5,00,000 (b) ₹6,25,000
(c) ₹3,75,000 (d) ₹4,00,000

Answer: (d) ₹4,00,000 — Rate is on cost: COGS = 20,00,000 × 100/125 = 16,00,000; GP = 20,00,000 − 16,00,000 = ₹4,00,000.

2. Which one of the following denotes gross profit? EO/AO 2021

(a) Cost of goods sold + Opening stock (b) Sales less cost of goods sold
(c) Sales less purchases (d) Net profit less expenses of the period

Answer: (b) Sales less cost of goods sold — Gross profit is net sales over COGS. Sales less purchases ignores stocks and direct expenses.

3. Which one of the following is correct? (A) Operating profit = Net profit − Non-operating expenses − Non-operating incomes (B) Operating profit = Net profit + Non-operating expenses + Non-operating incomes (C) Operating profit = Net profit + Non-operating expenses − Non-operating incomes (D) Operating profit = Net profit − Non-operating expenses + Non-operating incomes 2025

(A) (B)
(C) (D)

Answer: (C) — Net profit already deducted non-operating expenses and added non-operating incomes; reverse both to isolate operating profit.

CHAPTER 20

Final Accounts II: Balance Sheet, Marshalling and Classification

CHAPTER AT A GLANCE

- Final Accounts II: Balance Sheet, Marshalling and Classification
  - 1 Balance Sheet and Classification of Assets
    - Weightage in UPSC EPFO (2017–2025)
    - 20.1 Balance Sheet: Meaning and Features
    - 20.2 Classification of Assets
    - Current Assets under Schedule III
  - 2 Liabilities, Provisions and Contingent Liabilities
    - 20.3 Classification of Liabilities
    - 20.4 Provision and Contingent Liability
    - Decision Sequence
    - Charge against Profit and Appropriation of Profit
  - 3 Forms of the Balance Sheet, Grouping and Marshalling
    - 20.5 Forms of the Balance Sheet
    - 20.6 Grouping and Marshalling
    - 20.7 Opening Entry (Arjun Stores)
  - 4 Cash Flow Statement (Indirect Method)
    - 20.10 Cash Flow Statement
    - Indirect Method
    - 20.11 Identifying the Correct Classification
  - 5 Previous Year Questions: UPSC EPFO

1 Balance Sheet and Classification of Assets

Part III · Measurement and Financial Statements

➤ Weightage in UPSC EPFO (2017–2025)

One question (EO/AO 2021) on the period within which current liabilities are payable. Chapter also supports questions on contingent liabilities (Chapter 3) and the operating cycle.

➤ 20.1 Balance Sheet: Meaning and Features

- Statement of assets, liabilities and capital of a business at a particular date
- Also called Statement of Financial Position
- Assets = Liabilities + Capital
- Capital = Assets − Outside liabilities
- Net profit increases capital; net loss and drawings reduce it

➤ 20.2 Classification of Assets

Asset: resource controlled by the enterprise as a result of past events, from which future economic benefits are expected to flow. Classified mainly into non-current and current.

Class	Meaning	Examples
Current assets	Held for conversion into cash in the operating cycle or within 12 months	Stock, debtors, bills receivable, prepaid expenses, cash, bank
Fictitious assets	Debit balances that are not real resources, written off	Preliminary expenses, discount on issue of shares, debit balance of P&L

➤ Current Assets under Schedule III

An asset is current when it:

- Is expected to be realised in the normal operating cycle
- Is held primarily for trading
- Is expected to be realised within twelve months after reporting date
- Is cash or a cash equivalent
- All other assets are non-current
- **Operating cycle:** time between acquisition of assets for processing and their realisation in cash
- Working capital = Current assets − Current liabilities

2 Liabilities, Provisions and Contingent Liabilities

Part III · Measurement and Financial Statements

➤ 20.3 Classification of Liabilities

Liability: present obligation from past events, settlement of which is expected to result in an outflow of resources. Capital is the owner's residual interest, not an outside liability.

Category	Meaning	Examples
Current liabilities	Payable in the operating cycle or within twelve months	Trade creditors, bills payable, bank overdraft, outstanding expenses, income received in advance, provision for tax, current maturities of long-term loans
Contingent liabilities	Possible obligations depending on an uncertain event; not in the totals	Pending lawsuits, guarantees given, bills discounted with recourse

Under Schedule III a liability is current when it is settled in the normal operating cycle, held primarily for trading, or due within twelve months after reporting date (EO/AO 2021: current liabilities are payable within a year).

➤ 20.4 Provision and Contingent Liability

Standard: AS-29; Ind AS equivalent: Ind AS 37.

- **Provision:** liability of uncertain timing or amount, measured with substantial estimation
- **Contingent liability:** possible obligation confirmed only by uncertain future events, or a present obligation that fails the recognition tests

Basis	Provision	Contingent liability
Recognition	Recognised: P&L charged, liability in Balance Sheet	Not recognised; disclosed in notes unless remote

➤ Decision Sequence

- (1) Present obligation from a past event?
- (2) Outflow probable?
- (3) Reliable estimate?
- "Yes" to all three → recognise a provision; otherwise contingent liability (disclosed unless remote)
- Contingent assets are never recognised

➤ Charge against Profit and Appropriation of Profit

Basis	Provision	Reserve
Nature	Charge against profit	Appropriation of profit kept in business
Effect on net profit	Reduces it	Does not reduce it
Part of owner's equity	No	Yes

3 Forms of the Balance Sheet, Grouping and Marshalling

Part III · Measurement and Financial Statements

➤ 20.5 Forms of the Balance Sheet

- Sole proprietor or partnership: no prescribed format; horizontal (T) form used
- Company: Schedule III to Companies Act, 2013 (Section 129)
- Division I (vertical form): companies not following Ind AS
- Division II: Ind AS companies

➤ 20.6 Grouping and Marshalling

- **Grouping:** items of a similar nature under a common heading (cash, bank, debtors and stock under "current assets")
- **Marshalling:** arranging assets and liabilities in a particular order for easy reading and comparison

Basis	Order of liquidity	Order of permanence
Assets	Most liquid first: cash → bank → bills receivable → debtors → stock → investments → fixed assets → goodwill	Most permanent first: goodwill → land and buildings → plant → furniture → investments → stock → debtors → bank → cash

➤ 20.7 Opening Entry (Arjun Stores)

Opening entry of Arjun Stores on 1 April 2026

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
1 Apr	Machinery A/c *(Being opening balances brought forward)*	**Dr.**	1,50,000		Asset (Machinery) ↑ → Debit
	Furniture A/c	**Dr.**	50,000		Asset (Furniture) ↑ → Debit
	Stock A/c	**Dr.**	80,000		Asset (Stock) ↑ → Debit
	Debtors A/c	**Dr.**	70,000		Asset (Debtors) ↑ → Debit
	Bank A/c	**Dr.**	38,000		Asset (Bank) ↑ → Debit
	Cash A/c	**Dr.**	12,000		Asset (Cash) ↑ → Debit
	To Capital A/c			3,15,000	Equity (Capital) ↑ → Credit
	To 10% Bank Loan A/c			40,000	Liability (Loan) ↑ → Credit
	To Creditors A/c			45,000	Liability (Creditors) ↑ → Credit

4 Cash Flow Statement (Indirect Method)

Part III · Measurement and Financial Statements

➤ 20.10 Cash Flow Statement

- Shows inflows and outflows of cash and cash equivalents during a period
- Classified into operating, investing and financing activities
- Governed by AS-3; Ind AS 7 for Ind AS companies

Activity	Meaning	Examples
Operating	Principal revenue-producing activities	Cash from customers; payments to suppliers and employees; income tax paid
Financing	Changes in size and composition of owners' capital and borrowings	Issue of shares or debentures; raising or repaying loans; interest paid; dividends paid

➤ Indirect Method

- Start with net profit before tax
- Add back non-cash and non-operating charges (depreciation, interest expense, loss on sale of assets)
- Deduct non-operating incomes
- Adjust for working capital changes: increase in current asset → deduct; increase in current liability → add
- Deduct tax paid

➤ 20.11 Identifying the Correct Classification

Item	Classification
Trade payables due in 60 days; bank overdraft; provision for tax	Current liability
Debentures redeemable after 5 years	Non-current (long-term borrowings)
Pending lawsuit, outcome uncertain	Contingent liability – notes
Loose tools; stores and spares	Inventories

5 Previous Year Questions: UPSC EPFO

Part III · Measurement and Financial Statements

1. When are current liabilities payable? EO/AO 2021

(a) Within a year
(b) After one year but within five years
(c) Within five years
(d) Subject to a contingency

Answer: (a) Within a year — Current liabilities fall due within twelve months or the operating cycle; (d) describes a contingent liability, not recognised.

CHAPTER 21

Adjustments, Provisions & Reserves

CHAPTER AT A GLANCE

Adjustments, Provisions & Reserves
- 1 Meaning and Need for Adjustments
  - Weightage in UPSC EPFO (2017–2025)
  - 21.1 Meaning and Need
- 2 Stock, Depreciation, Outstanding and Prepaid Expenses, Accrued and Advance Income
  - 21.2 Closing Stock and Depreciation
  - 21.3 Outstanding and Prepaid Expenses
  - 21.4 Accrued Income and Income Received in Advance
- 3 Bad Debts, Provision for Doubtful Debts and Discount on Debtors
  - 21.5 Bad Debts and Provision for Doubtful Debts
  - 21.6 Provision for Discount on Debtors
- 4 Other Adjustments
  - 21.7 Manager's Commission
  - Interest on Capital and Drawings
  - Goods Withdrawn, Free Samples and Loss by Fire
- 5 Provisions and Reserves
  - 21.9 Provision versus Reserve
  - 21.10 Types of Reserves
- 6 Previous Year Questions: UPSC EPFO

1 Meaning and Need for Adjustments

Part III · Measurement and Financial Statements

➤ Weightage in UPSC EPFO (2017–2025)

Five questions: discount on debtors (EO/AO 2023), bad debts and provision (APFC 2023), provision versus reserve (APFC 2023, 2025), rent received in advance (2025).

➤ 21.1 Meaning and Need

Adjustments are entries passed at the end of the period, before final accounts, for items that relate to the period but are unrecorded or wrongly recorded.

- **Outside the trial balance:** recorded at **two places**: Trading/P&L Account and Balance Sheet.
- **Inside the trial balance:** shown at **one place** only.

2 Stock, Depreciation, Outstanding and Prepaid Expenses, Accrued and Advance Income

Part III · Measurement and Financial Statements

➤ 21.2 Closing Stock and Depreciation

- **Closing stock** = lower of cost and net realisable value.
  - Outside TB: credit of Trading A/c and current asset.
  - Inside TB: Balance Sheet only.
  - Opening stock: always inside TB (debit of Trading A/c).
- **Depreciation:** outside TB: charged to P&L and deducted from asset; inside TB: P&L only.

➤ 21.3 Outstanding and Prepaid Expenses

- **Outstanding expense:** incurred but not paid; a liability. Salary ₹8,000 a month, paid for 10 months: outstanding ₹16,000.

Outstanding salary

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Salary A/c	**Dr.**	16,000		Expense (Salary) ↑ → Debit
	To Outstanding Salary A/c *(Being salary outstanding)*			16,000	Liability ↑ → Credit

- **Prepaid (unexpired) expense:** paid this year, benefit next year; an asset. Insurance ₹24,000 paid 1 Oct 2025 for a year: unexpired ₹12,000 at 31 March 2026.

➤ 21.4 Accrued Income and Income Received in Advance

- **Accrued income:** earned but not received; an asset. Interest earned ₹18,000, received ₹13,500: accrued ₹4,500.
- **Income received in advance (unearned):** for goods/services supplied next year; a liability. Rent received for 14 months at ₹10,000: advance ₹20,000 (Rent Received debited).

Item	Nature	P&L	Balance Sheet
Outstanding expense	Liability	Added to expense	Current liability
Prepaid expense	Asset	Deducted from expense	Current asset
Accrued income	Asset	Added to income	Current asset
Income received in advance	Liability	Deducted from income	Current liability

3 Bad Debts, Provision for Doubtful Debts and Discount on Debtors

Part III · Measurement and Financial Statements

➤ 21.5 Bad Debts and Provision for Doubtful Debts

- **Bad debts:** irrecoverable amounts from customers; actual loss charged to P&L.
- **Provision for Doubtful Debts:** estimated loss on remaining debtors, charged to current year (conservatism, matching).
  - Usually a percentage of debtors after deducting further bad debts.

- Debtor's account is not touched; shown as deduction from debtors.

- **P&L charge = bad debts (TB) + further bad debts + new provision − old provision.**
  - If negative, excess old provision is credited to P&L.
  - Example: 12,000 + 50,000 + (40,000 − 25,000) = ₹77,000.

➤ 21.6 Provision for Discount on Debtors

- **Good debtors = debtors − further bad debts − new provision for doubtful debts.**
- Debtors ₹2,10,000; further bad debts ₹10,000; doubtful 5%; discount 2%: good debtors ₹1,90,000; provision ₹3,800.
- EO/AO 2023: discount 24,000 + provision (23,000 − 14,000) = ₹33,000.

4 Other Adjustments

➤ 21.7 Manager's Commission

- Calculated on profit before commission unless the agreement says otherwise.
- **Before charging: P × R / 100. After charging: P × R / (100 + R).**
- Profit ₹2,20,000 at 10%: before ₹22,000; after ₹20,000.

➤ Interest on Capital and Drawings

- **Interest on capital:** debited to P&L, added to capital; net capital unchanged.
  - Capital ₹5,00,000 plus ₹1,00,000 introduced on 1 October at 10%: ₹55,000.
- **Interest on drawings:** income in P&L, deducted from capital.
  - Drawings ₹60,000 evenly through the year at 10%: 6 months, ₹3,000.

➤ Goods Withdrawn, Free Samples and Loss by Fire

Goods used for	Credit	Debit
Proprietor's use	Purchases	Drawings
Free samples	Purchases	Advertisement
Charity	Purchases	Charity
Building	Purchases	Building

- **Loss by fire:** goods ₹50,000 destroyed, claim admitted ₹35,000.
  - Trading A/c credited ₹50,000: abnormal loss does not reduce gross profit.
  - P&L debited ₹15,000; claim ₹35,000 is a current asset.

5 Provisions and Reserves

➤ 21.9 Provision versus Reserve

- **Provision:** set aside as a **charge against profit** for a known liability of uncertain amount or a known fall in asset value.
- **Reserve: appropriation of profit** to strengthen financial position or meet unknown contingencies; shown under Reserves and Surplus.

Basis	Provision	Reserve
Nature	Charge against profit; reduces taxable profit	Appropriation of profit; no effect on taxable profit
Compulsion	Must be created, even in a loss year	Discretionary, except by law or agreement (e.g. DRR); only when there is profit

➤ 21.10 Types of Reserves

Type	Meaning
General reserve	No specific purpose; usable for any purpose, including dividend
Specific reserves	Stated purpose only: Dividend Equalisation Reserve, Workmen Compensation Fund, Investment Fluctuation Fund, Debenture Redemption Reserve (DRR)
Revenue reserves	From normal operating profits; available for dividend
Capital reserves	From capital profits (premium on shares, profit on sale of fixed assets); normally not for dividend; may write off capital losses or issue bonus shares
Reserve capital	Uncalled share capital, called only on winding up
Secret reserve	Not shown in balance sheet; conflicts with true and fair view (Sec 129)

- Under Sec 71(4), unlisted companies keep a DRR of at least 10% of outstanding debentures.

6 Previous Year Questions: UPSC EPFO

Part III · Measurement and Financial Statements

1. Trial Balance of a firm as on 31-12-2022 (printed as a table in the paper). The additional bad debts during the year are ₹2,00,000. The firm maintains a provision for doubtful debts equal to 10% of the trade receivables' balances. The total amount to be charged to Profit and Loss A/c (for the year ending 31-12-2022) for bad debts written off and provision created will be: APFC 2023

(a) ₹2,50,000 (b) ₹1,30,000
(c) ₹90,000 (d) ₹3,30,000

Answer: (d) ₹3,30,000 — Receivables 15,00,000 − 2,00,000 = 13,00,000; provision 1,30,000; total 2,00,000 + 1,30,000 = 3,30,000.

2. Trial Balance as on 31 March 2022: Trade receivables ₹2,50,000; Provision for discount to debtors ₹14,000 (Cr); Discount to debtors ₹4,000 (Dr). An additional discount of ₹20,000 was allowed. Provision for discount is 10% of trade receivables. The total amount to be charged to P&L for discount allowed and provision created is: EO/AO 2023

(a) ₹25,000
(b) ₹13,000 (c) ₹9,000
(d) ₹33,000

Answer: (d) ₹33,000 — Discount 24,000 + additional provision (23,000 − 14,000 = 9,000) = 33,000.

3. Which one of the following statements is correct? APFC 2023

(a) Capital reserves are normally created out of free/distributable profits
(b) Dividend equalisation reserve is a general reserve
(c) General reserve can be used only for specific purposes
(d) 'Provision' is a charge against profit

Answer: (d) 'Provision' is a charge against profit — Capital reserves come from capital profits; DER is specific; general reserve is free; provision is debited before net profit.

4. Which one of the following statements is correct? EO/AO 2025

(A) Reserve created is a charge against profits
(B) Capital reserves are created out of distributable profits
(C) General reserve can be used only for specific purposes
(D) Provision is a charge against profit

Answer: (D) Provision is a charge against profit — Same concept as APFC 2023; a reserve is an appropriation, not a charge.

5. What will be the adjustment entry if rent received in advance is ₹2,000? EO/AO 2025

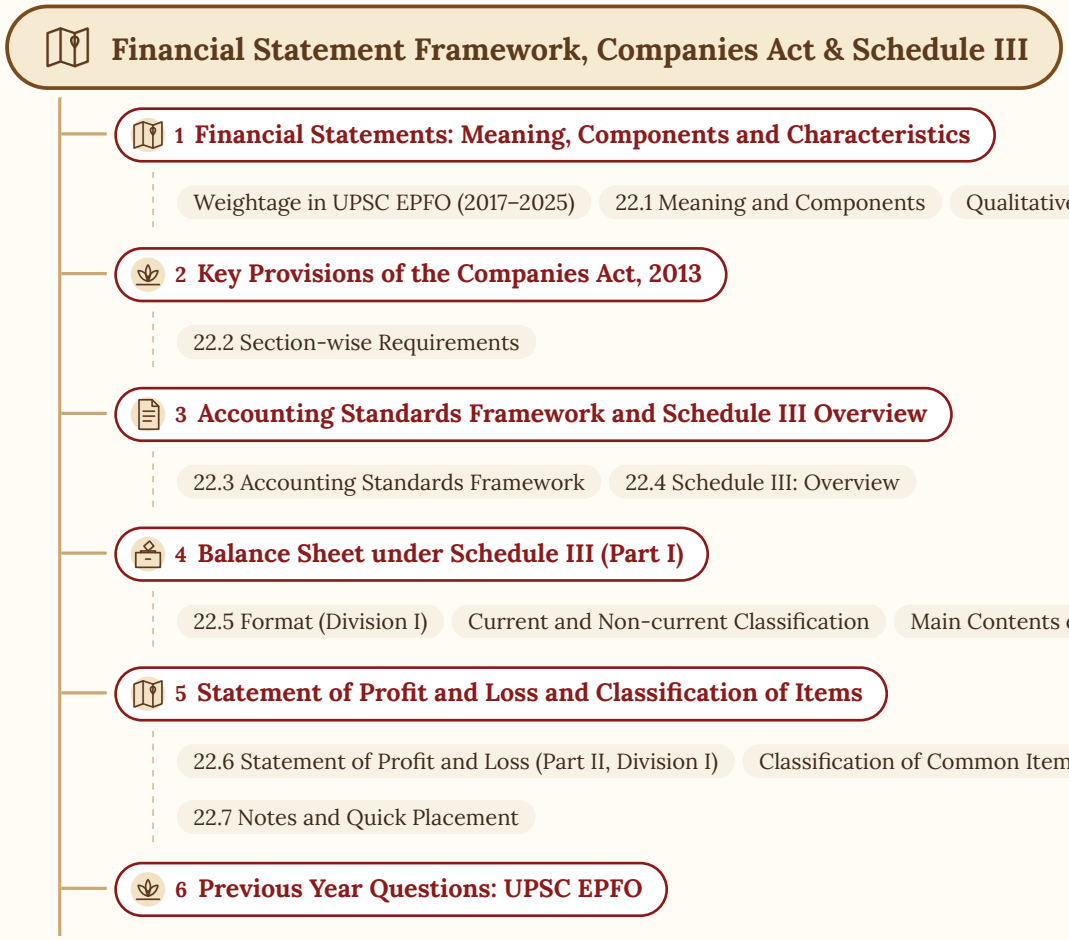
(A) Dr Profit and Loss A/c; Cr Rent A/c
(B) Dr Rent Received A/c; Cr Rent Received in Advance A/c
(C) Dr Rent Received in Advance A/c; Cr Rent Received A/c
(D) Dr Rent A/c; Cr Profit and Loss A/c

Answer: (B) Dr Rent Received A/c; Cr Rent Received in Advance A/c — Unearned rent leaves income (debit) and becomes a liability (credit); (C) is next year's reversing entry.

CHAPTER 22

Financial Statement Framework, Companies Act & Schedule III

CHAPTER AT A GLANCE



1 Financial Statements: Meaning, Components and Characteristics

Part III · Measurement and Financial Statements

➤ Weightage in UPSC EPFO (2017–2025)

One direct question (EO/AO 2017: the Schedule that prescribes financial statement formats).

➤ 22.1 Meaning and Components

Financial statements present the financial position, performance and cash flows of an enterprise and must give a true and fair view.

Under **Section 2(40)** they include:

- (1) Balance sheet
- (2) Profit and loss account (income and expenditure account for a not-for-profit company)
- (3) Cash flow statement
- (4) Statement of changes in equity, if applicable

- (5) Any explanatory note
- One Person Company, small company, dormant company and private start-up company may omit the cash flow statement.

➤ Qualitative Characteristics

Key Terms

Reliability	Free from material error and bias.
Relevance	Timely; influences decisions; includes materiality.
Understandability	Understood by users with reasonable knowledge.
Comparability	Across periods and across firms; needs consistency.

2 Key Provisions of the Companies Act, 2013

➤ 22.2 Section-wise Requirements

Section	Subject	Main requirements
2(41)	Financial year	Ends on 31 March every year.
128	Books of account	Accrual basis and double entry; preserved for 8 years.
129	Financial statements	True and fair view; follow notified standards and Schedule III; laid before the AGM; consolidated statements if subsidiaries, associates or joint ventures exist [129(3)].
133	Accounting standards	Prescribed by the Central Government as recommended by ICAI, after examining NFRA's recommendations.
134	Approval and signing	Approved by the Board; signed by the chairperson or two directors, and the CEO, CFO and company secretary.
136	Copies to members	At least 21 days before the AGM.
137	Filing with Registrar	Within 30 days of the AGM (Form AOC-4).
92	Annual return	Within 60 days of the AGM (MGT-7).
132	NFRA	National Financial Reporting Authority (2018): recommends accounting and auditing standards.

- **Special Acts:** Section 129(1) exempts insurance, banking and electricity companies, whose Acts specify the form.
  - Banking Regulation Act, 1949
  - Insurance Act, 1938
  - Electricity Act, 2003

3 Accounting Standards Framework and Schedule III Overview

➤ 22.3 Accounting Standards Framework

	Accounting Standards (AS)	Ind AS
Notified under	Companies (Accounting Standards) Rules, 2021	Companies (Indian Accounting Standards) Rules, 2015; IFRS-converged
Followed by	Companies not adopting Ind AS; Division I	Phase I (1 April 2016): net worth ₹500 crore or more. Phase II (1 April 2017): listed companies and those with net worth ₹250 crore or more.

- **ICAI** formulates and recommends standards.
- **NFRA** (Section 132) examines them.
- **Central Government (MCA)** notifies AS and Ind AS under Section 133.

➤ 22.4 Schedule III: Overview

- Prescribes form and contents of the Balance Sheet (Part I) and Statement of Profit and Loss (Part II).
- Replaced Revised Schedule VI.
- Other Schedules: I model articles, II useful lives of assets, IV independent directors, V managerial remuneration, VII CSR.

Division	Applies to	Standards
I	Companies preparing statements under the AS Rules	AS
II	Companies required to comply with Ind AS, other than NBFCs	Ind AS
III	NBFCs required to comply with Ind AS	Ind AS

- Vertical format with current and non-current classification and comparative figures.
- Act or accounting standard prevails over Schedule III where treatment differs.

4 Balance Sheet under Schedule III (Part I)

➤ 22.5 Format (Division I)

- **Equity and Liabilities:**
  - (1) Shareholders' funds: share capital, reserves and surplus
  - (2) Share application money pending allotment
  - (3) Non-current liabilities: long-term borrowings, deferred tax liabilities, long-term provisions
  - (4) Current liabilities: short-term borrowings, trade payables, other current liabilities, short-term provisions
- **Assets:**
  - (1) Non-current assets: property, plant and equipment, intangible assets, capital work-in-progress, non-current investments
  - (2) Current assets: current investments, inventories, trade receivables, cash and cash equivalents, short-term loans and advances, other current assets

➤ Current and Non-current Classification

- **Operating cycle:** time between acquiring assets for processing and realising them in cash; taken as 12 months if not identifiable.
- **Current asset:** one that is
  - expected to be realised, sold or consumed in the operating cycle
  - held mainly for trading
  - expected to be realised within 12 months after the reporting date
  - unrestricted cash or cash equivalent
- **Current liability:** one that is
  - expected to be settled in the operating cycle
  - held for trading
  - due within 12 months
- All others are non-current.

➤ Main Contents of Heads

Head	Main contents
Reserves and surplus	Capital reserve, securities premium, DRR, general reserve, surplus (debit balance of P&L shown as negative)
Other current liabilities	Interest accrued, income received in advance, unpaid dividends, calls in advance, outstanding expenses
Inventories	Raw materials, WIP, finished goods, stores; lower of cost and NRV
Other current assets	Prepaid expenses, accrued income

5 Statement of Profit and Loss and Classification of Items

Part III · Measurement and Financial Statements

➤ 22.6 Statement of Profit and Loss (Part II, Division I)

- I Revenue from operations
- II Other income
- III Total income
- IV Expenses: cost of materials consumed, employee benefits expense, finance costs, depreciation and amortisation, other expenses
- IX Profit before tax
- X Tax expense (current and deferred)
- XV Profit for the period
- XVI Earnings per equity share (basic and diluted)
- **Division II (Ind AS):** no extraordinary items; adds Other Comprehensive Income; ends with Total Comprehensive Income; requires Statement of Changes in Equity.

➤ Classification of Common Items

Item	Head
Sale of products and services; sale of scrap	Revenue from operations
Interest and dividend received; profit on sale of assets	Other income
Interest on debentures, loans and bank overdraft	Finance costs
Rent, power, repairs, insurance, bad debts	Other expenses

➤ 22.7 Notes and Quick Placement

- **Contingent liabilities** (claims not acknowledged as debts, guarantees): disclosed in notes (AS-29 / Ind AS 37), per full disclosure convention.
- **Calls in arrears:** deducted under share capital.
- **Securities premium:** reserves and surplus.
- **Bank overdraft:** short-term borrowings.
- **Bills payable:** trade payables.
- **Unpaid dividend, outstanding salary:** other current liabilities.
- **Provision for tax:** short-term provisions.
- **Goodwill, patents, software:** intangible assets.
- **Cheques in hand:** cash and cash equivalents.

6 Previous Year Questions: UPSC EPFO

Part III · Measurement and Financial Statements

1. Under which Schedule of the Companies Act, 2013 are the formats of financial statements prescribed? EO/AO 2017

(a) Schedule I
(b) Schedule II
(c) Schedule III
(d) Schedule IV

Answer: (c) Schedule III — Schedule III gives the Balance Sheet and P&L formats; I is model articles, II useful lives, IV independent directors.

CHAPTER 23

Accounting for Not-for-Profit Organisations

CHAPTER AT A GLANCE



1 Nature of NPOs and the Receipts and Payments Account

Part III · Measurement and Financial Statements

➤ Weightage in UPSC EPFO (2017–2025)

Five questions: EO/AO 2017 (nature of I&E Account; legacies), 2021 (who prepares R&P Account; nature of I&E Account), 2023 (total subscription received). Most tested: I&E Account is a nominal account.

➤ 23.1 Meaning and Characteristics

A **Not-for-Profit Organisation (NPO)** is formed to promote education, health, sports, culture, religion, charity or welfare; surplus is used for its objectives, not distributed to members.

- Examples: clubs, schools, charitable hospitals, libraries.
- Legal form: society, public charitable trust or Section 8 company; run by an elected managing committee.
- Funds: subscriptions, donations, grants, legacies, entrance fees, investment income.
- No owner's capital: the **capital fund** replaces it; surplus is added to it.
- Follows double entry; final accounts: R&P Account, I&E Account, Balance Sheet.

➤ 23.3 Receipts and Payments Account

- **Meaning:** classified summary of the cash book; prepared by non-trading concerns.

- **Real account** on the **cash basis**.
- Receipts on debit side, payments on credit side; capital or revenue, of any year.
- Begins with opening cash and bank balances; ends with closing balances.
- Excludes non-cash items: depreciation, outstanding and accrued amounts, bad debts.
- **Limitations:** does not show surplus or deficit; mixes capital and revenue items; ignores outstanding and prepaid items.

2 Income and Expenditure Account and Balance Sheet

➤ 23.4 Income and Expenditure Account

- **Meaning:** NPO's counterpart of the P&L Account; a **nominal account** on the **accrual basis**.
- Expenses and losses debited; incomes and gains credited; current year's revenue items only.
- Balance is surplus (or deficit), transferred to capital fund.

Included	Excluded
Current year's revenue incomes and expenses after adjusting outstanding, prepaid, accrued and advance items; depreciation; profit or loss on sale of assets	Opening and closing cash and bank balances; capital receipts (legacies, life membership fees, specific donations); capital payments (assets, fixed deposits); sale proceeds of assets

➤ Illustration: Sunrise Sports Club

Item	Working	₹
Subscription income	1,30,000 − 6,000 − 4,000 + 10,000 + 3,000	1,33,000
Salaries	72,000 + 6,000 outstanding	78,000
Equipment sale	Book value 12,000 − 9,000 sold: loss to I&E	3,000

- Equipment bought ₹60,000; building-fund donation, life membership fees, legacy and sale proceeds are not taken to I&E.
- Subscriptions given: received 1,30,000; outstanding 6,000 (opening), 10,000 (closing); advance 3,000 (opening), 4,000 (closing).

➤ Opening Capital Fund

- If not given, prepare an opening statement of affairs.
- **Capital fund = Total assets − Total liabilities** (including opening cash and bank balance).

➤ 23.5 Comparison

Basis	Receipts and Payments A/c	Income and Expenditure A/c
Nature	Real account; summary of cash book	Nominal account; like P&L A/c
Basis	Cash	Accrual
Items	Capital and revenue, of any year	Revenue items of the current year only

Basis	Receipts and Payments A/c	Income and Expenditure A/c
Balances	Opening and closing cash/bank	No opening balance; closing is surplus or deficit
Non-cash items	Not included	Included

3 Capital Fund and Special Items

Part III · Measurement and Financial Statements

➤ 23.6 Capital Fund

- **Meaning:** excess of assets over liabilities; replaces owner's capital.
- **Closing capital fund = Opening capital fund + Surplus (– Deficit) + Capitalised receipts** (legacies, life membership fees, capitalised entrance fees).
- **Legacy:** amount received under a deceased person's will; non-recurring, so a **capital receipt**.
  - Shown in R&P Account; added to capital fund; not credited to I&E (EO/AO 2017).

➤ Treatment of Receipts

Type	Treatment
General donation (small, recurring)	Revenue; credited to I&E Account
Specific donation (building, prize, library)	Capital; credited to a specific fund on the liabilities side
Endowment fund	Capital; only its income may be spent
Government grant	Revenue grant: income; grant for a specific asset: capital

- Income from investments of a specific fund: added to the fund, not to I&E.
- Entrance fees: capital or revenue as the question instructs; if silent, revenue is common convention.
- Life membership fees: paid once instead of annual subscription; capital receipt.
- Sale of old fixed assets: proceeds to R&P; only profit or loss to I&E.
- Consumables consumed = opening stock + purchases – closing stock.

4 Calculation of Subscriptions

Part III · Measurement and Financial Statements

➤ 23.7 Subscriptions

- **R&P Account:** subscriptions **received** (any year).
- **I&E Account:** subscriptions **due for the current year**.
- Outstanding subscriptions: asset. Subscriptions received in advance: liability.

Income from cash received (I&E)	Cash received from income (R&P)
Subscriptions received	Income for the year (members × rate)
Less: outstanding at beginning	Add: outstanding at beginning
Add: outstanding at end	Less: outstanding at end
Add: advance at beginning	Less: advance at beginning

Income from cash received (I&E)	Cash received from income (R&P)
Less: advance at end	Add: advance at end

Subscriptions due but not received (amount illustrative)

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Subscriptions Outstanding A/c **Dr.**	xxx		Asset (Outstanding Subscriptions) ↑ → Debit
	To Subscriptions A/c *(Being subscriptions due but not received)*		xxx	Revenue (Subscription) ↑ → Credit

- **EO/AO 2023:** 70 members at ₹1,000; outstanding ₹16,000 (2021), ₹18,000 (2022); advance ₹12,000 (2021), ₹11,000 (2022).
  - Cash received = 70,000 + 16,000 − 18,000 − 12,000 + 11,000 = **₹67,000**.
- Legacy, life membership fees: capital fund. Donation for building: building fund.
- Depreciation: I&E only, never in R&P.

5 Previous Year Questions: UPSC EPFO

Part III · Measurement and Financial Statements

1. A club had the following information: subscription outstanding on 31.3.2021 ₹16,000 and on 31.3.2022 ₹18,000; subscription received in advance on 31.3.2021 ₹12,000 and on 31.3.2022 ₹11,000; number of members 70; annual subscription per member ₹1,000. Find out the total subscription received during the year 2021-22. EO/AO 2023

(a) ₹67,000 (b) ₹71,000
(c) ₹69,000 (d) ₹77,000

Answer: (a) ₹67,000 — 70,000 + 16,000 − 18,000 − 12,000 + 11,000 = 67,000; the question asks cash received, not income.

2. Income and Expenditure Account is a: EO/AO 2017

(a) Real Account (b) Personal Account
(c) Nominal Account (d) Capital Account

Answer: (c) Nominal Account — It records incomes and expenses of the period and its surplus or deficit goes to the capital fund.

3. Legacies are generally: EO/AO 2017

(a) capitalised and taken to Balance Sheet (b) treated as income
(c) treated as expenditure (d) kept in suspense

Answer: (a) capitalised and taken to Balance Sheet — A legacy is non-recurring, so a capital receipt added to the capital fund.

4. Which of the following concerns prepare a Receipts and Payments Account? EO/AO 2021

(a) Trading concerns
(b) Non-trading concerns (c) Manufacturing concerns
(d) Companies

Answer: (b) Non-trading concerns — Not-for-profit organisations such as clubs and societies summarise their cash book in it.

5. Income and Expenditure Account is a: EO/AO 2021

(a) Real Account
(b) Personal Account
(c) Nominal Account
(d) Representative Personal Account

Answer: (c) Nominal Account — Repeat of 2017; the Receipts and Payments Account, by contrast, is real.

CHAPTER 24

Company Accounts I – Share Capital and Issue of Shares

CHAPTER AT A GLANCE

- Company Accounts I – Share Capital and Issue of Shares
  - 1 The Company and its Share Capital
    - Relevance for UPSC EPFO
    - 24.1 Meaning and Features of a Company
    - 24.2 Categories of Share Capital
  - 2 Kinds of Shares and Legal Limits on Issue
    - 24.3 Kinds of Shares (Section 43)
    - 24.4 Procedure and Legal Limits
  - 3 Journal Entries for Issue of Shares for Cash
    - 24.5 Issue at Par
    - 24.6 Calls in Arrears and Calls in Advance
    - 24.7 Over-subscription and Under-subscription
  - 4 Premium, Discount, Sweat Equity and Shares for Consideration other than Cash
    - 24.9 Issue at a Premium (Section 52)
    - 24.10 Issue at a Discount (Section 53) and Sweat Equity (Section 54)
    - 24.11 Issue for Consideration other than Cash
    - 24.13 Quick Rules

1 The Company and its Share Capital

Part IV · Company Accounts and Financial Instruments

➤ Relevance for UPSC EPFO

No question from this chapter has appeared in the EPFO papers of 2015–2025.

➤ 24.1 Meaning and Features of a Company

Under **Section 2(20)** a company is one incorporated under the Companies Act, 2013 or any previous company law.

- Artificial person created by law; exists on registration with the Registrar of Companies (RoC).
- Separate legal entity; perpetual succession.
- Limited liability: limited to unpaid amount on shares.
- Shares freely transferable in a public company; restricted in a private company.

Type	Section	Main feature
Private company	2(68)	2 to 200 members; restricts share transfer
Public company	2(71)	Minimum 7 members; may invite the public
Government company	2(45)	At least 51% paid-up capital held by Governments
Section 8 company	8	Promotes charity; no dividend

➤ 24.2 Categories of Share Capital

Category	Meaning
Authorised capital, Sec 2(8)	Maximum capital the Memorandum authorises
Issued capital, Sec 2(50)	Part of authorised capital offered for subscription
Called-up capital, Sec 2(15)	Part of subscribed capital demanded so far
Paid-up capital, Sec 2(64)	Called-up – calls in arrears

- Uncalled capital = subscribed – called-up.
- **Reserve capital:** uncalled capital to be called only on winding up.
- **Capital reserve:** reserve from capital profits; not for dividend.

2 Kinds of Shares and Legal Limits on Issue

➤ 24.3 Kinds of Shares (Section 43)

- A company limited by shares may have only two kinds: **equity** and **preference** share capital.
- **Preference shares:** preferential right to fixed dividend and to repayment of capital on winding up.

Basis	Equity	Preference
Dividend	Varies with profit; after preference dividend	Fixed rate; paid first
Capital on winding up	Last claim	Before equity
Redemption	Not redeemable	Must be redeemable (Sec 55)

- **Cumulative** preference shares carry unpaid dividend forward (presumed unless stated otherwise).
- **Section 55:** irredeemable preference shares cannot be issued.
  - Redeem within 20 years (30 for infrastructure projects).
  - If out of profits, equal amount goes to Capital Redemption Reserve.

➤ 24.4 Procedure and Legal Limits

Rule	Limit	Source
Minimum subscription	90% of issue size for public issues	Sec 39(1)
Application money	Not less than 5% of nominal value	Sec 39(2)
Refund if minimum not received	Within 15 days of closure; else directors liable with 15% interest	Sec 39(3)
One call	Not more than 25% of face value	Table F
Interest on calls in arrears / advance	Not more than 10% p.a. / 12% p.a.	Table F

- Table F in Schedule I is the model Articles of Association.

3 Journal Entries for Issue of Shares for Cash

➤ 24.5 Issue at Par

- Application money is first credited to **Share Application A/c**, not Share Capital.
  - Until allotment it is only an offer; refundable if shares are not allotted.

Ganga Ltd: 50,000 shares of ₹10; ₹3 application, ₹4 allotment, ₹3 call

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Bank A/c	**Dr.**	1,50,000		Asset (Bank) ↑ → Debit
	To Equity Share Application A/c *(Being application money received)*			1,50,000	Liability (Application money) ↑ → Credit
	Equity Share Allotment A/c	**Dr.**	2,00,000		Asset (Receivable) ↑ → Debit
	To Equity Share Capital A/c *(Being allotment money due)*			2,00,000	Equity (Share Capital) ↑ → Credit

➤ 24.6 Calls in Arrears and Calls in Advance

Basis	Calls in arrears	Calls in advance
Meaning	Called but unpaid on due date	Received before being called up (if articles permit)
Treatment	Deducted from called-up capital	Liability under Other Current Liabilities, not share capital
Interest	Up to 10% p.a. (income)	Up to 12% p.a. (expense)

➤ 24.7 Over-subscription and Under-subscription

- **Over-subscription:** applications exceed shares offered.
  - Board may reject some in full and refund, allot pro rata, or combine both.
  - Example: applied 1,000, allotted 800 (₹3 application, ₹4 allotment): excess 600; payable on allotment 3,200 − 600 = **₹2,600**.
- **Under-subscription:** shares allotted only to extent applied for, if minimum subscription is received.

4 Premium, Discount, Sweat Equity and Shares for Consideration other than Cash

➤ 24.9 Issue at a Premium (Section 52)

- Excess of issue price over face value is credited to **Securities Premium A/c**.
- Capital receipt, never revenue; shown under Reserves and Surplus.
- **Section 52(2)** uses:
  - (a) fully paid bonus shares
  - (b) writing off preliminary expenses
  - (c) writing off expenses, commission or discount on an issue
  - (d) premium on redemption of preference shares or debentures
  - (e) buy-back under Section 68
- Cannot be used to pay dividend.

Godavari Ltd: allotment due ₹6 on 30,000 shares of ₹10 issued at ₹5 premium

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Equity Share Allotment A/c **Dr.**	1,80,000		Asset (Receivable) ↑ → Debit
	To Equity Share Capital A/c		30,000	Equity (Share Capital) ↑ → Credit
	To Securities Premium A/c *(Being allotment due: capital ₹1, premium ₹5)*		1,50,000	Equity (Reserve) ↑ → Credit

➤ 24.10 Issue at a Discount (Section 53) and Sweat Equity (Section 54)

- **Section 53(1):** issue at a discount prohibited; such shares are void.
- **Exceptions:** sweat equity (Sec 54); shares to creditors on conversion of debt under resolution plan or RBI scheme (Sec 53(2A)).
- **Sweat equity shares (Sec 2(88)):** equity shares to directors or employees at a discount or for non-cash consideration.
  - Special resolution needed.
  - Limit: 15% of paid-up equity capital in a year or ₹5 crore of issue value, whichever is higher; 25% in total.
  - Lock-in: three years.

➤ 24.11 Issue for Consideration other than Cash

- **Shares to issue = Amount payable ÷ Issue price per share.**
- Machinery ₹4,40,000: ₹20,000 cash, balance in ₹10 shares at 20% premium: 35,000 shares at ₹12 (capital ₹3,50,000, premium ₹70,000).

➤ 24.13 Quick Rules

- Kinds of capital: equity and preference only (Sec 43).
- No dividend from securities premium.
- No issue at a discount (Sec 53); sweat equity is the exception (Sec 54).

CHAPTER 25

Company Accounts II – Forfeiture and Reissue of Shares

CHAPTER AT A GLANCE

- Company Accounts II – Forfeiture and Reissue of Shares
  - 1 Meaning and Procedure of Forfeiture
    - Weightage in UPSC EPFO
    - The power to forfeit must be given by the Articles of Association; otherwise **Table F** (Schedule I, Companies Act, 2013) applies.
    - Procedure (Table F, clauses 28–34)
    - **Surrender**: a member may voluntarily give up shares he cannot pay for; the entries are the same as for forfeiture.
  - 2 Accounting for Forfeiture
    - 25.2 The Forfeiture Entry
    - Illustration 1: Shares Issued at Par
    - Illustration 2: Issued at Premium – Premium Not Received
  - 3 Reissue of Forfeited Shares and Capital Reserve
    - 25.3 Reissue of Forfeited Shares
    - Key Formulae
    - Illustration 3: All Shares Reissued at a Discount
    - Illustration 4: Part of the Shares Reissued
  - 4 Balance Sheet Presentation and Identifying the Correct Treatment
    - 25.4 Presentation in the Balance Sheet
    - 25.5 Identifying the Correct Treatment

1 Meaning and Procedure of Forfeiture

Part IV · Company Accounts and Financial Instruments

➤ Weightage in UPSC EPFO

No question on forfeiture appears in the EPFO papers of 2015–2025. The topic lends itself to one-step numerical questions (amount forfeited, capital reserve, minimum reissue price).

➤ The power to forfeit must be given by the Articles of Association; otherwise **Table F** (Schedule I, Companies Act, 2013) applies.

Procedure (Table F, clauses 28–34)

The power to forfeit must be given by the Articles of Association. Where the articles are silent, the provisions of **Table F** (Schedule I, Companies Act, 2013) apply.

➤ Procedure (Table F, clauses 28–34)

Step	Procedure
1	The Board serves a notice on the defaulting member requiring payment of the unpaid amount with interest.

Step	Procedure
2	The notice names a day, not earlier than 14 days from the date of service, on or before which payment must be made, and states that the shares are liable to be forfeited if not paid.
3	If the notice is not complied with, the Board passes a resolution of forfeiture.
4	The member's name is removed from the Register of Members and the shares become the property of the company.

➤ **Surrender: a member may voluntarily give up shares he cannot pay for; the entries are the same as for forfeiture.**

- The person ceases to be a member in respect of the forfeited shares.
- Money already paid is not refunded.
- He remains liable to pay all money owing on the shares at the date of forfeiture (Table F, clause 32).

Surrender: a member may voluntarily give up shares he cannot pay for. If the articles allow, the company may accept the surrender; the accounting entries are the same as for forfeiture.

2 Accounting for Forfeiture

Part IV · Company Accounts and Financial Instruments

➤ 25.2 The Forfeiture Entry

- **Debit Share Capital A/c** with the amount called up on the forfeited shares.
- **Credit the Allotment / Call A/cs** (or Calls in Arrears A/c) with the amount unpaid.
- **Credit Share Forfeiture A/c** with the amount received, excluding any premium received.
- If the premium is unpaid, Securities Premium A/c is also debited.

➤ Illustration 1: Shares Issued at Par

Sindhu Ltd: shares of ₹10 each, ₹3 application, ₹3 allotment, ₹2 first call, ₹2 final call. Ravi, holding 200 shares, paid application and allotment only; his shares were forfeited.

Forfeiture of Ravi's 200 shares (called up ₹10, received ₹6 per share)

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Equity Share Capital A/c **Dr.**	2,000		Equity (Share Capital) ↓ → Debit
	To Equity Share First and Final Call A/cs		800	Asset (Calls due) ↓ → Credit
	To Share Forfeiture A/c *(Being 200 shares forfeited)*		1,200	Equity (amount retained) ↑ → Credit

➤ Illustration 2: Issued at Premium – Premium Not Received

If Kunal (100 shares) paid only the application ₹3 and the premium ₹2 was due on allotment, the unpaid premium is reversed:

Forfeiture of Kunal's 100 shares; unpaid premium reversed

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Equity Share Capital A/c	Dr.	1,000		Equity (Share Capital) ↓ → Debit
	Securities Premium A/c	Dr.	200		Equity (Premium credited but never received) ↓ → Debit
	To Equity Share Allotment and Call A/cs			900	Asset (Allotment and call due) ↓ → Credit
	To Share Forfeiture A/c *(Being 100 shares forfeited)*			300	Equity (amount retained) ↑ → Credit

Pro rata allotment: if excess application money was adjusted against allotment, the unpaid allotment is reduced by that excess (e.g. 800 × ₹4 − ₹600 = ₹2,600), and the Share Forfeiture credit includes the full amount paid on application. Crediting the full allotment is a common error.

3 Reissue of Forfeited Shares and Capital Reserve

➤ 25.3 Reissue of Forfeited Shares

Forfeited shares may be reissued by the Board at par, at a premium or at a discount. **Limit on discount:** the discount cannot exceed the amount forfeited on those shares.

➤ Key Formulae

- **Minimum reissue price** (as fully paid) = Face value − Amount forfeited per share.
- **Capital Reserve** = Amount forfeited on shares reissued − Discount allowed on reissue.
- **Forfeited amount per share** = Total forfeited ÷ Number of shares forfeited (use this when only part of the shares is reissued).

➤ Illustration 3: All Shares Reissued at a Discount

Ravi's 200 shares (forfeited amount ₹1,200) were reissued at ₹8 per share as fully paid. Minimum reissue price = ₹10 − ₹6 = ₹4 per share.

Reissue of 200 shares at ₹8 as fully paid; discount ₹2 per share

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Bank A/c	Dr.	1,600		Asset (Bank) ↑ → Debit
	Share Forfeiture A/c	Dr.	400		Equity (forfeited amount used for discount) ↓ → Debit
	To Equity Share Capital A/c *(Being 200 shares reissued at ₹8 as fully paid)*			2,000	Equity (Share Capital) ↑ → Credit
	Share Forfeiture A/c	Dr.	800		Equity (Forfeiture balance) ↓ → Debit
	To Capital Reserve A/c *(Being balance of forfeited amount (1,200 − 400) transferred)*			800	Equity (Capital Reserve) ↑ → Credit

➤ Illustration 4: Part of the Shares Reissued

Of 800 forfeited shares (₹3,000 forfeited, i.e. ₹3.75 per share), 500 shares were reissued at ₹9 as fully paid: Capital Reserve = 500 × ₹3.75 − 500 × ₹1 = ₹1,375.

4 Balance Sheet Presentation and Identifying the Correct Treatment

➤ 25.4 Presentation in the Balance Sheet

- **Share Forfeiture A/c** (shares not yet reissued) → added to subscribed capital in the Share Capital note.
- **Capital Reserve** → Reserves and Surplus; not available for dividend.

➤ 25.5 Identifying the Correct Treatment

Situation	Treatment
Share Capital debited on forfeiture	With amount called up on those shares
Share Forfeiture credited	With amount received, excluding premium received

CHAPTER 26

Company Accounts III – Rights Issue, Bonus Shares, Buy-back

CHAPTER AT A GLANCE

- Company Accounts III – Rights Issue, Bonus Shares, Buy-back
  - 1 Rights Issue (Section 62)
    - Weightage in UPSC EPFO
    - Three Ways to Change Share Capital
    - 26.1 Rights Issue
  - 2 Bonus Shares (Section 63)
    - 26.2 Meaning and Sources
    - Accounting Entries for Bonus Issue
    - Illustration 2: Fully Paid Bonus
  - 3 Buy-back of Shares (Sections 68–70)
    - 26.3 Meaning and Requirements
    - Illustration 4: Maximum Buy-back (Three Tests)
  - 4 Effects Compared
    - 26.4 Effects of Corporate Actions

1 Rights Issue (Section 62)

Part IV · Company Accounts and Financial Instruments

➤ Weightage in UPSC EPFO

No question on these corporate actions appears in the EPFO papers of 2015–2025. They suit statement-based questions on sources, limits and effects.

➤ Three Ways to Change Share Capital

A company may raise money from existing shareholders through a **rights issue**, convert reserves into share capital through a **bonus issue**, or return surplus funds by a **buy-back** of its own shares.

➤ 26.1 Rights Issue

Section 62(1)(a) requires new equity shares to be first offered to the existing equity shareholders in proportion to their holding. Such an offer is a rights issue.

Point	Provision
Offer	By notice specifying the number of shares offered
Period	Open for not less than 15 days and not more than 30 days; if not accepted, deemed declined
Renunciation	Unless the articles provide otherwise, the shareholder may renounce the right in favour of any other person
Other routes – Sec 62(1)(b), (c)	ESOS or preferential issue, by special resolution

Options before a shareholder: subscribe in full, renounce the right, subscribe in part and renounce the rest, or let the offer lapse.

Alpha Ltd: market price ₹150; rights 1 : 4 at ₹100.

Step	Working	₹
Value of 4 old shares + 1 new share	4 × 150 + 100	700
Theoretical ex-rights price	700 ÷ 5	140
Value of right per existing share	150 − 140	10

Formula: Ex-rights price = (M × N + S × R) ÷ (N + R), where M = market price, N = shares held, S = subscription price, R = rights shares.

2 Bonus Shares (Section 63)

Part IV · Company Accounts and Financial Instruments

➤ 26.2 Meaning and Sources

Bonus shares are fully paid shares issued to existing members free of cost by converting reserves into share capital (capitalisation of reserves).

Permitted Sources – Sec 63(1)	Conditions – Sec 63(2), (3)
Free reserves	Authorised by the articles
Securities premium account	Authorised in general meeting on the Board's recommendation
Capital redemption reserve account	No default in interest or principal on fixed deposits or debt securities
Not out of reserves created by revaluation of assets (proviso to Sec 63(1))	No default in statutory dues of employees (PF, gratuity, bonus)

Free reserves – Sec 2(43): reserves available for distribution as dividend; unrealised gains and revaluation reserves are excluded. A bonus issue once announced cannot be withdrawn.

Restriction on sources: securities premium (Sec 52(2)(a)) and capital redemption reserve may be used only for fully paid bonus shares; making partly paid shares fully paid must come from free reserves or surplus.

➤ Accounting Entries for Bonus Issue

Case	Entries
Issue of fully paid bonus shares	(1) Capital Redemption Reserve / Securities Premium / General Reserve / Surplus (P&L) A/c Dr, To Bonus to Shareholders A/c; (2) Bonus to Shareholders A/c Dr, To Equity Share Capital A/c
Making partly paid shares fully paid	(1) General Reserve / Surplus A/c Dr, To Bonus to Shareholders A/c; (2) Final Call A/c Dr, To Share Capital A/c; (3) Bonus to Shareholders A/c Dr, To Final Call A/c

➤ Illustration 2: Fully Paid Bonus

Beta Ltd: 2,00,000 equity shares of ₹10 fully paid; General Reserve ₹10,00,000; Securities Premium ₹3,00,000; CRR ₹2,00,000; Revaluation Reserve ₹4,00,000. Bonus 1 : 2, using CRR and Securities Premium in full and the balance from General Reserve (revaluation reserve not used).

Bonus of 1,00,000 shares of ₹10

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Capital Redemption Reserve A/c **Dr.**	2,00,000		Equity (Reserve) ↓ → Debit
	Securities Premium A/c **Dr.**	3,00,000		Equity (Reserve) ↓ → Debit
	General Reserve A/c **Dr.**	5,00,000		Equity (Reserve) ↓ → Debit
	To Bonus to Shareholders A/c *(Being bonus approved)*		10,00,000	Liability (Bonus payable in shares) ↑ → Credit
	Bonus to Shareholders A/c **Dr.**	10,00,000		Liability (Bonus payable) ↓ → Debit
	To Equity Share Capital A/c *(Being 1,00,000 fully paid bonus shares allotted)*		10,00,000	Equity (Share Capital) ↑ → Credit

3 Buy-back of Shares (Sections 68–70)

Part IV · Company Accounts and Financial Instruments

➤ 26.3 Meaning and Requirements

Buy-back means the purchase by a company of its own shares; the shares are extinguished, so capital is reduced.

Requirement	Provision of Section 68
Sources – 68(1)	(a) free reserves; (b) securities premium; (c) proceeds of shares or other specified securities (not of the same kind of shares)
Authority – 68(2)(a), (b)	Authorised by articles; special resolution (Board resolution enough if ≤ 10% of paid-up equity capital and free reserves)
Size limit – 68(2)(c)	≤ 25% of aggregate paid-up capital and free reserves; for equity, number of shares ≤ 25% of paid-up equity capital in that financial year
Debt-equity – 68(2)(d)	Debts after buy-back ≤ twice the paid-up capital and free reserves (2 : 1), unless a higher ratio is notified
Destruction – 68(7)	Securities bought back extinguished and physically destroyed within 7 days of completion

- **Section 69 – Capital Redemption Reserve:** when shares are bought back out of free reserves or securities premium, an amount equal to the nominal value of shares bought back is transferred to CRR.
- **Section 70 – Prohibitions:** no buy-back through a subsidiary or an investment company, or while the company is in default in repaying deposits, debentures or term loans.

➤ Illustration 4: Maximum Buy-back (Three Tests)

Delta Ltd: Equity share capital ₹20,00,000 (2,00,000 shares of ₹10); Securities Premium ₹4,00,000; General Reserve ₹11,00,000; Surplus ₹5,00,000; loans ₹50,00,000. Buy-back at ₹25 out of free reserves.

Test	Working	Max shares
Resources test (25%)	Paid-up capital + free reserves = 20 + 4 + 11 + 5 = ₹40 lakh; 25% = ₹10,00,000; ÷ ₹25	40,000

Test	Working	Max shares
Shares outstanding test	25% of 2,00,000 shares	50,000
Debt-equity test (2 : 1)	Permitted debt ₹52 lakh ≥ loans ₹50 lakh	satisfied
Maximum buy-back	Lowest of the tests	40,000

4 Effects Compared

➤ 26.4 Effects of Corporate Actions

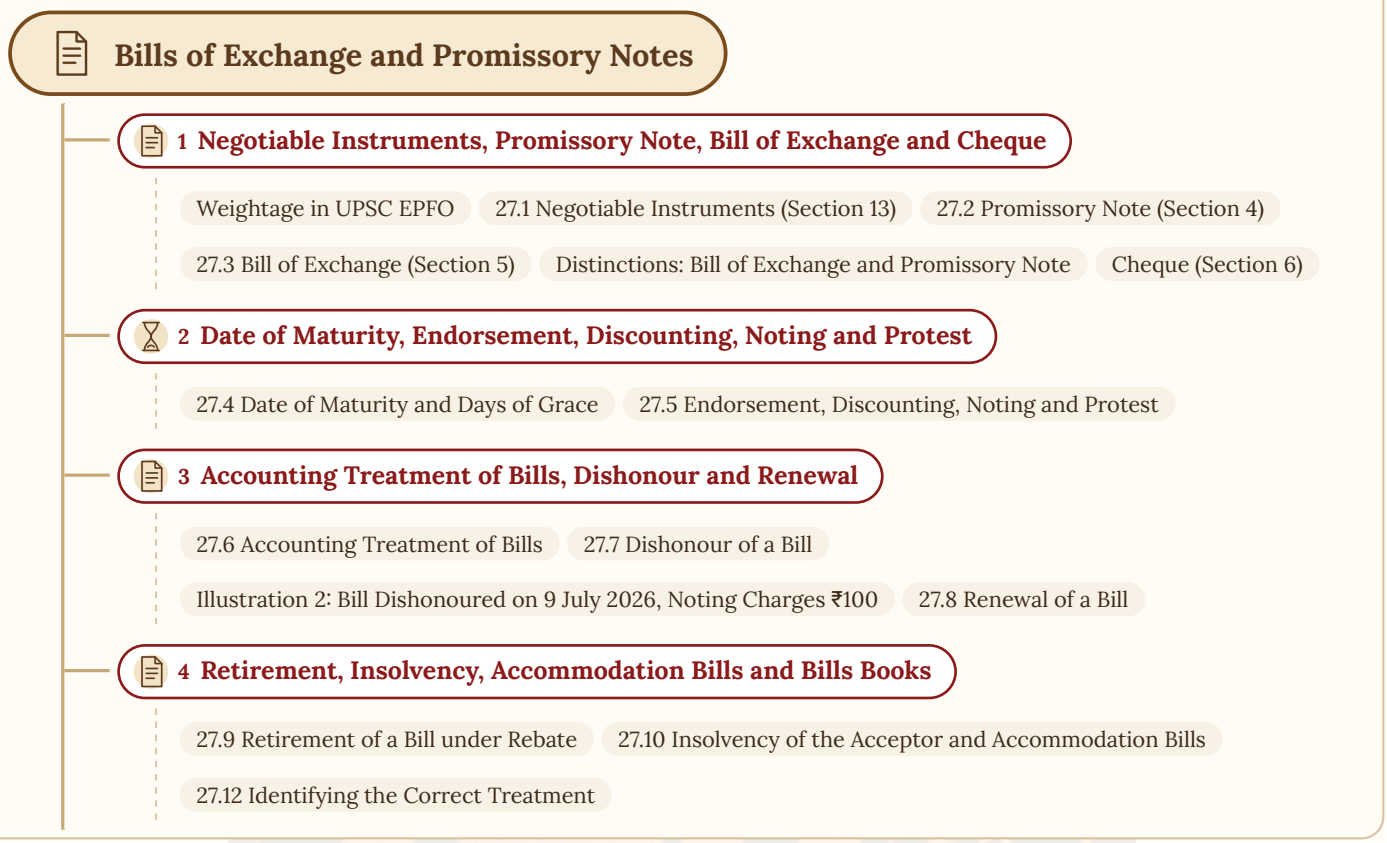
Action	Number of shares	Share capital	Reserves	Cash	Net worth	EPS
Rights issue	Increases	Increases	Premium, if any, increases	Increases	Increases	Usually falls
Bonus issue	Increases	Increases	Decrease	No change	No change	Falls
Buy-back	Decreases	Decreases	Decrease	Decreases	Decreases	Rises
Stock split	Increases	No change	No change	No change	No change	Falls

In a stock split the face value per share falls (a ₹10 share split into two of ₹5). In a bonus issue the face value stays the same.

CHAPTER 27

Bills of Exchange and Promissory Notes

CHAPTER AT A GLANCE



1 Negotiable Instruments, Promissory Note, Bill of Exchange and Cheque

Part IV · Company Accounts and Financial Instruments

➤ Weightage in UPSC EPFO

No question on bills appears in the EPFO papers of 2015–2025. Suitable areas are the definitions in Sections 4, 5 and 6, the parties, the due date and simple discount and rebate calculations.

➤ 27.1 Negotiable Instruments (Section 13)

Section 13: a negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer.

Feature	Explanation
Better title	A holder in due course (Sec 9) – one who took the instrument for consideration, before maturity and in good faith – gets a good title even if the transferor's title was defective

➤ 27.2 Promissory Note (Section 4)

Section 4: a promissory note is an instrument in writing containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person or the bearer. **Parties:** Maker and Payee.

➤ 27.3 Bill of Exchange (Section 5)

Section 5: a bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or the bearer. It binds the debtor only after he signs his acceptance.

Party	Role
Drawer	Makes the bill and gives the order to pay (creditor)
Drawee	Person directed to pay (debtor)
Acceptor	Drawee after signing acceptance; primarily liable

- **Essentials:** in writing, signed by the drawer; unconditional order to pay; drawee, payee and amount certain; money only; duly stamped; accepted by the drawee (time bill). **Inland bill** (Sec 11) is drawn or payable in India; **foreign bill** (Sec 12) is any other.

➤ Distinctions: Bill of Exchange and Promissory Note

Basis	Bill of exchange	Promissory note
Drawn by	Creditor	Debtor (maker)
Acceptance	Required for a time bill	Not required
Primary liability	Acceptor; drawer's liability is secondary	Maker

➤ Cheque (Section 6)

Section 6: a cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.

Basis	Bill of exchange	Cheque
Drawee	Any person, including a bank	Always a specified bank
Payable	On demand or after a period	Always on demand
Acceptance	Required (time bill)	Not required

Section 138: dishonour of a cheque for want of funds is an offence: imprisonment up to two years, or fine up to twice the amount of the cheque, or both.

2 Date of Maturity, Endorsement, Discounting, Noting and Protest

Part IV · Company Accounts and Financial Instruments

➤ 27.4 Date of Maturity and Days of Grace

For a time bill or note, three days of grace are added to the date on which the period ends (Sec 22). No days of grace on instruments payable on demand, at sight or on presentment, or on cheques.

Section	Rule
Sec 23	Period in months: counted to the corresponding date; if none, to the last day of the month
Sec 25	If the date of maturity is a public holiday (including Sunday), the instrument is due on the preceding business day

➤ 27.5 Endorsement, Discounting, Noting and Protest

Key Terms

Endorsement (Sec 15)	Signing on the back of the instrument for negotiation. Kinds: blank, full / special, restrictive, conditional, sans recourse.
Discounting	Encashing a bill with a bank before maturity, less discount; an expense of the holder.
Noting (Sec 99)	Notary's record of dishonour on the instrument, with date, reason and charges.
Protest (Sec 100)	Notary's certificate of dishonour; compulsory for foreign bills (Sec 104), optional for inland bills.

3 Accounting Treatment of Bills, Dishonour and Renewal

➤ 27.6 Accounting Treatment of Bills

A bill is **Bills Receivable** (asset) for the drawer or holder and **Bills Payable** (liability) for the acceptor. The holder may retain, discount, endorse or send it for collection.

Arun sold goods to Bina for ₹20,000 on 6 April 2026 and drew a 3-month bill, which Bina accepted.

Arun's books (drawer): sale on credit

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
6 Apr	Bina A/c	**Dr.**	20,000		Asset (Debtor) ↑ → Debit
	To Sales A/c *(Being goods sold on credit)*			20,000	Revenue (Sales) ↑ → Credit

Arun's books – bill discounted; discount ₹600

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Bank A/c	**Dr.**	19,400		Asset (Bank) ↑ → Debit
	Discount A/c	**Dr.**	600		Expense (Discount) ↑ → Debit
	To Bills Receivable A/c *(Being bill discounted with bank)*			20,000	Asset (Bills Receivable) ↓ → Credit

➤ 27.7 Dishonour of a Bill

On dishonour, the bill loses its value and the original debt revives; the drawer debits the acceptor with the bill and the noting charges.

➤ Illustration 2: Bill Dishonoured on 9 July 2026, Noting Charges ₹100

Arun's books on dishonour of a bill retained, noting charges ₹100

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Bina A/c	**Dr.**	20,100		Asset (Debtor) ↑ → Debit
	To Bills Receivable A/c			20,000	Asset (Bills Receivable) ↓ → Credit
	To Cash A/c *(Being bill dishonoured; noting charges paid)*			100	Asset (Cash) ↓ → Credit

➤ 27.8 Renewal of a Bill

Renewal: the acceptor may ask the drawer to cancel the old bill and draw a new one for a further period, with interest. Example: Bina pays ₹5,000 cash and accepts a new 2-month bill for the balance plus 12% interest: 15,000 × 12/100 × 2/12 = ₹300; new bill = ₹15,300.

4 Retirement, Insolvency, Accommodation Bills and Bills Books

➤ 27.9 Retirement of a Bill under Rebate

When the acceptor pays before the due date, the bill is retired and the holder allows a **rebate** – a loss to the holder, a gain to the acceptor.

Illustration: a ₹20,000 bill retired one month early at 12% p.a. carries a rebate of ₹200.

Retirement – Arun's books

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Bank A/c	**Dr.**	19,800		Asset (Bank) ↑ → Debit
	Rebate on Bills A/c	**Dr.**	200		Expense/Loss (Rebate) ↑ → Debit
	To Bills Receivable A/c *(Being bill retired with rebate)*			20,000	Asset (Bills Receivable) ↓ → Credit

➤ 27.10 Insolvency of the Acceptor and Accommodation Bills

If the acceptor becomes insolvent, the bill is treated as dishonoured; the amount recovered is received in cash and the balance is written off as bad debts.

A trade bill arises from a genuine sale. An **accommodation bill** is drawn and accepted without consideration, only to help the parties raise funds by discounting it.

➤ 27.12 Identifying the Correct Treatment

Situation	Answer
Unconditional promise signed by the debtor	Promissory note – Sec 4
Unconditional order signed by the creditor	Bill of exchange – Sec 5
Bill drawn on a specified banker payable on demand	Cheque – Sec 6

CHAPTER 28

Ratio Analysis: Financial & Accounting Ratios

CHAPTER AT A GLANCE

- Ratio Analysis: Financial & Accounting Ratios
  - 1 Meaning, Objectives and Classification of Ratios
    - Weightage in UPSC EPFO
    - 28.1 Meaning of Accounting Ratio and Ratio Analysis
    - Classification of Ratios
    - Building Blocks: Items Used in Ratios
  - 2 Liquidity Ratios and Effect of Transactions
    - 28.2 Liquidity Ratios
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  - 3 Solvency and Activity (Turnover) Ratios
    - 28.4 Solvency Ratios
    - 28.5 Activity Ratios
  - 4 Profitability and Market-based Ratios
    - 28.6 Profitability Ratios
    - Operating Profit and Non-operating Items
    - Market-based (Shareholder) Ratios
    - DuPont Analysis
  - 5 Uses, Limitations and Ratio Selection
    - 28.8 Uses and Limitations of Ratio Analysis
    - 28.9 Identifying the Appropriate Ratio

1 Meaning, Objectives and Classification of Ratios

Part V · Analysis of Financial Statements

➤ Weightage in UPSC EPFO

No question on ratio analysis has been asked directly in the EO/AO and APFC papers of 2017–2025. The topic supports questions on operating profit (2025 PYQ, see Chapter 19), working capital and the effect of a transaction on a ratio.

➤ 28.1 Meaning of Accounting Ratio and Ratio Analysis

An **accounting ratio** is a mathematical expression of the relationship between two related figures taken from the financial statements. **Ratio analysis** is the process of computing, comparing and interpreting such ratios to judge the financial position and performance of an enterprise.

- **Objectives:** to judge liquidity and solvency, measure efficiency and profitability, and help in planning and control.
- **Standards of comparison:** past ratios, competitors' ratios, industry averages, budgeted ratios.

➤ Classification of Ratios

Basis	Category	Examples
Traditional	Income statement, balance sheet and composite (mixed) ratios	Gross profit ratio; current ratio; inventory turnover
Functional	Liquidity, solvency, activity (turnover), profitability	Current ratio; debt-equity; inventory turnover; ROCE

➤ Building Blocks: Items Used in Ratios

Component	How it is computed
Quick (liquid) assets	Current assets − inventories − prepaid expenses
Shareholders' funds	Equity share capital + preference share capital + reserves and surplus
Long-term debt	Long-term borrowings + long-term provisions
Capital employed	Shareholders' funds + long-term debt; or non-current assets + working capital

2 Liquidity Ratios and Effect of Transactions

Part V · Analysis of Financial Statements

➤ 28.2 Liquidity Ratios

Liquidity ratios measure the ability of a business to meet its short-term obligations.

Ratio	Formula	Conventional norm
Current ratio (working capital ratio)	Current Assets ÷ Current Liabilities	2 : 1
Quick ratio (liquid / acid-test ratio)	(Current Assets − Inventories − Prepaid Expenses) ÷ Current Liabilities	1 : 1
Absolute liquid ratio (cash ratio)	(Cash and Bank + Marketable Securities) ÷ Current Liabilities	0.5 : 1
Defensive interval measure (in days)	Quick Assets ÷ Average Daily Cash Operating Expenses	Higher is safer

A current ratio below 1 : 1 means working capital is negative; a very high ratio means idle funds. The quick ratio excludes inventory and prepaid expenses; the absolute liquid ratio excludes trade receivables also.

➤ 28.3 Effect of Transactions on Liquidity Ratios

The answer depends on which side(s) of the ratio the transaction touches and on whether the ratio is above or below one.

Existing ratio	Equal increase in CA and CL	Equal decrease in CA and CL
More than 1 (e.g. 2 : 1)	Ratio decreases	Ratio increases
Less than 1 (e.g. 0.8 : 1)	Ratio increases	Ratio decreases
Equal to 1	No change	No change

A transaction between two current assets does not change the current ratio; one between a current and a non-current item always changes it.

Transaction (₹30,000; CA 3,00,000, CL 1,50,000)	Current ratio (2.00)	Quick ratio (1.33)
Purchase of goods on credit	1.83 ↓	1.11 ↓
Payment to trade creditors	2.25 ↑	1.42 ↑
Cash purchase of goods	no change	1.13 ↓

3 Solvency and Activity (Turnover) Ratios

Part V · Analysis of Financial Statements

➤ 28.4 Solvency Ratios

Solvency ratios measure the ability of a firm to meet its long-term obligations.

Ratio	Formula	Norm / reading
Debt-equity ratio	Long-term Debts ÷ Shareholders' Funds	2 : 1 is considered safe; lower is safer for lenders
Proprietary ratio	Shareholders' Funds ÷ Total Assets	Higher = stronger owners' base (about 0.5 or more)
Interest coverage	Net Profit before Interest and Tax ÷ Interest on Long-term Debts	Times; about 6 or more is comfortable

Debt-equity ratio: if return on investment exceeds the rate of interest, equity shareholders gain (trading on equity). **Interest coverage** uses profit before interest and tax, because interest is paid before tax.

Transaction (debt ₹3,00,000; funds ₹6,00,000; 0.5 : 1)	Debt-equity ratio
Issue of equity shares for cash	Decrease
Issue of debentures for cash	Increase

➤ 28.5 Activity Ratios

Activity ratios measure the speed with which resources are converted into revenue. Where opening and closing balances are available, the average is used.

Ratio	Formula	Related period
Inventory turnover	Cost of Revenue from Operations ÷ Average Inventory	Holding period = 365 ÷ ratio
Trade receivables turnover	Net Credit Revenue from Operations ÷ Average Trade Receivables	Collection period = 365 ÷ ratio
Trade payables turnover	Net Credit Purchases ÷ Average Trade Payables	Payment period = 365 ÷ ratio

Operating cycle = inventory holding period + collection period. **Cash conversion cycle** = operating cycle − payment period. If gross profit is 25% on cost, it is 20% on revenue.

4 Profitability and Market-based Ratios

Part V · Analysis of Financial Statements

➤ 28.6 Profitability Ratios

Profitability ratios relate profit to revenue (margins) or to funds invested (returns).

Ratio	Formula
Gross profit ratio	Gross Profit ÷ Net Revenue from Operations × 100
Operating ratio	(Cost of Revenue + Operating Expenses) ÷ Net Revenue from Operations × 100
Operating profit ratio	Operating Profit ÷ Net Revenue from Operations × 100 = 100 − Operating ratio
Net profit ratio	Net Profit (after tax) ÷ Net Revenue from Operations × 100

➤ Operating Profit and Non-operating Items

Operating profit = revenue from operations − cost of revenue − operating expenses; non-operating items (interest, dividend received, profit or loss on sale of fixed assets, loss by fire) are excluded. Therefore Operating profit = Net profit + Non-operating expenses − Non-operating incomes. Asked in the 2025 combined EO/AO and APFC paper (Chapter 19).

➤ Market-based (Shareholder) Ratios

Ratio	Formula
Earnings per share (EPS)	(PAT − Preference Dividend) ÷ Number of Equity Shares
Dividend per share (DPS)	Dividend Paid to Equity Shareholders ÷ Number of Equity Shares
Dividend payout ratio	DPS ÷ EPS × 100

➤ DuPont Analysis

Return on shareholders' funds = PAT ÷ Revenue (net profit margin) × Revenue ÷ Total Assets (asset turnover) × Total Assets ÷ Shareholders' Funds (equity multiplier).

5 Uses, Limitations and Ratio Selection

Part V · Analysis of Financial Statements

➤ 28.8 Uses and Limitations of Ratio Analysis

- **Uses:** simplifies large accounting data; helps in intra-firm and inter-firm comparison; useful in planning and forecasting.
- **Limitations:** based on historical figures and ignore price-level changes; ignore qualitative factors; exposed to window dressing at the year end; accounting policies affect comparability.

➤ 28.9 Identifying the Appropriate Ratio

Purpose or situation	Ratio
Ability to pay current liabilities out of all current assets	Current ratio
Immediate paying capacity, ignoring inventory	Quick (acid-test) ratio
Share of borrowed long-term funds in capital structure	Debt-equity ratio
Number of times interest is covered by earnings	Interest coverage ratio

CHAPTER 29

Cash Flow Statement (AS-3 and Ind AS 7)

CHAPTER AT A GLANCE

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    - Objectives
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    - Definitions under AS-3
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    - Illustration: XYZ Ltd

1 Weightage, Meaning, Objectives and Legal Position

Part V · Analysis of Financial Statements

➤ Weightage in UPSC EPFO

No direct question in EO/AO and APFC papers of 2017–2025, but a standard syllabus topic. Likely areas: classification, interest and dividend treatment, cash equivalents, short numericals.

➤ Meaning of Cash Flow Statement

- Shows inflows and outflows of **cash and cash equivalents** during an accounting period.
- Classified under operating, investing and financing activities.
- **AS-3 (Revised), Cash Flow Statements:** for companies following Accounting Standards.
- **Ind AS 7, Statement of Cash Flows:** for companies following Ind AS.

➤ Objectives

- Show sources and uses of cash.
- Explain why profit and cash differ.
- Judge liquidity and ability to pay dividends, interest and debts.

➤ Legal Position and Limitations

- **Section 2(40), Companies Act, 2013:** "financial statement" includes a cash flow statement.
- **Exempt:** One Person Company, small company, dormant company, start-up private company.
- **Limitations:** ignores non-cash transactions; does not show profit.

2 Cash and Cash Equivalents

Part V · Analysis of Financial Statements

➤ Definitions under AS-3

Key Terms

Cash	Cash on hand and demand deposits with banks.
Cash equivalents	Short-term, highly liquid investments readily convertible into known amounts of cash and subject to an insignificant risk of change in value. It normally qualifies only when maturity is three months or less from the date of acquisition.

Item	Cash equivalent?	Reason
Treasury bill of 91 days purchased on 1 March	Yes	Maturity within three months of acquisition
Fixed deposit of one year	No	Maturity exceeds three months (investing activity)

➤ Movements that are NOT Cash Flows

- Transfers within cash and cash equivalents do not change the total.
- Examples: cash deposited in a bank; purchase of a 60-day treasury bill out of cash.

3 Classification of Cash Flows

Part V · Analysis of Financial Statements

➤ The Three Activities

Activity	Meaning	Inflows (examples)	Outflows (examples)
Operating	Principal revenue-producing activities	Cash sales; collections from trade receivables; royalties, fees, commission	Payments to suppliers; wages; operating expenses; income tax paid
Investing	Acquisition and disposal of long-term assets and other investments not in cash equivalents	Sale of fixed assets; sale of shares of other enterprises; repayment of loans given	Purchase of fixed assets; purchase of shares of other enterprises; loans given
Financing	Activities that change owners' capital and borrowings	Issue of shares or debentures; borrowings	Buy-back of shares; redemption of debentures; repayment of loans

➤ Interest and Dividends

- **Financial enterprise** (bank, finance company): interest and dividends are part of principal activity.
- **Other companies:** they are not.

Item (AS-3)	Financial enterprise	Non-financial enterprise
Interest paid	Operating	Financing
Interest received	Operating	Investing
Dividend received	Operating	Investing
Dividend paid	Financing	Financing

- **Ind AS 7:** interest and dividends may be classified as operating, investing or financing, if applied consistently.

➤ Other Special Items

- **Sale of plant:** whole proceeds are an investing inflow; profit or loss is removed from net profit under the indirect method.
- **Bank overdraft and cash credit:** financing; under Ind AS 7 an overdraft repayable on demand is included in cash equivalents.
- **Premium on redemption of debentures; underwriting commission:** financing.
- **Purchase of goodwill or patents:** investing.

➤ Non-cash Transactions

- **Excluded** and disclosed elsewhere: assets acquired against issue of shares, conversion of debentures into equity shares, bonus shares.
- **Depreciation, amortisation, profit or loss on sale of assets:** affect profit without cash flow; adjusted in the indirect method.

4 Cash Flow from Operating Activities

Part V · Analysis of Financial Statements

- AS-3 permits two methods for operating cash flows; both give the same net cash from operating activities.
- Investing and financing cash flows are always reported gross.

Basis	Direct method	Indirect method
Starting point	Major classes of gross cash receipts and payments	Net profit before tax and extraordinary items
Adjustments	Accrual figures converted to cash figures	Non-cash items, non-operating items and changes in working capital
Merit	AS-3 encourages it	Widely used

➤ Direct Method

Cash item	Computation
Cash received from customers	Cash sales + credit sales + opening trade receivables − closing trade receivables

Cash item	Computation
Cash paid to suppliers	Cash purchases + credit purchases + opening trade payables − closing trade payables
Income tax paid	Opening provision + tax provided during the year − closing provision

➤ Indirect Method: Steps

- **Net profit before tax** = closing surplus − opening surplus + transfer to reserves + provision for tax + interim dividend.
- **Add** non-cash and non-operating charges: depreciation, amortisation, loss on sale of assets, interest paid.
- **Deduct** non-operating incomes: profit on sale of assets, interest and dividend received. Result: operating profit before working capital changes.
- **Adjust** changes in current assets and liabilities to get cash generated from operations; deduct income tax paid.

Change	Treatment
Increase in a current asset (cash locked up)	Deduct
Decrease in a current asset	Add
Increase in a current liability (payment postponed)	Add
Decrease in a current liability	Deduct

5 Comprehensive Illustration: XYZ Ltd

Part V · Analysis of Financial Statements

➤ Illustration: XYZ Ltd

Depreciation ₹80,000; machinery of book value ₹40,000 sold for ₹30,000; investments costing ₹40,000 sold for ₹50,000; debentures of ₹1,00,000 redeemed; interest paid ₹25,000; dividend received ₹6,000; income tax paid ₹45,000; interim dividend ₹50,000; shares issued ₹2,00,000; machinery purchased ₹2,70,000.

Particulars	₹
Net profit before tax	1,85,000
Add: depreciation 80,000; loss on sale of machinery 10,000; interest paid 25,000	1,15,000
Less: profit on sale of investments 10,000; dividend received 6,000	(16,000)
Operating profit before working capital changes	2,84,000
Working capital changes (inventories −30,000; receivables +20,000; payables +20,000)	10,000
Cash generated from operations	2,94,000
Less: income tax paid	(45,000)
A. Net cash from operating activities	2,49,000
B. Net cash used in investing activities (−2,70,000 + 30,000 + 50,000 + 6,000)	(1,84,000)
C. Net cash from financing activities (+2,00,000 − 1,00,000 − 25,000 − 50,000)	25,000
Net increase in cash (A + B + C)	90,000

Particulars	₹
Opening cash 70,000; closing cash	1,60,000

- **Direct method check:** receipts from customers ₹12,20,000, less suppliers ₹7,30,000 and expenses ₹1,96,000, gives the same ₹2,94,000.

CHAPTER 30

Fund Flow Statement and Comparative Statements

CHAPTER AT A GLANCE

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    - Concept of Fund and Flow
    - Schedule of Changes in Working Capital
    - Funds from Operations
    - Fund Flow versus Cash Flow Statement
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    - Meaning and Formulae
    - Illustration: Comparative Statement of Profit and Loss, Mehta Ltd
  - **4 Common-size Statements and Trend Analysis**
    - Common-size Statements (Vertical Analysis)
    - Trend Analysis
    - Comparison of the Three Techniques
    - Common Errors

1 Weightage and Tools of Financial Statement Analysis

Part V · Analysis of Financial Statements

➤ Weightage in UPSC EPFO

No question on fund flow, comparative or common-size statements in 2017–2025. Likely areas: meaning of "fund", items causing a flow of funds, base used in common-size statements.

➤ Tools of Analysis

Analysis of financial statements identifies strengths and weaknesses by relating items of the balance sheet and statement of profit and loss.

Tool	Main purpose	Type
Comparative statements	Change in each item between two or more periods	Horizontal
Common-size statements	Each item as a percentage of a common total	Vertical
Trend analysis	Direction of change over several years from a base year	Horizontal
Fund flow statement	Sources and uses of working capital	Dynamic

- **Horizontal (dynamic):** compares the same item over several years.
- **Vertical (static):** relates items of the same year.
- **External:** by outsiders from published statements.
- **Internal:** by management.

2 Fund Flow Statement

➤ Concept of Fund and Flow

- **Fund** = working capital = current assets − current liabilities.
- **Flow of funds:** a transaction changes working capital; happens only when it affects one current and one non-current item.
- **Fund flow statement:** sources and applications of funds; explains change in working capital between two balance sheet dates.

Accounts affected	Example	Flow of funds?
Current and current	Cash collected from debtors; creditors paid in cash	No
Non-current and non-current	Machinery bought by issue of shares; bonus shares; depreciation	No
Current and non-current	Issue of shares for cash; purchase of machinery for cash; long-term loan received	Yes

Sources of funds	Applications of funds
Funds from operations	Loss from operations
Issue of shares or debentures; long-term loans	Purchase of fixed assets and long-term investments
Sale of fixed assets and long-term investments	Redemption of shares or debentures; payment of dividend

➤ Schedule of Changes in Working Capital

Change	Effect on working capital
Increase in current asset	Increases
Decrease in current liability	Increases
Decrease in current asset	Decreases
Increase in current liability	Decreases

➤ Funds from Operations

- **Funds from operations:** working capital generated by trading operations.
- It differs from net profit: the profit and loss account contains non-fund items (depreciation, amortisation) and non-operating items (profit or loss on sale of fixed assets and investments).
- **Add** to net profit: transfer to reserves, dividend appropriated, provision for tax (if non-current), depreciation, amortisation, loss on sale of fixed assets.
- **Deduct:** profit on sale of fixed assets and other non-operating gains.
- **Example:** net profit ₹80,000 + depreciation ₹20,000 + goodwill written off ₹10,000 − profit on sale of machinery ₹5,000 = ₹1,05,000.
- Depreciation is not a source of funds; it is added back only because it reduced profit without reducing working capital.

➤ Fund Flow versus Cash Flow Statement

Basis	Fund flow statement	Cash flow statement
Meaning of fund	Working capital	Cash and cash equivalents
Basis	Accrual	Cash
Legal status	Not required by any Accounting Standard	Required by AS-3 / Ind AS 7 and Section 2(40)
Use	Long-term financial planning	Short-term cash planning and liquidity

- **Limitations of fund flow statement:** rearranges data already in the balance sheets; replaced in published accounts by the cash flow statement.

3 Comparative Statements (Horizontal Analysis)

Part V · Analysis of Financial Statements

➤ Meaning and Formulae

- **Comparative statements:** figures of two or more periods side by side, with absolute and percentage change.
- **Absolute change** = current year figure − previous year figure
- **Percentage change** = absolute change ÷ previous year figure × 100 (previous year is always the denominator).

➤ Illustration: Comparative Statement of Profit and Loss, Mehta Ltd

Particulars	2024-25 (₹)	2025-26 (₹)	Change (%)
Revenue from operations	20,00,000	25,00,000	25.00
Cost of revenue	12,00,000	16,00,000	33.33
Gross profit	8,00,000	9,00,000	12.50
Profit after tax	3,15,000	3,85,000	22.22

- Revenue rose 25%, cost of revenue 33.33%, so gross profit grew only 12.5%.
- Percentage change of a total is not the sum of the percentage changes of its items.

4 Common-size Statements and Trend Analysis

Part V · Analysis of Financial Statements

➤ Common-size Statements (Vertical Analysis)

- Each item is a percentage of a common base of the same year; base = 100.
- **Statement of profit and loss:** base is revenue from operations.
- **Balance sheet:** base is total assets (equal to total equity and liabilities).
- **Common-size %** = item ÷ base × 100
- **Example:** cost of revenue rose from 60% to 64% of revenue, so profit after tax per ₹100 of revenue fell from ₹15.75 to ₹15.40, though profit after tax rose by 22.22%.
- Comparative answers "how much has it changed?"; common-size answers "what proportion does it form?"

➤ Trend Analysis

- Studies movement of an item over several years.

- One year is the base year (figure = 100); the base year should be a normal year.
- **Trend percentage** = (Figure of current year ÷ Figure of base year) × 100

Year	Revenue (₹)	Trend %	Net profit (₹)	Trend %
2021-22 (base)	40,00,000	100	4,00,000	100
2024-25	46,00,000	115	3,80,000	95
2025-26	60,00,000	150	6,40,000	160

➤ Comparison of the Three Techniques

Basis	Comparative	Common-size	Trend
Type	Horizontal	Vertical	Horizontal
Periods	Usually two years	One year	Several years
Base	Previous year figure of each item	Revenue or total assets of the same year	Base-year figure = 100

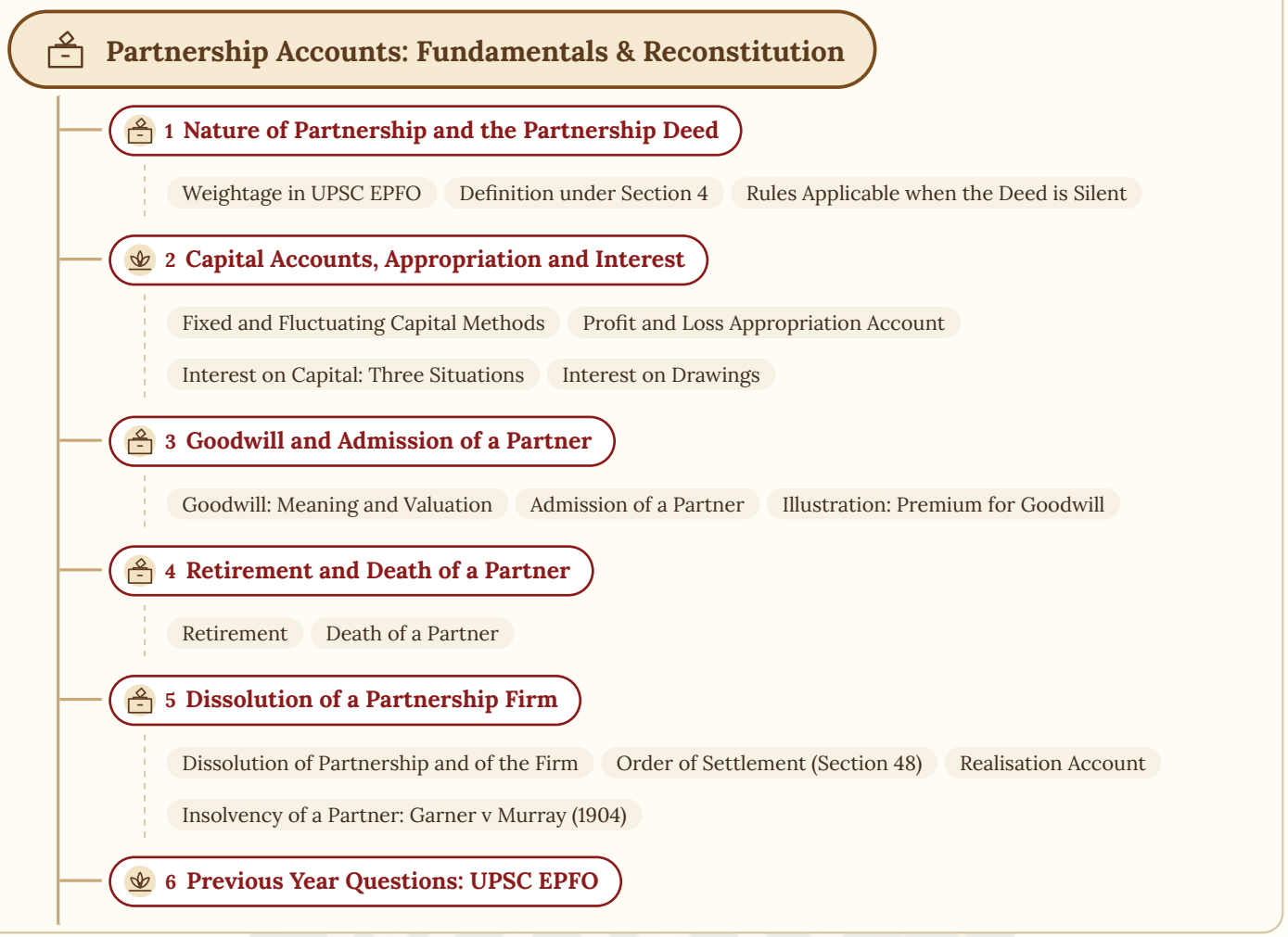
➤ Common Errors

- Using the current year as denominator in percentage change.
- Taking total liabilities (excluding equity) as base of a common-size balance sheet.
- Choosing an abnormal year as base year.

CHAPTER 31

Partnership Accounts: Fundamentals & Reconstitution

CHAPTER AT A GLANCE



1 Nature of Partnership and the Partnership Deed

Part VI · Partnership and Special Accounts

➤ Weightage in UPSC EPFO

Only EO/AO question (2017): default sharing of profits and losses (Section 13).

➤ Definition under Section 4

- **Partnership** (Section 4, Indian Partnership Act, 1932): "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."
- Partners are collectively a **firm**.

Essential feature	Explanation
Two or more persons	Minimum 2; maximum 50 (Rule 10, Companies (Miscellaneous) Rules, 2014)
Mutual agency	Each partner is principal and agent (Section 18)

Essential feature	Explanation
Unlimited liability	Jointly and severally liable (Section 25)

- Sharing of profits alone does not prove partnership; the decisive test is mutual agency.
- Registration is optional.

➤ Rules Applicable when the Deed is Silent

Matter	Rule	Section
Sharing of profits and losses	Equally, irrespective of capital contributed	13(b)
Interest on capital	Not allowed; if agreed, payable only out of profits	13(c)
Salary to a partner	Not allowed	13(a)
Interest on a partner's loan or advance	6% per annum	13(d)

- **Recall aid: Equal, Nil, Six:** profits equal; no interest on capital, drawings or salary; 6% on loans.

2 Capital Accounts, Appropriation and Interest

➤ Fixed and Fluctuating Capital Methods

Basis	Fixed capital method	Fluctuating capital method
Accounts per partner	Two: Capital and Current	One: Capital only
When used	Only if the deed so provides	Normal when nothing is stated

➤ Profit and Loss Appropriation Account

- Extension of the Profit and Loss Account; starts with net profit and shows its distribution.
- **Debited:** interest on capital, salary, share of profit.
- **Credited:** interest on drawings.
- **Charges against profit** (debited to Profit and Loss Account, not Appropriation): interest on a partner's loan, payable even in a loss.

➤ Interest on Capital: Three Situations

Provision in the deed	Treatment
Deed silent	No interest (Section 13(c))
Allowed as a charge	Allowed in full even in a loss
Allowed, nothing said about charge	An appropriation: no interest in a loss; if profit is less than the interest, profit is divided in the ratio of interest

- **Commission of 10% on profit after charging it** = profit before commission × 10/110.

➤ Interest on Drawings

- Charged only if the deed provides for it.
- If dates are unknown, charge six months on the total.

- Equal monthly drawings, average period: 6.5 months at the beginning, 6 in the middle, 5.5 at the end.

3 Goodwill and Admission of a Partner

Part VI · Partnership and Special Accounts

➤ Goodwill: Meaning and Valuation

- **Goodwill:** value of the reputation of a business that enables it to earn more than the normal profit of similar firms.
- **AS-26:** only purchased goodwill is recorded.

Method	Formula
Average profit	Average profit × years' purchase
Super profit	(Average profit − Normal profit) × years' purchase
Capitalisation of average profit	(Average profit × 100 ÷ Normal rate) − Capital employed
Capitalisation of super profit	Super profit × 100 ÷ Normal rate

- **Normal profit** = Capital employed × Normal rate of return
- **Hidden goodwill** = implied total capital − actual total capital

➤ Admission of a Partner

- New partner admitted only with consent of all existing partners (Section 31).
- **Sacrificing ratio** = Old share − New share.
- **Goodwill:** shared in the sacrificing ratio.
- **Revaluation and reserves:** shared in the old ratio.
- AS-26 does not allow goodwill to be raised merely because a partner is admitted; the premium goes through capital accounts.
- **Revaluation Account:** records changes in asset and liability values so that gains and losses before admission belong to the old partners alone.

➤ Illustration: Premium for Goodwill

P and Q share 3:1; R gets 1/5; goodwill ₹2,00,000, so R's premium = ₹40,000.

R's premium for goodwill ₹40,000 brought in cash

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Bank A/c	Dr.	40,000		Asset (Bank) ↑ → Debit
	To Premium for Goodwill A/c			40,000	Equity (premium) ↑ → Credit
	Premium for Goodwill A/c	Dr.	40,000		Equity (premium) ↓ → Debit
	To P's Capital A/c			30,000	Equity (Capital) ↑ → Credit
	To Q's Capital A/c			10,000	Equity (Capital) ↑ → Credit (sacrificing ratio 3:1)

4 Retirement and Death of a Partner

Part VI · Partnership and Special Accounts

➤ Retirement

- Remaining partners acquire the retiring partner's share.

- **Gaining ratio** = New share − Old share; gainers compensate the retiring partner for goodwill in this ratio.
- Revaluation profit or loss and reserves: shared by all partners in the old ratio.
- **Example:** B retires; A and C gain 1/6 each; B's goodwill ₹60,000 is borne ₹30,000 each.

Goodwill of retiring partner B (gaining ratio 1:1)

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	A's Capital A/c	**Dr.**	30,000		Equity (Capital) ↓ → Debit (gainer pays)
	C's Capital A/c	**Dr.**	30,000		Equity (Capital) ↓ → Debit
	To B's Capital A/c			60,000	Equity (Capital) ↑ → Credit

➤ Death of a Partner

- Treated like retirement; amount is paid to the legal representatives.
- Capital account is credited with capital, goodwill, reserves, revaluation profit and profit up to death.
- **Joint life policy** on all partners: shared in the old ratio.

5 Dissolution of a Partnership Firm

Part VI · Partnership and Special Accounts

➤ Dissolution of Partnership and of the Firm

- **Dissolution of partnership:** firm continues.
- **Dissolution of the firm** (Section 39): ends the relation between all partners.

➤ Order of Settlement (Section 48)

- **Losses** (including deficiencies of capital): first out of profits, next out of capital, lastly by partners in their profit-sharing ratio.
- **Assets are applied:**
  - (i) to pay debts to third parties
  - (ii) to pay each partner rateably his advances (loans)
  - (iii) to pay each partner rateably his capital
  - (iv) the residue, in the profit-sharing ratio

➤ Realisation Account

- Assets (except cash, bank and fictitious assets) are transferred to it at book value.
- Outside liabilities are transferred to its credit.
- Partner's loan is repaid directly, not through it.
- Realisation profit or loss is shared in the profit-sharing ratio.

➤ Insolvency of a Partner: Garner v Murray (1904)

- Deficiency is borne by solvent partners in the ratio of their capitals before dissolution, not the profit-sharing ratio.
- A partner whose capital is already in debit bears no part.

6 Previous Year Questions: UPSC EPFO

Part VI · Partnership and Special Accounts

1. In the absence of any provision in the partnership agreement, profits and losses are shared: EO/AO 2017

(a) in the capital ratio
(b) equally
(c) in the ratio of loans given by partners
(d) in the ratio of initial capital

Answer: (b) equally — Section 13(b): partners share profits and losses equally whatever their capital, unless the agreement says otherwise.

CHAPTER 32

Consignment and Joint Venture Accounts

CHAPTER AT A GLANCE

- Consignment and Joint Venture Accounts
  - 1 Meaning of Consignment
    - Weightage in UPSC EPFO
    - Consignor and Consignee
    - Proforma Invoice and Account Sales
    - Commission to the Consignee
  - 2 Accounting Entries for Consignment
    - Accounts Maintained
    - Illustration: R of Delhi and S of Mumbai
  - 3 Normal and Abnormal Loss; Valuation of Unsold Stock
    - Normal Loss and Abnormal Loss
    - Valuation of Unsold Stock
    - Goods Sent at Invoice Price
  - 4 Joint Venture Accounts
    - Meaning and Features
    - Methods of Keeping Accounts
    - Illustration (Separate Books)
  - 5 Previous Year Questions: UPSC EPFO

1 Meaning of Consignment

Part VI · Partnership and Special Accounts

➤ Weightage in UPSC EPFO

EO/AO 2017 asked two questions: account credited with abnormal loss on consignment; account debited with purchases for a joint venture.

➤ Consignor and Consignee

- **Consignment:** sending goods by their owner to an agent for sale on the owner's behalf and at the owner's risk.
- **Consignor:** the owner. **Consignee:** the agent.
- Ownership stays with the consignor until the goods are sold; sending goods on consignment is not a sale.

Basis	Consignment	Sale
Ownership	Remains with consignor until sale to a third party	Passes to the buyer at once
Relation	Principal and agent	Seller and buyer

➤ Proforma Invoice and Account Sales

- **Proforma invoice:** sent by consignor with the goods, giving quantity, quality and price; creates no debt; not entered in the books.
- **Account sales:** periodical statement from consignee to consignor showing goods sold, expenses, commission and net balance.

➤ Commission to the Consignee

Type	Meaning	Basis
Ordinary	Remuneration for selling the goods	Percentage of gross sales
Del credere	Additional commission for guaranteeing collection of credit sales; the consignee bears bad debts	Normally on total sales (cash and credit)
Over-riding	Extra commission for selling above invoice price or pushing a new product	Sales or the excess over a specified price

- **With del credere:** credit sales are treated as cash sales for the consignor; bad debts do not appear in the Consignment Account.
- **Without it:** bad debts are debited to the Consignment Account.

2 Accounting Entries for Consignment

➤ Accounts Maintained

- **Consignor:** Consignment Account (nominal; shows profit or loss on each consignment) and personal account of the consignee.
- **Consignee:** only a personal account of the consignor.
- **Goods Sent on Consignment Account:** closed by transfer to the Purchases Account (or credited to the Trading Account).

➤ Illustration: R of Delhi and S of Mumbai

- 500 radios consigned, costing ₹2,000 each.
- Freight and insurance paid by R: ₹20,000.
- 20 radios destroyed in transit; insurer admits ₹30,000.
- S sells 400 radios at ₹2,800.
- Commission: 5% ordinary plus 1% del credere.

Illustration: Consignment to S (books of R, the consignor)

Date	Particulars		Dr. ₹	Cr. ₹	DEALER Logic
	Consignment to Mumbai A/c	**Dr.**	10,00,000		Asset-type account (goods with agent) ↑ → Debit
	To Goods Sent on Consignment A/c *(Being 500 radios sent on consignment)*			10,00,000	Revenue-type account ↑ → Credit
	Consignment to Mumbai A/c	**Dr.**	20,000		Expense (freight, insurance) ↑ → Debit
	To Bank A/c *(Being freight and insurance paid)*			20,000	Asset (Bank) ↓ → Credit
	S's A/c	**Dr.**	11,20,000		Asset (amount due from S) ↑ → Debit
	To Consignment to Mumbai A/c *(Being 400 radios sold at 2,800)*			11,20,000	Revenue (sales) ↑ → Credit
	Abnormal Loss A/c	**Dr.**	40,800		Loss ↑ → Debit
	To Consignment to Mumbai A/c *(Being abnormal loss, 20 × (2,000 + 40))*			40,800	Expense/asset-type account ↓ → Credit

- **Unsold stock:** 80 radios at ₹2,060 each = ₹1,64,800.
- **Profit** = 11,20,000 − 8,24,000 (400 × 2,060) − 6,000 − 4,000 − 67,200 = ₹2,18,800.

3 Normal and Abnormal Loss; Valuation of Unsold Stock

Part VI · Partnership and Special Accounts

➤ Normal Loss and Abnormal Loss

Basis	Normal loss	Abnormal loss
Meaning	Unavoidable loss inherent in the nature of goods or handling	Avoidable loss caused by accident or carelessness
Examples	Evaporation, leakage, drying, wastage	Fire, theft, flood, accident in transit
Treatment	No separate entry; absorbed in the cost of remaining goods	Credited to the Consignment Account; then transferred to Profit and Loss after setting off any insurance claim

- **Example:** 1,000 units at ₹200, freight ₹10,000; 100 units stolen; insurer pays ₹15,000.
- Abnormal loss = 100 × 210 = ₹21,000; net loss to Profit and Loss = ₹6,000.

➤ Valuation of Unsold Stock

- **Valued at** cost or net realisable value, whichever is lower.
- **Cost includes:** cost of goods; all consignor's expenses (packing, freight, transit insurance, duty); consignee's non-recurring expenses up to the godown (unloading, cartage, octroi).

Included in stock value	Excluded from stock value
Cost of goods	Godown rent, insurance after arrival at godown
Consignor's expenses: packing, freight, carriage, transit insurance, duty	Selling expenses: advertisement, salesmen's salary, delivery charges
Consignee's non-recurring expenses: unloading, cartage to godown, octroi	Commission, bad debts, discount

➤ Goods Sent at Invoice Price

- Goods may be invoiced above cost so the consignee does not learn the cost; the excess is **loading**.
- **Removing loading:** debit Goods Sent on Consignment A/c, credit Consignment A/c.
- **Loading on unsold stock:** debit Consignment A/c, credit Stock Reserve A/c.
- **Example:** invoicing at cost + 25% means loading is 20% of invoice price (25/125).

4 Joint Venture Accounts

Part VI · Partnership and Special Accounts

➤ Meaning and Features

- **Joint venture:** temporary agreement between two or more persons (co-venturers) to carry out a specific business.
- Profit or loss shared in an agreed ratio (equally if nothing is agreed).
- Ends when the venture is completed; needs no firm name.

Basis	Joint venture	Partnership	Consignment
Nature	Temporary, one venture	Continuing business	Continuing agency
Relation	Co-venturers	Partners, mutual agents	Principal and agent

➤ Methods of Keeping Accounts

Method	Accounts opened	Profit found in
1. Separate set of books	Joint Bank A/c, Joint Venture A/c, venturers' personal accounts	Joint Venture A/c
2. Each venturer records all transactions	Joint Venture A/c and personal account of each other venturer	Joint Venture A/c in each set
3. Each venturer records only his own transactions	"Joint Venture with ... A/c" in each set	Memorandum Joint Venture A/c

- Purchases for the venture are never debited to the ordinary Purchases Account; they are debited to the Joint Venture A/c.
- **Method 3:** a **Memorandum Joint Venture Account**, outside the double-entry books, combines all transactions to find total profit.

➤ Illustration (Separate Books)

Item	₹
M and N share 3:2; contribute	1,50,000 and 90,000
Goods purchased	2,00,000

Item	₹
Freight	12,000
Selling expenses	8,000
Sales	2,90,000
Unsold goods taken over by M	15,000
Profit = 2,90,000 + 15,000 − 2,20,000	85,000
Share: M (3/5); N (2/5)	51,000; 34,000

5 Previous Year Questions: UPSC EPFO

Part VI · Partnership and Special Accounts

1. Abnormal loss on consignment is credited to: EO/AO 2017

(a) Profit and Loss Account
(b) Consignee's Account
(c) Consignment Account
(d) Income and Expenditure Account

Answer: (c) Consignment Account — Abnormal Loss A/c Dr To Consignment A/c removes the accidental loss, so the consignment shows its normal result.

2. When goods are purchased for the Joint Venture, the amount is debited to: EO/AO 2017

(a) Purchase Account
(b) Joint Venture Account
(c) Venturer's Capital Account
(d) Profit and Loss Account

Answer: (b) Joint Venture Account — All venture costs are collected in the Joint Venture Account to find its separate profit; ordinary Purchases is not used.

CHAPTER 33

Branch and Departmental Accounting

CHAPTER AT A GLANCE



1 Meaning and Kinds of Branches

Part VI · Partnership and Special Accounts

Weightage in UPSC EPFO: 2 questions (EO/AO 2017) — the nature of the Branch Account under the debtors system and the basis for apportioning electric power among departments.

➤ 33.1 Meaning and Kinds of Branches

A **branch** is a unit of a business located away from the head office (HO) that carries on the same business under the control of the HO. **Branch accounting** is the system by which the HO ascertains the profit or loss of each branch separately.

Kind of branch	Features	Accounting method
Dependent branch	Goods supplied by HO; expenses paid by HO; cash remitted to HO; no complete set of books at the branch	Debtors system; stock and debtors system; final accounts system
Independent branch	Buys and sells on its own; keeps a full set of books under double entry	Branch and HO keep reciprocal accounts
Foreign branch	Situated outside India; keeps books in foreign currency	Translation under AS-11 / Ind AS 21

2 Debtors System

Part VI · Partnership and Special Accounts

➤ 33.2 Debtors System

Under the debtors system, used for small dependent branches, the HO opens one **Branch Account** for each branch. It is debited with everything the HO gives to the branch and credited with everything the HO receives from it. The balancing figure is the branch profit or loss.

- It is prepared in the books of the HO only; its purpose is to find the profit or loss of the branch. For this reason it is classified as a **nominal account** (official answer, EO/AO 2017).

Debit side	Credit side
Opening branch assets: stock, debtors, petty cash, prepaid expenses, fixed assets	Opening branch liabilities: outstanding expenses, creditors
Goods and cash sent to branch; closing branch liabilities	Cash remitted by branch; goods returned; closing branch assets
Balancing figure: profit	Balancing figure: loss

Illustration: opening debtors ₹25,000; cash sales ₹90,000; credit sales ₹1,20,000; collected ₹1,10,000; discount ₹2,000; bad debts ₹1,000. Closing debtors = 25,000 + 1,20,000 − 1,10,000 − 2,000 − 1,000 = ₹32,000; cash remitted = 90,000 + 1,10,000 = ₹2,00,000.

➤ Goods Sent at Invoice Price

HO often sends goods at a fixed invoice price (cost plus a percentage). The Branch Account is then prepared at invoice price and the **loading** is removed through extra entries. Loading = mark-up ÷ (100 + mark-up) of invoice price.

Stock reserve on closing stock (cost plus 25%)

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Branch A/c **Dr.** *(Being stock reserve created)*	7,000		Asset (Branch) ↑ → Debit
	To Stock Reserve A/c		7,000	Liability (Reserve) ↑ → Credit

3 Stock and Debtors System

Part VI · Partnership and Special Accounts

➤ 33.3 Stock and Debtors System

For larger dependent branches the HO wants closer control over stock. Under the **stock and debtors system**, goods are invoiced at selling price and several accounts are kept for each branch, so that any shortage or surplus of stock is revealed.

Account	Purpose
Branch Stock A/c (at invoice price)	Shows goods sent, sales and closing stock; the balancing figure is shortage or surplus
Branch Debtors A/c	Records credit sales, collections, discounts and bad debts
Branch Adjustment A/c	Collects loading; its balance is the gross profit of the branch
Branch Profit and Loss A/c	Gross profit less expenses and cost of shortage = net profit

Shortage = opening stock + goods sent − sales − closing stock (all at invoice price).

4 Independent and Foreign Branches

Part VI · Partnership and Special Accounts

➤ 33.4 Independent and Foreign Branches

An independent branch keeps a complete set of books. The HO maintains a **Branch Account** and the branch maintains a **Head Office Account**. These are reciprocal personal accounts: their balances should be equal and opposite.

Before combining, the balances are reconciled for goods and cash in transit; at the year end the branch trial balance is incorporated in the HO books and the reciprocal balances cancel out.

➤ Foreign Branches (AS-11)

Under AS-11: monetary items (cash, debtors, creditors) are translated at the closing rate in both cases; fixed assets at cost at the historical rate (integral) or closing rate (non-integral); income and expenses at the transaction-date rate (average acceptable). Exchange difference goes to Profit and Loss Account (integral) or Foreign Currency Translation Reserve (non-integral).

An **integral foreign operation** works as an extension of the Indian business. Ind AS 21 uses the concept of functional currency for the same purpose.

5 Departmental Accounting

Part VI · Partnership and Special Accounts

➤ 33.5 Departmental Accounting

A **department** is a section of a business dealing in a particular line of goods. Departmental accounts show the trading result and net profit of each department, usually in a columnar Trading and Profit and Loss Account. They help to compare departments and decide whether to expand or close one.

Expenses of one department are charged to it directly; common expenses are apportioned on the benefit each department receives.

Expense	Basis of apportionment
Rent, rates, taxes; repairs and insurance of building	Floor area occupied
Electric power	Horsepower of motors × machine hours
Canteen, welfare, ESI and PF	Number of employees (or wages)
Depreciation and repairs of plant	Value of plant and machinery
Advertisement, selling expenses, discount allowed, bad debts	Sales (bad debts: credit sales)
Carriage inwards, discount received	Purchases

Electric power: bill ₹45,000; A: 10 HP × 300 hours = 3,000; B: 4 HP × 500 = 2,000; C: 8 HP × 500 = 4,000. Ratio 3:2:4 → A ₹15,000, B ₹10,000, C ₹20,000.

➤ Inter-departmental Transfers

Goods transferred from one department to another are credited to the transferring department and debited to the receiving department,. When a transfer price includes profit, the profit in the receiving department's closing stock is **unrealised** and a stock reserve is created.

X transfers goods to Y at cost plus 25%; Y's closing stock includes ₹20,000 of them. Unrealised profit = 20,000 × 25/125 = ₹4,000.

Unrealised profit in inter-departmental stock

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Profit and Loss A/c (or Department X) **Dr.** *(Being stock reserve created for unrealised profit)*	4,000		Expense/Loss ↑ → Debit
	To Stock Reserve A/c		4,000	Liability (Reserve) ↑ → Credit

6 Previous Year Questions: UPSC EPFO

Part VI · Partnership and Special Accounts

1. Branch Account under Debtors System is a: EO/AO 2017

(a) Real Account (b) Personal Account
(c) Nominal Account (d) Liability Account

Answer: (c) Nominal Account (official key) — Its balancing figure is the branch profit or loss, so it works as a nominal account; some books call it personal, but the key says Nominal.

2. The cost of electric power is apportioned over the departments according to: EO/AO 2017

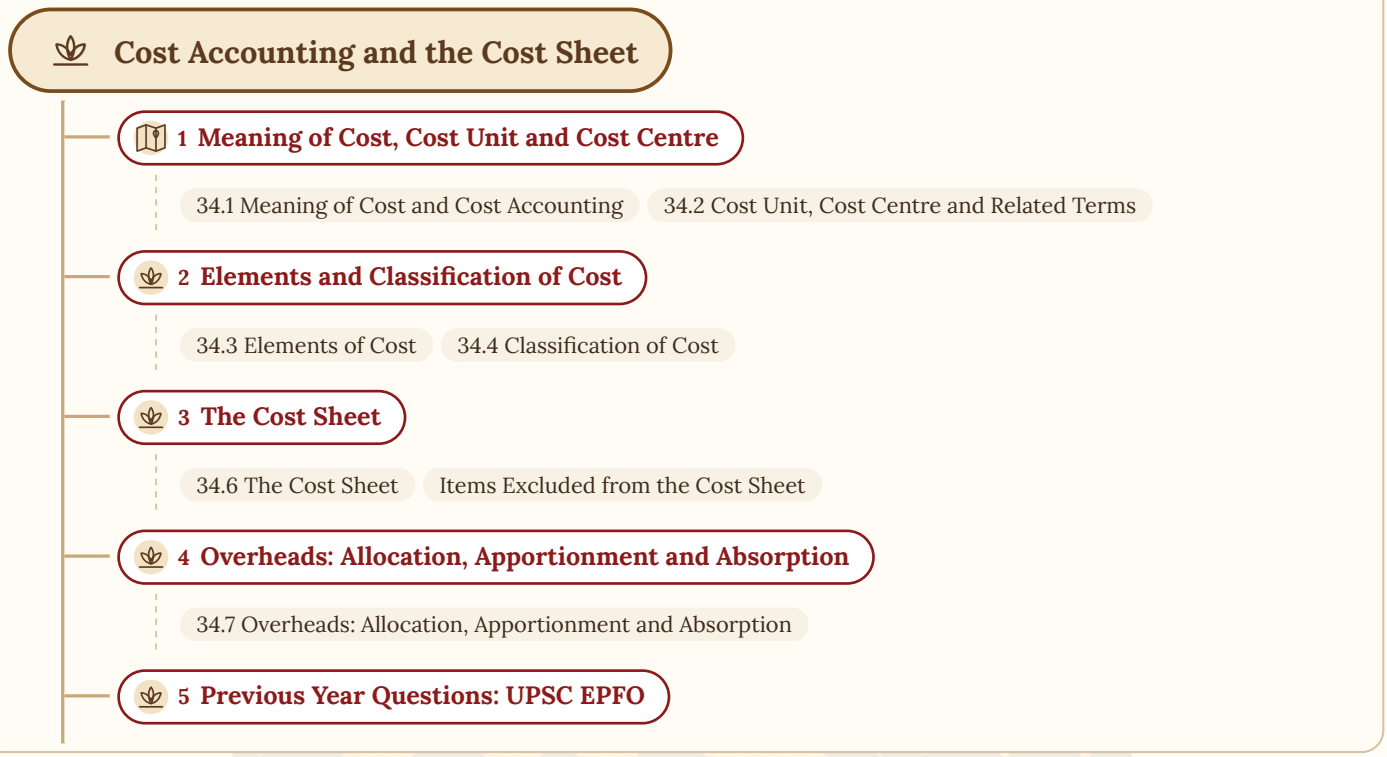
(a) horsepower of motors
(b) number of light points (c) horsepower × machine hours
(d) machine hours

Answer: (c) horsepower × machine hours — Power used depends on motor capacity and running time; light points are the basis for lighting.

CHAPTER 34

Cost Accounting and the Cost Sheet

CHAPTER AT A GLANCE



1 Meaning of Cost, Cost Unit and Cost Centre

Part VII · Costing, Insurance and Auditing

Weightage in UPSC EPFO: 1 question (APFC 2015) on the total factory overhead rate per labour hour; EO/AO 2017 on apportioning electric power is covered in Chapter 33. Overhead absorption is the tested area.

➤ 34.1 Meaning of Cost and Cost Accounting

Cost accounting collects, classifies and assigns costs to products, jobs, processes and departments. The definitions below are those of CIMA, London.

Term	Meaning (in substance, CIMA)
Cost	The amount of expenditure (actual or notional) incurred on, or attributable to, a specified thing or activity.
Costing	The technique and process of ascertaining costs.
Cost accounting	The process of accounting for cost from the point at which expenditure is incurred to the establishment of its relationship with cost centres and cost units.

Its three purposes are **ascertainment**, **control** and **decision-making**.

Financial accounting is compulsory for companies (Companies Act, 2013); cost accounting is voluntary, except cost records prescribed under Sec 148 of the Companies Act, 2013.

➤ 34.2 Cost Unit, Cost Centre and Related Terms

A **cost unit** is a unit of product, service or time in relation to which costs are ascertained or expressed – a car, or a composite unit such as passenger-kilometre. A **cost centre** is a location, person or item of equipment (or a group of these) for which costs are ascertained and used for cost control. Costs are first collected by cost centres and then charged to cost units.

Key Terms

Profit centre	A segment responsible for both revenue and cost, hence for profit
Investment centre	A segment responsible for profit and for the capital invested in it – judged by return on investment
Responsibility centre	Any unit headed by a manager answerable for its performance

2 Elements and Classification of Cost

Part VII · Costing, Insurance and Auditing

➤ 34.3 Elements of Cost

Total cost is made up of three elements – **material, labour and expenses**. Each is either direct (traceable to a cost unit economically) or indirect. All indirect costs taken together are called **overheads**.

Element	Direct (part of prime cost)	Indirect (part of overheads)
Material	Raw material that becomes part of the product	Lubricating oil, small tools, stores and spares
Labour	Wages of workers working directly on the product	Wages of supervisors, store-keepers; idle time wages
Expenses	Royalty based on production	Factory rent, power, office rent, carriage outward

Freight (carriage) **inward** is part of direct material cost; freight (carriage) **outward** is part of selling and distribution overheads.

➤ 34.4 Classification of Cost

Cost is classified by nature (material, labour, expenses), function (production, administration, selling, distribution), traceability (direct, indirect), behaviour (fixed, variable, semi-variable), normality (abnormal cost – strike, fire, theft – is kept out of product cost) and decision-making use.

Fixed cost stays the same in total within a relevant range of output, so fixed cost per unit falls as output rises – rent, salaries. **Variable cost** changes in total in direct proportion to output, so per unit it stays constant – direct material. **Semi-variable cost** has a fixed and a variable part – telephone.

High-low method: cost ₹45,000 at 10,000 units, ₹60,000 at 15,000 units. Variable rate = 15,000 ÷ 5,000 = ₹3; fixed part = 45,000 − 30,000 = ₹15,000.

Cost	Meaning
Marginal cost	Cost of one more unit; in practice the variable cost per unit

Cost	Meaning
Differential cost	Difference in total cost between two alternatives
Opportunity cost	Benefit given up by choosing one alternative over the next best; not recorded in the books
Sunk cost	A past cost that cannot be recovered; irrelevant for future decisions
Imputed (notional) cost	A hypothetical cost with no cash outlay – rent of own building

Joint cost is the cost of a single process that yields two or more products. **Common cost** is the cost of a facility shared by several products or departments.

3 The Cost Sheet

Part VII · Costing, Insurance and Auditing

➤ 34.6 The Cost Sheet

A **cost sheet** shows the elements of cost of a product for a period, built up stage by stage.

Stage	How it is obtained
Prime cost	Direct materials consumed + Direct labour + Direct expenses
Works (factory) cost	Prime cost + Factory overheads + Opening WIP – Closing WIP – Sale of scrap
Cost of production	Works cost + Office and administration overheads
Cost of goods sold	Cost of production + Opening – Closing stock of finished goods
Cost of sales (total cost)	Cost of goods sold + Selling and distribution overheads
Sales	Cost of sales + Profit

Prime cost is also called first cost; works cost is factory cost; cost of sales is total cost.

➤ Items Excluded from the Cost Sheet

- **Purely financial charges:** loss on sale of fixed assets, interest on loans, preliminary expenses, fines and penalties.
- **Appropriations of profit:** income tax, dividends paid, transfers to reserves.
- **Abnormal items:** loss by fire or theft, abnormal idle time due to strike.

Illustration: cost of sales ₹6,50,000. Profit 20% on sales = 25% on cost (6,50,000 × 20/80 = ₹1,62,500), so sales = ₹8,12,500.

4 Overheads: Allocation, Apportionment and Absorption

Part VII · Costing, Insurance and Auditing

➤ 34.7 Overheads: Allocation, Apportionment and Absorption

Overheads are the aggregate of indirect material, indirect labour and indirect expenses. Bases of apportionment: rent – floor area; electric power – horsepower × machine hours (EO/AO 2017); plant depreciation – capital value of plant; canteen – number of workers.

Allocation charges a whole item to one cost centre; **apportionment** shares a common item on a fair basis; **re-apportionment** transfers service-department costs to production departments; **absorption** charges production-centre overheads to units through a rate.

Method	Formula
Percentage of direct material cost	Overheads ÷ Direct material cost × 100
Direct labour hour rate	Overheads ÷ Direct labour hours
Machine hour rate	Overheads ÷ Machine hours

Pre-determined overhead rate = Budgeted overheads ÷ Budgeted base. Total overhead rate = Fixed overhead rate + Variable overhead rate, where fixed rate = budgeted fixed overheads ÷ normal hours (the APFC 2015 pattern). Example: ₹3,60,000 ÷ 15,000 hours = ₹24; variable ₹16; total ₹40 per hour.

Under-absorption: absorbed < actual. **Over-absorption:** absorbed > actual. Example: rate ₹12 × actual 38,000 hours = ₹4,56,000 absorbed; actual overheads ₹4,70,000, so ₹14,000 is under-absorbed.

A small amount is written off to the Costing Profit and Loss Account; a large amount by a supplementary rate.

5 Previous Year Questions: UPSC EPFO

Part VII · Costing, Insurance and Auditing

1. The budgeted monthly fixed cost of a factory is ₹2,20,000 and the normal monthly output is 12,000 standard labour hours. The standard variable overhead rate is ₹25 per hour. What is the total factory overhead rate per hour? APFC 2015

(a) ₹40.33 (b) ₹41.67
(c) ₹42.67 (d) ₹43.33

Answer: (d) ₹43.33 — Fixed rate = 2,20,000 ÷ 12,000 = ₹18.33; add the variable rate of ₹25 per hour in full to get ₹43.33.

2. Cost of electric power is apportioned over the various departments according to: EO/AO 2017

(a) horsepower of motors
(b) number of light points (c) horsepower of motors × machine hours
(d) machine hours

Answer: (c) horsepower of motors × machine hours — Power consumed depends on both motor size and running time; light points are the basis for lighting.

CHAPTER 35

Insurance Claims and Principles of Insurance

CHAPTER AT A GLANCE

Insurance Claims and Principles of Insurance
- 1 Meaning and Principles of Insurance
  - 35.1 Meaning of Insurance
  - 35.2 Principles of Insurance
- 2 Types of Insurance: Private and Social
  - 35.3 Types of Insurance
- 3 Claim for Loss of Stock
  - 35.4 Claim for Loss of Stock
- 4 Claim for Loss of Profit
  - 35.5 Claim for Loss of Profit (Consequential Loss Policy)
  - Sum Insurable under a Loss of Profit Policy
- 5 Previous Year Questions: UPSC EPFO

1 Meaning and Principles of Insurance

Part VII · Costing, Insurance and Auditing

Weightage in UPSC EPFO: 6 questions (APFC 2015, EO/AO 2017, APFC 2023, 2025) — principles of insurance 4, claims 2: private vs social insurance, sum insurable under a loss of profit policy, subrogation, mitigation, life insurance as not indemnity, and insurance claim as capital receipt.

➤ 35.1 Meaning of Insurance

Insurance is a contract by which one party (the insurer) undertakes, in return for a consideration called the **premium**, to pay the other party (the insured) a sum of money on a specified event or to make good a loss caused by a specified risk. The document containing the contract is the **policy**.

It works on pooling of risk: the losses of the few are met from the premiums of the many. The regulator is IRDAI (IRDA Act, 1999).

➤ 35.2 Principles of Insurance

1. Utmost Good Faith (Uberrimae Fidei): both parties must disclose all **material facts** fully, even without being asked. Non-disclosure makes the contract voidable at the option of the aggrieved party. Under Section 45, Insurance Act, 1938 (as amended in 2015), a life policy cannot be called in question after three years from the date of the policy, revival or rider.

2. Insurable Interest: the insured must stand to suffer a financial loss if the subject-matter is damaged or lost. Without it, the contract is a wager and is void. In life insurance it must exist at the time of the policy; in fire insurance at the time of contract and of loss; in marine insurance at the time of loss.

3. Indemnity: the insurer compensates the insured for the **actual loss** suffered, up to the sum insured; the insured must not make a profit out of a loss. It applies to all general insurance. Stock worth ₹8,00,000 insured for ₹10,00,000 and wholly destroyed gives a claim of ₹8,00,000.

Life insurance is not a contract of indemnity: human life cannot be valued in money, so a fixed sum assured is paid. Personal accident policies are also not indemnity contracts (PYQ 2025).

4. Contribution: where the same risk is insured with two or more insurers (double insurance), the insured recovers only the actual loss and the insurers share it rateably. It is a corollary of indemnity and does not apply to life insurance.

5. Subrogation: after paying the claim, the insurer steps into the shoes of the insured and acquires the insured's rights against the third party responsible for the loss. It is a corollary of indemnity; the recovery is limited to the amount paid, and it does not apply to life insurance.

6. Proximate Cause (Causa Proxima): the insurer is liable only if the loss is caused by an insured peril that is the proximate (nearest, dominant and effective) cause of the loss.

7. Mitigation of Loss: the insured must take all reasonable steps to minimise the loss, as a prudent uninsured person would (PYQ 2025).

2 Types of Insurance: Private and Social

Part VII · Costing, Insurance and Auditing

➤ 35.3 Types of Insurance

Private insurance is bought voluntarily under a contract. **Social insurance** is a scheme created by law, usually compulsory for a defined class such as employees, financed largely by their and their employers' contributions.

Basis	Private insurance	Social insurance
Participation	Voluntary	Mandatory
Funding	Fully funded	Need not be fully funded

Social insurance relevant to EPFO: the EPF Scheme 1952, the Employees' Pension Scheme, 1995 and the EDLI Scheme, 1976 under the EPF Act, 1952; and ESIC under the ESI Act, 1948 – now merged into the Code on Social Security, 2020.

3 Claim for Loss of Stock

Part VII · Costing, Insurance and Auditing

➤ 35.4 Claim for Loss of Stock

Stock on the date of fire is estimated by a **Memorandum Trading Account** from the last balance sheet to the date of fire. **Loss of stock = Stock on date of fire – Value of**

salvage (both at cost). **Stock on date of fire = Opening stock + Purchases + Direct expenses − Cost of goods sold**, where cost of goods sold = Sales − Gross profit at the normal rate.

Many fire policies carry an **average clause**. If the stock is under-insured, the insured bears a proportionate share of the loss. **Claim = Loss of stock × Sum insured ÷ Value of stock on the date of fire.**

Illustration: stock on date of fire ₹1,90,000; salvage ₹40,000; sum insured ₹1,52,000. Claim = 1,50,000 × 1,52,000 ÷ 1,90,000 = ₹1,20,000.

Journal entries for the claim

Date	Particulars	Dr. ₹	Cr. ₹	DEALER Logic
	Loss by Fire A/c **Dr.** *(Being cost of stock destroyed by fire)*	1,50,000		Loss (Expense) ↑ → Debit
	To Trading A/c		1,50,000	Asset (Stock) ↓ → Credit
	Insurance Company A/c **Dr.** *(Being claim admitted; balance written off)*	1,20,000		Asset (Claim receivable) ↑ → Debit
	Profit and Loss A/c **Dr.**	30,000		Expense/Loss ↑ → Debit
	To Loss by Fire A/c		1,50,000	Loss ↓ (transferred out) → Credit

A claim for stock destroyed is a revenue item. A claim for machinery or a building destroyed is a **capital receipt**; any excess over book value is a capital profit (APFC 2023).

4 Claim for Loss of Profit

Part VII · Costing, Insurance and Auditing

➤ 35.5 Claim for Loss of Profit (Consequential Loss Policy)

An ordinary fire policy pays only for physical loss. A **consequential loss policy** covers the loss of gross profit due to the fall in turnover and the increased cost of working during the interruption.

Key Terms

Standard turnover	Turnover in the 12 months before the damage corresponding to the indemnity period
Gross profit (for this policy)	Net profit + Insured standing charges
Short sales	Standard turnover − Actual turnover during the indemnity period

Step	Computation
1	Rate of GP = (Net profit + Insured standing charges) ÷ Turnover of the last year × 100
2	Loss of GP = Short sales × Rate of GP; add increased cost of working; deduct savings in insured standing charges
3	Average clause: if sum insured < GP on adjusted annual turnover, claim = Gross claim × Sum insured ÷ GP on adjusted annual turnover

Illustration: gross claim ₹3,90,000; sum insured ₹15,84,000 against GP on adjusted annual turnover ₹17,60,000 (90%), so claim = ₹3,51,000.

➤ Sum Insurable under a Loss of Profit Policy

Sum insurable = (Annual turnover ± adjustment under special circumstances clause) × Rate of gross profit. Example (EO/AO 2017): turnover ₹88,00,000 + 10% = 96,80,000; GP 20%; sum insurable = ₹19,36,000.

5 Previous Year Questions: UPSC EPFO

Part VII · Costing, Insurance and Auditing

1. Date of fire: 01.03.2016. Turnover from 01.03.2015 to 29.02.2016: ₹88,00,000. Agreed gross profit ratio: 20%. The special circumstances clause provides for a 10% increase in turnover. What is the sum insurable? EO/AO 2017

(a) ₹19,36,000
(b) ₹48,40,000
(c) ₹10,32,000
(d) ₹24,20,000

Answer: (a) ₹19,36,000 — Adjusted turnover 88,00,000 + 10% = 96,80,000; sum insurable is gross profit: 96,80,000 × 20%.

2. The principle of subrogation allows: APFC 2023

(a) Investment of policy amount
(b) Refund for insured and insured's insurance company
(c) Automatic renewal of the policy
(d) Indemnification of the insured

Answer: (b) Refund for insured and insured's insurance company — After paying, the insurer recovers from the third party at fault. Some keys give (d), but indemnity itself is a separate principle.

3. Which of the following are typical differences between private insurance and social insurance? 1. Individual equity versus social adequacy 2. Voluntary versus mandatory 3. Contractual rights versus statutory rights 4. Full funding versus not necessarily full funding APFC 2015

(a) 1 and 2 only
(b) 2 and 3 only
(c) 1, 3 and 4 only
(d) 1, 2, 3 and 4

Answer: (d) 1, 2, 3 and 4 — All four are standard distinctions; the first feature of each pair is private insurance, the second social insurance.

4. Which principle of insurance requires the insured to take reasonable steps to minimise the loss? 2025

(a) Subrogation
(b) Utmost good faith
(c) Co-operation
(d) Mitigation

Answer: (d) Mitigation — The insured must act as a prudent uninsured person would; co-operation is not a recognised principle.

5. Which one of the following is NOT a contract of indemnity? 2025

(a) Fire insurance
(b) Life insurance
(c) Marine insurance
(d) Motor insurance

Answer: (b) Life insurance — Human life cannot be valued, so a fixed sum assured is paid; fire, marine and motor pay only actual loss.

6. Insurance claim received for machinery completely damaged by fire is a: APFC 2023

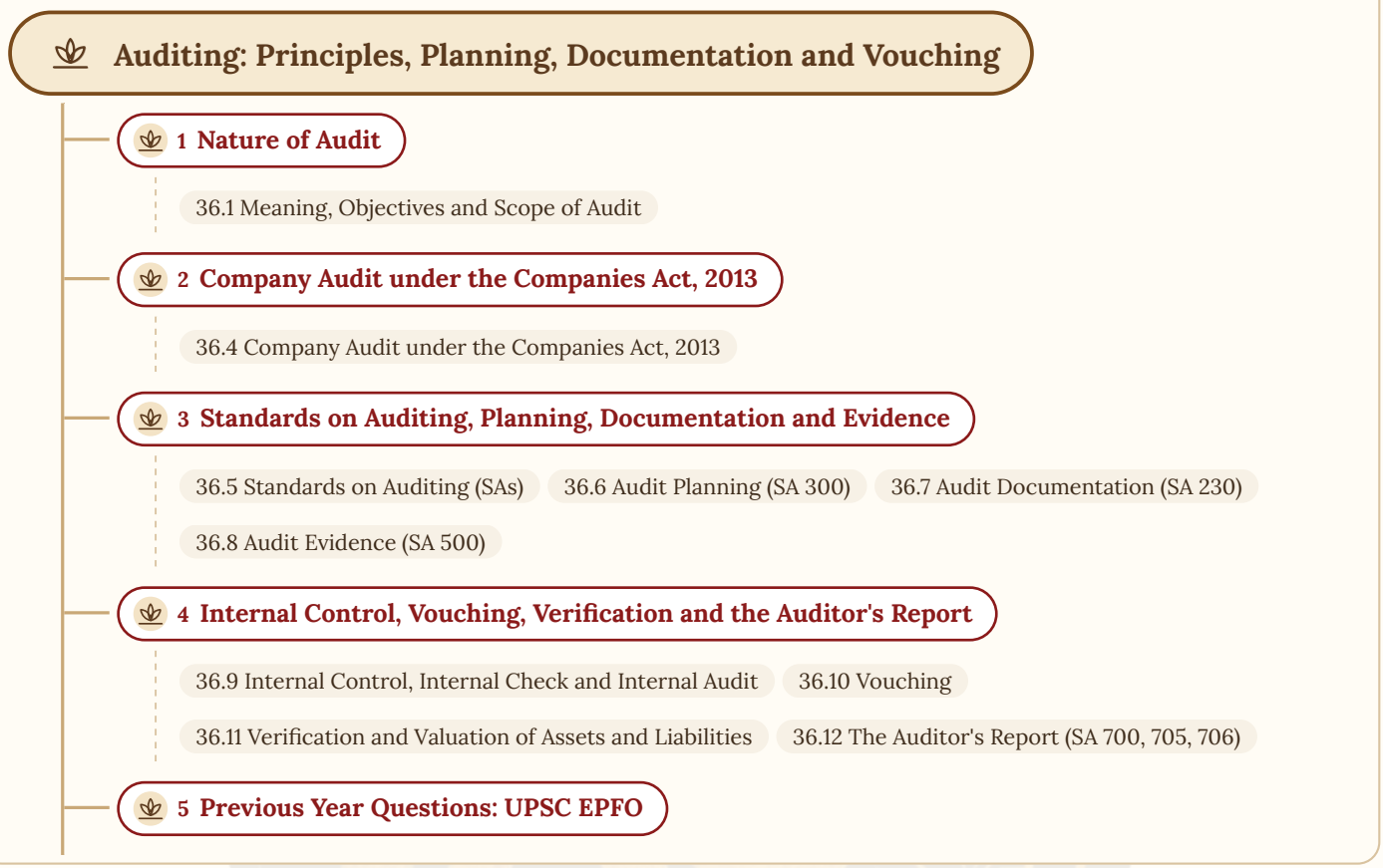
(a) Capital receipt
(b) Revenue receipt
(c) Capital expenditure
(d) Revenue expenditure

Answer: (a) Capital receipt — The claim replaces a fixed asset, so it is a capital receipt.

CHAPTER 36

Auditing: Principles, Planning, Documentation and Vouching

CHAPTER AT A GLANCE



1 Nature of Audit

Part VII · Costing, Insurance and Auditing

Weightage in UPSC EPFO: 6 questions, all since 2023 (EO/AO 2023, APFC 2023, 2025) — fraud reporting threshold, what audit does not cover, overall audit strategy, audit documentation, vouching and verification. A rising area.

➤ 36.1 Meaning, Objectives and Scope of Audit

ICAI describes an **audit** as an independent examination of financial information of any entity, conducted with a view to expressing an opinion thereon (not a certificate of accuracy).

Overall objective (SA 200): to obtain reasonable assurance that the financial statements are free from material misstatement, whether due to fraud or error. Detection of errors and frauds is a secondary (incidental) objective; the primary responsibility rests with management.

Not covered in an audit: preparation of books of account (duty of management, Sec 128; APFC 2023), preparation of financial statements (the Board, Sec 134), day-to-day management, and guaranteeing that no fraud exists. Sec 144 bars a company's auditor from book-keeping services.

Errors are unintentional; **frauds** are intentional – misappropriation of assets (teeming and lading) and fraudulent financial reporting (window dressing). An audit gives reasonable, not absolute, assurance.

2 Company Audit under the Companies Act, 2013

➤ 36.4 Company Audit under the Companies Act, 2013

Appointment (Sec 139): the subsequent auditor of a non-Government company is appointed by members at the first AGM to hold office till the sixth AGM (five years) [139(1)]; the first auditor by the Board within 30 days of registration [139(6)]; the auditor of a Government company by the CAG [139(5)]. A casual vacancy is filled by the Board within 30 days [139(8)].

Rotation [Sec 139(2)]: listed companies and prescribed classes cannot appoint an individual as auditor for more than one term of five consecutive years, or an audit firm for more than two terms of five consecutive years; a cooling-off period of five years follows.

Services barred by Section 144: accounting and book-keeping; internal audit; design of financial information systems; actuarial services; investment advisory; investment banking; management services.

Removal before term needs a special resolution and prior approval of the Central Government [140(1)]; **resignation** is by Form ADT-3 within 30 days [140(2)]. Only a Chartered Accountant in practice, or a firm with a majority of CA partners, may be auditor [141(1)]. **Disqualified** are a body corporate (other than LLP), an officer or employee of the company, a person indebted to it above ₹5 lakh, and an auditor of more than 20 companies [141(3)].

Section 143: the auditor has a right of access at all times to books, accounts and vouchers [143(1)] and reports to members on whether the financial statements give a true and fair view [143(2)].

CARO 2020 is issued under Section 143(11); it requires the auditor to report on 21 additional matters (clauses i to xxi). It does not apply to banking companies, insurance companies, Section 8 companies and one person companies.

Fraud reporting [Section 143(12)]: for a fraud of ₹1 crore or above, the auditor reports to the Board / Audit Committee within 2 days; the Board replies within 45 days; the auditor reports to the Central Government in Form ADT-4 within 15 days (EO/AO 2023). A fraud below ₹1 crore is reported only to the Audit Committee or Board within 2 days.

Internal audit (Sec 138) is compulsory for every listed company and prescribed unlisted companies; the statutory auditor cannot be the internal auditor. **Cost audit (Sec 148):** the cost auditor must be a cost accountant; the statutory auditor cannot be cost auditor [148(3)].

3 Standards on Auditing, Planning, Documentation and Evidence

➤ 36.5 Standards on Auditing (SAs)

Standards on Auditing are issued by the Auditing and Assurance Standards Board (AASB) of ICAI. Every company auditor must comply with them [143(9)]. Numbering: SA 200–299 general principles; 300–499 risk assessment; 500–599 audit evidence; 700–799 reporting.

➤ 36.6 Audit Planning (SA 300)

Planning means establishing the overall audit strategy for the engagement and developing an audit plan.

The **overall audit strategy** is broad and prepared first; it sets the scope, timing and direction of the audit. The **audit plan** is detailed and operational; it converts the strategy into procedures.

Audit risk = Risk of material misstatement (inherent risk × control risk) × Detection risk. Only detection risk is controlled by the auditor.

➤ 36.7 Audit Documentation (SA 230)

Audit documentation is the record of audit procedures performed, relevant audit evidence obtained, and conclusions reached; also called working papers. The **audit file** is the folder or storage medium containing the audit documentation. Thus the audit file is the container and audit documentation is its content – the two are not the same (PYQ 2025).

➤ 36.8 Audit Evidence (SA 500)

The auditor must obtain **sufficient appropriate** audit evidence. Sufficiency is the measure of quantity; appropriateness is the measure of quality – relevance and reliability. Assertions tested: existence, completeness, rights and obligations, valuation, cut-off, presentation.

4 Internal Control, Vouching, Verification and the Auditor's Report

➤ 36.9 Internal Control, Internal Check and Internal Audit

Internal control is the process designed and maintained by those charged with governance and management to provide reasonable assurance about reliable financial reporting, effective operations, safeguarding of assets and compliance with laws. Internal check relies on **segregation of duties** – no single person handles a transaction from beginning to end.

➤ 36.10 Vouching

Vouching is the examination of documentary evidence (vouchers) in support of the entries in the books of account, to establish the authenticity and validity of the transactions recorded; it is called the backbone of auditing. The primary objective is to verify the authenticity of transactions (PYQ 2025); detection of errors and frauds is incid-

ental. **Routine checking** covers arithmetic accuracy; **test checking** (SA 530) means checking some items instead of all.

➤ 36.11 Verification and Valuation of Assets and Liabilities

Verification means obtaining evidence to establish the existence, ownership, possession, valuation and proper disclosure of the assets and liabilities in the balance sheet. **Valuation** is one part of it. Checking the historical accuracy of the accounts is not an objective of verification (PYQ 2025); that is tested through vouching and routine checking.

➤ 36.12 The Auditor's Report (SA 700, 705, 706)

Opinion	When given
Unmodified (clean)	Statements prepared, in all material respects, in accordance with the framework
Qualified	Material but not pervasive – "except for"
Adverse	Material and pervasive – no true and fair view
Disclaimer	Unable to obtain sufficient appropriate evidence – no opinion expressed

An Emphasis of Matter paragraph (SA 706) draws attention to a properly disclosed matter without modifying the opinion.

5 Previous Year Questions: UPSC EPFO

Part VII · Costing, Insurance and Auditing

1. Which one of the following aspects is not covered in audit? APFC 2023

(a) Examination of the system of accounting and internal control
(b) Preparation of books of accounts
(c) Reporting to the appropriate person/ body
(d) Verification of the authenticity and validity of transactions

Answer: (b) Preparation of books of accounts — Books are prepared by management (Sec 128); the auditor examines them and is barred from book-keeping services by Sec 144.

2. Which one of the following sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan? APFC 2023

(a) Audit program
(b) Overall audit strategy
(c) Completion memorandum
(d) Audit plan

Answer: (b) Overall audit strategy — The wording is from SA 300; the audit plan is developed from the strategy.

3. Which one of the following statements about audit documentation is not correct? 2025

(a) Audit documentation includes audit programmes
(b) Audit file and audit documentation are the same
(c) Audit documentation includes summaries of significant matters
(d) Audit documentation may be recorded on paper or electronic or any other media

Answer: (b) Audit file and audit documentation are the same — Under SA 230 the audit file is the container; audit documentation is its content.

4. In the context of auditing, the primary objective of vouching is: 2025

(a) To detect errors in financial statements
(b) To evaluate internal controls
(c) To verify the authenticity of transactions
(d) To assess management performance

Answer: (c) To verify the authenticity of transactions — Vouching examines the documentary evidence behind each entry; error detection is a by-product.

5. Which one of the following is not an objective of verification in auditing? 2025

(a) Checking the historical accuracy of accounts
(b) Verification of the existence of assets
(c) Verification of valuation of assets
(d) Verification of authority of acquisition of assets

Answer: (a) Checking the historical accuracy of accounts — Verification concerns balance-sheet items on a date; historical accuracy of transactions is the field of vouching.

6. An auditor is required to report a fraud to the Central Government when the amount involved in the fraud is: EO/AO 2023

(a) more than ₹20 lakh
(b) more than ₹50 lakh
(c) more than ₹75 lakh
(d) ₹1 crore or above

Answer: (d) ₹1 crore or above — Sec 143(12) with Rule 13: frauds of ₹1 crore or above go to the Central Government in Form ADT-4.

APPENDIX

Appendix: Key Rules, Numbers and Formulas

CHAPTER AT A GLANCE

Appendix: Key Rules, Numbers and Formulas
- 1 Rules: Debit and Credit, Equations, Books and Concepts (A.1 - A.3)
  - A.1 Rules of Debit and Credit
  - A.2 Accounting Equations and Books of Account
  - A.3 Accounting Concepts and Conventions at a Glance
- 2 Numbers: Standards, Sections and Limits (A.4 - A.7)
  - A.4 Accounting Standards and Standard-Setters
  - A.5 Key Section Numbers
  - A.6 Share Capital and Company Accounts: Important Numbers
  - A.7 Other Important Numbers
- 3 Master Formula Sheet (A.8)
  - Trading, Profit and Inventory
  - Adjustments, NPO, Goodwill and Partnership
  - Insurance Claims and Cost Accounting
  - Ratios
- 4 Key Theory Points: Quick Answers (A.9)
- 5 Previous Year Questions at a Glance and Final Checklist (A.10 - A.11)
  - A.10 All 69 EPFO Questions in One Line
  - A.11 Final Revision Checklist

1 Rules: Debit and Credit, Equations, Books and Concepts (A.1 - A.3)

Appendix

Weightage in UPSC EPFO: 69 accountancy, auditing and insurance questions have appeared across EO/AO 2017, 2021, 2023, APFC 2015, 2023 and the 2025 combined paper.

➤ A.1 Rules of Debit and Credit

Every transaction is recorded with an equal debit and credit (dual aspect). **DEALER**: Dividends/Drawings, Expenses/Losses, Assets → increase is **Debit**; Liabilities, Equity/Capital, Revenue/Gains → increase is **Credit**. A decrease goes the opposite way.

Golden rule	Statement
Personal	Debit the receiver, Credit the giver
Real	Debit what comes in, Credit what goes out
Nominal	Debit all expenses and losses, Credit all incomes and gains

Tested in 2025: "Capital account has a debit balance" is incorrect. A debit balance on capital arises only when accumulated losses and drawings exceed the capital.

➤ A.2 Accounting Equations and Books of Account

Equation	Illustration
Assets = Liabilities + Capital; Capital = Assets − Liabilities	
Profit = Closing capital − Opening capital + Drawings − Additional capital	7,20,000 − 5,00,000 + 60,000 − 1,00,000 = 1,80,000
Working capital = Current assets − Current liabilities	

Book	Key point
Journal	Book of original (prime) entry (EO/AO 2021: first book of entry)
Trial balance	A statement, not an account; agreement is not conclusive proof of accuracy

➤ A.3 Accounting Concepts and Conventions at a Glance

Concept	Meaning
Money measurement	Only events measurable in money are recorded
Going concern (AS-1)	Business will continue; assets at cost less depreciation, not realisable value
Consistency (AS-1)	Same policies from year to year
Accrual (AS-1)	Record when earned or incurred, not when cash moves
Conservatism	Anticipate no profit; provide for all possible losses
Full disclosure	Material items and facts are disclosed

AS-1 fundamental assumptions: **Going concern, Consistency, Accrual**. Policy selection: **Prudence, Substance over form, Materiality**; consistency is not one of them.

2 Numbers: Standards, Sections and Limits (A.4 - A.7)

Appendix

➤ A.4 Accounting Standards and Standard-Setters

Item	Key fact
NFRA	Sec 132; constituted 1 October 2018; recommends standards, oversees audit quality
Ind AS	IFRS-converged; Phase I from 1 April 2016 (net worth 500 crore or more); Phase II from 1 April 2017 (250 crore or more)
Key Ind AS	2 Inventories; 7 Cash Flows; 16 PPE; 115 Revenue; 116 Leases

➤ A.5 Key Section Numbers

Section	Subject	What to remember
53	Shares at discount	Prohibited (exception: sweat equity, Sec 54)
62 / 63	Further issue / Bonus shares	Rights offer open 15 to 30 days / bonus not from revaluation reserve
68	Buy-back	Limits 10% / 25%; debt not more than twice capital + free reserves
128	Books of account	Preserved 8 financial years

Section	Subject	What to remember
139	Auditors	Individual one term, firm two terms of 5 years; cooling-off 5 years
143(12)	Fraud reporting	1 crore or above → Central Government; below → Audit Committee or Board
Partnership Act 13	Mutual rights	No remuneration; equal profit and loss

➤ A.6 Share Capital and Company Accounts: Important Numbers

Topic	Number / limit
Application money	Not less than 5% of nominal amount (Sec 39(2))
Minimum subscription	90% of the issue
Current liabilities (Schedule III)	Due within 12 months or the operating cycle (EO/AO 2021)

➤ A.7 Other Important Numbers

Topic	Number / rule
Partners in a firm	Minimum 2; maximum 50
Current ratio; quick ratio	2 : 1; 1 : 1

3 Master Formula Sheet (A.8)

Appendix

➤ Trading, Profit and Inventory

Item	Formula
Cost of goods sold	Opening stock + Net purchases + Direct expenses - Closing stock; also = Sales - Gross profit
Markup conversion	% on sales = c / (100 + c) x 100, c = % on cost; 25% on cost = 20% on sales
Straight line	(Cost - Residual value) / Useful life
Inventory valuation (AS-2)	Lower of cost and NRV; NRV = Selling price - Costs of completion - Costs to sell

➤ Adjustments, NPO, Goodwill and Partnership

Item	Formula
Charge for bad debts	Bad debts + New provision - Old provision
Subscription income	Received - Opening o/s + Closing o/s + Opening advance - Closing advance
Super profit	Average profit - Normal profit; Normal = Capital employed x NRR / 100; Goodwill = Super profit x Years' purchase
Sacrificing / Gaining ratio	Old share - New share / New share - Old share

➤ Insurance Claims and Cost Accounting

Item	Formula
Loss of stock	Stock on date of fire - Salvage; average clause: Loss x Policy value / Value of stock

Item	Formula
Sum insurable (loss of profit)	Annual turnover (adjusted) x GP rate
Works cost / Cost of production / Cost of sales	Prime cost + Factory OH +/- WIP / + Office OH / + Selling OH
P/V ratio; Break-even point	Contribution / Sales x 100; Fixed cost / P/V ratio

➤ Ratios

Ratio	Formula
Current ratio	Current assets / Current liabilities
Quick ratio	(Current assets - Inventories - Prepaid) / Current liabilities
EPS	(PAT - Preference dividend) / Equity shares

4 Key Theory Points: Quick Answers (A.9)

Appendix

Question	Answer
Asset that is not depreciated	Freehold land (unlimited life)
Objective of depreciation	Allocation of cost over useful life, not valuation
Difference divisible by 2 / by 9	Wrong side / transposition
Errors not revealed by the trial balance	Omission, principle, compensating, two-sided commission
Provision vs reserve	Provision: charge against profit. Reserve: appropriation of profit
Deferred revenue expenditure	Heavy advertisement, preliminary expenses; written off over years

5 Previous Year Questions at a Glance and Final Checklist (A.10 - A. 11)

Appendix

➤ A.10 All 69 EPFO Questions in One Line

Topic	Key fact tested
Concepts	No anticipation of profit → conservatism; team rifts not recorded → money measurement; contingent liability notes → full disclosure; matching is not a fundamental assumption
Trial balance, errors	TB is a statement of balances; machinery in Purchases Book → principle
Capital vs revenue	Preliminary expenses → deferred revenue; engine overhaul → capital
Final accounts, NPO	GP 4,00,000; provision for discount 33,000; bad debts 3,30,000; I&E Account nominal; subscription 67,000
Insurance	Sum insurable 19,36,000; life insurance not indemnity
Auditing	Fraud 1 crore or above → Central Government; preparation of books not part of audit; vouching verifies authenticity

Concepts (11) and trial balance and errors (8) form over a quarter of questions; auditing and insurance appear in every paper since 2023.

➤ A.11 Final Revision Checklist

- Name the concept behind any practice; recite G-C-A and Prudence-Substance-Materiality (A.2, A.3).
- Recall Sec 53, 54, 62, 63, 68, 128, 139, 143(12) (A.4, A.5).
- Classify errors and capital vs revenue items; compute bad debts, goodwill, ratios and insurance claims (A.8, A.9).
- In the exam hall: mark "not", "only" and "always"; check whether rates are on cost or on sales.