

SRI CHANDRASEKHARENDRA SARASWATHI VISWA MAHAVIDYALAYA

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DEPARTMENT OF COMMERCE



**B.Com General
ODL Mode (Semester Pattern)**

**Advanced Accountancy I
(4 Credits)**

Course Design and Preparation Committee

Prof.Dr.B. Balaji Srinivasan

Dean, Faculty of Management Studies,
Commerce and HR
SCSVMV, Kanchipuram.

Dr.J.Santhi

Head, Department of Commerce
SCSVMV, Kanchipuram.

Course Writer

Dr.P.Balaji

Assistant Professor
Department of Commerce
SCSVMV, Kanchipuram.

Programme Coordinator

Dr.P.Balaji

Assistant Professor
Department of Commerce
SCSVMV, Kanchipuram.

B.Com. General SELF- LEARNING MATERIAL (SLM)

Course: ADVANCED ACCOUNTANCY I

Course Introduction

This course provides a comprehensive understanding of advanced financial accounting topics. It covers accounting standards, royalty accounts, and credit-based systems like hire purchase and instalments. Students will learn to handle branch and departmental accounting for decentralized operations. The course also includes insurance claims and investment accounting practices. Overall, it equips learners with practical skills for complex financial reporting and analysis.

Unit I:

Accounting information system-Concept- users of accounting information – Accounting Standards-concept-types – benefits- difficulties in standard setting- standard setting in India (Theory only)

Unit II:

Royalty Accounts: Meaning – Minimum rent – Short workings – Recoupment of short workings – Accounting records in the books of the lessor and lessee – Sub lease.

Unit III:

Hire Purchase and Instalment Systems : Hire purchase system – Features – Calculation of interest – Accounting treatment in the books of buyer and seller (excluding hire purchase trading accounts and stock and debtors system) – Default and repossession – Complete repossession - Partial repossession- Instalment system – Difference between hire purchase system and instalment system

Unit IV:

Branch Accounts: Branch accounting – types of branches – independent branch – debtors' system (excluding stock and debtors system, foreign branches) Departmental Accounts- allocation of expenses – inter-department transfers (Excluding unrealized profit

on closing stock)

Unit V:

Insurance Claims: Claims for loss of stock – Calculation of normal and abnormal items – Application of average clause – Loss of profits – Steps in the preparation of claim under loss of profits policy. Investment Accounts– Meaning – Cum-dividend/Cum- interest – Ex-dividend/Ex- interest - Investment accounts in columnar form.

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ACCOUNTING STANDARDS

Structure

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- Learning Objectives
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- 1.2 Meaning of Accounting Standards:
- 1.3 Need for Accounting Standards:
- 1.4 Objectives of Accounting Standards:
- 1.5. Significance or advantages of Accounting Standards:
- 1.6. Limitations of Accounting Standards:
- 1.7. Accounting standards in Indian context:
- 1.8. The scope and functions of Accounting Standards Board are:
- 1.9. Conclusion
- Check Your Progress
- Let Us Sum Up
- Glossary of Terms
- Answers to Check Your Progress
- Suggested Reading

Overview

Accounting is not just a process of recording transactions but serves as a crucial information system for decision-making. This unit explores the conceptual foundations of accounting as an information system, identifies key users and their needs, and delves into the structure and significance of accounting standards, their types, benefits, and challenges in setting them—particularly in the Indian context.

Learning Objectives

By the end of this unit, students will be able to:

- Understand accounting as an information system
- Identify various users of accounting information
- Explain the concept and types of accounting standards

- Analyze the benefits and limitations of standard setting

Discuss the process and bodies involved in accounting standard setting in India

1.1 Introduction to Accounting as an Information System

Accounting standards are formal written guidelines issued by a professional accounting authority, the government, or another regulatory institution. They address various aspects of identifying, measuring, presenting, and disclosing financial transactions in financial reports. These standards act as a foundational structure that allows for the preparation of reliable and consistent financial statements. They are developed to bring uniformity to diverse accounting methods and policies. The main purpose of these standards is to limit the variety of accounting choices available when preparing financial statements, while still maintaining logical and reasonable options. This ensures that the financial reports of different organizations can be compared effectively, offering valuable insights to a wide range of users. Accounting standards outline the fundamental accounting concepts and how to apply them during the preparation and presentation of financial data, ensuring that the statements reflect a true and fair representation. This in turn promotes transparency and strengthens financial discipline in the market. Furthermore, they assist regulatory bodies in assessing the accuracy and reliability of financial reporting.

1.2 Meaning of Accounting Standards:

As defined by the Institute of Chartered Accountants of India (ICAI), Accounting Standards are formal documents that include rules, methods, and procedures issued by a recognized accounting authority, government body, or regulatory institution. These standards cover aspects such as the identification, valuation, processing, presentation, and disclosure of accounting transactions in financial reports.

In essence, an accounting standard can be viewed as a form of regulatory guideline—a framework for action, a settled foundation for accounting practices and behavior.

Accounting Standards primarily address the following areas:

- a. The recognition of financial events and transactions in the accounts;
- b. The valuation or quantification of these transactions and events;
- c. The format and clarity with which these transactions are reported in the financial statements

so that users can understand them easily; and

d. The necessary disclosures that should be included, allowing the general public, stakeholders, and especially potential investors to gain clarity on what the financial statements are conveying. This helps them to make well-informed and sound business decisions.

1.3. Need for Accounting Standards:

a) To eliminate discrepancies that may arise between accounting theories and actual practices, and to establish uniformity across diverse accounting principles used by different entities.

b) A meaningful comparison between two companies is only possible when they follow consistent accounting policies. For instance, if Company A applies the FIFO method for inventory valuation and Company B uses the LIFO method, comparing their financial outcomes would be inaccurate. Such a comparison becomes valid only when both companies use the same method for valuing inventory.

c) The objective is to create standardized accounting practices when preparing financial statements, ensuring consistency and accurate comparison of the financial data provided to users of accounting information.

d) To uphold fairness, consistency, and transparency in accounting methods, which enhances trust and satisfies the expectations of various users of financial reports.

e) To address and resolve potential conflicts of interest among the various external parties—such as investors, creditors, and analysts—who depend on the financial statements for decision-making.

f) Accounting standards help limit the range of accounting choices available during the preparation of financial statements, within reasonable boundaries. This enhances the comparability of financial reports across different organizations. Therefore, accounting standards serve as an essential tool to minimize financial disputes among key stakeholders in the economy.

g) To bring about alignment in accounting policies and procedures used by various businesses, enabling the standardization of diverse accounting treatments applied to different elements of financial reporting.

1.4. Objectives of Accounting Standards:

To bring uniformity to varied accounting methods and procedures

To minimize, as far as possible, the lack of comparability in financial reports

To enhance the trustworthiness and dependability of financial statements

To improve the mathematical precision and correctness in financial reporting

To help users interpret the accounting treatments applied in financial statements

To offer a consistent set of accounting practices, valuation guidelines, and requirements for disclosure

1.5. Significance or advantages of Accounting Standards:

1. Investors can benefit from accounting standards as they assist in evaluating the returns and risks associated with various investment options across different companies and countries.
2. These standards offer authoritative guidelines for public accountants (such as Chartered Accountants in India) when preparing financial statements. This ensures that the reports are created in a truthful and fair manner, promoting professional commitment and ethical integrity in the accounting field.
3. Accounting standards also contribute to enhancing the quality of auditing, aiding auditors in their role of providing accurate reports on financial statements.
4. Government bodies, tax departments, and other regulatory agencies view financial reports prepared under recognized standards as credible and trustworthy.
5. Such standardized financial statements serve as dependable resources for analysts, researchers, and consultants, facilitating economic analysis, forecasting, and strategic planning.

1.6. Limitations of Accounting Standards:

1. For some accounting issues, multiple valid approaches may exist, each supported by logical reasoning. As a result, selecting the most appropriate method among these alternatives can be challenging.
2. The implementation of accounting standards might lead to inflexibility, reducing the ability to adapt to unique situations, as they may encourage a more rigid approach to financial reporting.
3. Accounting standards do not have the authority to override legal provisions. They must be designed within the framework of existing laws and regulations.

1.7. Accounting standards in Indian context:

In India, the Accounting Standards are formulated and issued by the Accounting Standards Board (ASB), which functions under the Institute of Chartered Accountants of India (ICAI), in collaboration with the National Advisory Committee on Accounting Standards (NACAS). Recognizing the importance of bringing uniformity to the varied accounting methods and policies being followed across the country, the ICAI established the Accounting Standards Board on April 21, 1977.

1.8. The scope and functions of Accounting Standards Board are:

- a. To develop Accounting Standards that can be officially issued by the Council of the Institute in India. While drafting these standards, the Accounting Standards Board (ASB) considers relevant laws, customs, business practices, and the economic environment of the country.
- b. To align with the goals of the International Accounting Standards Committee (IASC), as the Institute is a member of this international body. The ASB takes into account the International Accounting Standards, adapting them where appropriate to suit Indian conditions and practices.
- c. To promote awareness and encourage the adoption of these standards by stakeholders involved in the preparation and presentation of financial statements.
- d. To release guidance notes and offer clarifications regarding issues related to the Accounting Standards.
- e. To periodically review and update the Accounting Standards as necessary.

1.9. Conclusion

Accounting as an information system is the foundation for financial communication. Its role becomes effective when governed by robust standards that promote clarity and comparability. Despite challenges, India's move toward global convergence through Ind AS has enhanced its credibility in global markets.

Check Your Progress

1. What is meant by accounting as an information system?
2. Who are the primary users of accounting information?
3. Explain the concept and types of accounting standards.
4. List any three benefits of accounting standards.
5. What are the major challenges in setting accounting standards?
6. What are the scope and functions of Accounting Standards Board?

Let Us Sum Up

This unit explained how accounting functions as an information system, identified the users of such information, and detailed accounting standards' purpose and implementation. We explored the benefits and challenges of standardization and outlined the standard-setting mechanisms in India.

Glossary of Terms

- Accounting Standards: Rules for preparing financial statements
- GAAP: Generally Accepted Accounting Principles
- IFRS: International Financial Reporting Standards
- Ind AS: Indian Accounting Standards aligned with IFRS
- ICAI: Institute of Chartered Accountants of India
- NFRA: National Financial Reporting Authority

Answers to Check Your Progress

1. A structured process that collects, processes, and communicates financial information.
2. Management, investors, creditors, regulators, tax authorities, etc.

3. Standards that guide financial reporting; types include GAAP, IFRS, Ind AS.
4. Uniformity, comparability, transparency.
5. Diverse practices, political pressures, rapid economic changes.
6. ICAI, NFRA, and MCA.

Suggested Reading

1. T.S. Grewal, “Double Entry Book Keeping”
2. ICAI publications on Accounting Standards
3. Narayanaswamy, R. – *Financial Accounting*
4. ACCA and IFRS Foundation Learning Materials
5. Ministry of Corporate Affairs website – www.mca.gov.in

ROYALTY ACCOUNTS

Structure

- Overview
- Learning Objectives
- 1.1 Meaning of Royalty
- 1.2 Difference Between Rent And Royalty
- 1.3 Important Terms In Connection With Royalty
- 1.4 Accounting Procedure
- 1.5 Accounting Records in the Books of the Lessor and Lessee
- 1.6 Conclusion
- Check Your Progress
- Let Us Sum Up
- Glossary of Terms
- Answers to Check Your Progress
- Suggested Reading

Overview

Royalty accounting deals with agreements where one party (lessee) pays another (lessor) for the right to use assets like patents, copyrights, trademarks, or mineral rights. These payments are governed by specific contractual terms, including minimum rent, short workings, and recoupment rights. This unit aims to provide a comprehensive understanding of royalty accounting from both the lessor's and lessee's perspectives, including treatment of subleases.

Learning Objectives

After studying this unit, learners will be able to:

- Define royalty and related terms such as minimum rent and short workings
- Explain the concept and process of recoupment of short workings
- Record royalty transactions in the books of both the lessor and lessee
- Understand the accounting treatment in case of a sublease agreement

1.1 Meaning of Royalty

Royalty refers to a recurring payment made periodically based on the production output or sales volume, in exchange for the right to use a specific asset or privilege. This payment is made by one party to another for the use of an asset. The individual who pays the royalty is known as the *lessee*, while the individual receiving the payment—typically the asset owner—is called the *lessor* or *landlord*. Examples include royalties paid by publishers to authors, by manufacturers to patent holders, or by companies extracting resources from oil wells to the property owners. The Royalty Account is treated as a nominal account and is similar in nature to a rent account. Being a nominal account, it is debited in the books of the lessee as an operational expense and credited in the books of the lessor as income. At the close of each financial year, the royalty account is transferred to the Profit and Loss Account to finalize the books.

1.2. Difference between Rent and Royalty

The key distinctions between **rent** and **royalty** are outlined below:

1. Rent is a payment made for the use of physical or tangible assets such as buildings, land, or equipment. In contrast, royalty is compensation paid for utilizing intangible assets or special rights, like mineral resources, patents, or copyrights.
2. The amount of rent remains constant and is usually predetermined, whereas royalty payments fluctuate based on the quantity of goods produced or sold, making them variable in nature.

1.3. Important Terms In Connection With Royalty

1. Lessor or Landlord:

This refers to the individual who owns a particular asset and grants another party the

right to use it in exchange for a payment called *royalty*. The owner who provides this usage right is known as the *lessor*.

2. Lessee:

The party who pays the royalty in return for the right to use the asset is termed as the *lessee*.

3. Minimum Rent / Dead Rent / Fixed Rent:

This is the least amount that the lessee must pay the lessor, regardless of whether any benefit has been derived from the use of the asset or right. This predetermined minimum amount is agreed upon at the start of the contract and ensures that the lessor receives a guaranteed income, even when production or sales are low. The lessee is liable to pay the higher of either the actual royalty or the minimum rent. This fixed payment is also known by terms like *dead rent*, *flat rent*, or *fixed rent*. However, under certain conditions outlined in the agreement, it may also be variable.

4. Shortworking:

When the royalty amount based on actual production or sales falls below the agreed minimum rent, the difference is termed as *shortworking*.

Formula:

Shortworking = Minimum Rent – Actual Royalty

Example:

If the minimum rent is ₹10,000 and the actual royalty is ₹4,000 in the first year and ₹9,500 in the second year, the shortworking will be ₹6,000 and ₹500 for the respective years.

5. Recoupment of Shortworking:

During the initial years of a lease, operations might not be fully active due to setup time, leading to shortworkings. To address this, lease agreements may include provisions for recouping such shortfalls. The various methods are:

(i) Without a Specified Time Limit:

In this case, the agreement allows the lessee to recover shortworkings at any time during

the lease period. Unrecouped balances are transferred to the Profit and Loss Account only in the final year of the lease term.

(ii) Within a Fixed Time Period:

Some contracts specify a fixed period—such as the first 3, 4, or 5 years—within which the lessee must recover shortworkings.

Example: If a coal mine is leased from 1st January 2000 for 10 years, and the agreement permits recoupment only within the first 4 years, then shortworkings can be recovered only up to 2003. Any remaining shortworking after this period is charged to the Profit and Loss Account.

(iii) Over a Specific Number of Subsequent Years:

Under this clause, each year's shortworking can be recovered within a defined number of years following the year it occurred.

Example: If a mine lease starts on 1st January 1990 for 20 years and the agreement allows for a 3-year recoupment window for each year's shortworking, then shortworking from 1990 can be recouped till 1993, from 1991 till 1994, and so on. Any amount not recouped within this allowed timeframe is transferred to the Profit and Loss Account in the year that recoupment right expires.

1.4 Accounting Procedure

The following points need to be noted down before preparing the Royalty Accounts:-

1. Name of Landlord and Lessee.
2. Period of Lease.
3. Commencement of agreement.
4. Royalty Rates.
5. Minimum Rent.
6. Right of recoupment of shortworkings.
7. Mode of payment to Landlord.

A calculation table may be prepared before making the Journal entries which makes easy solution, The format of table is as follows:-

Year	Output	Royalty	Short working	Shortworking recouped	Unrecouped shortworkings transferred to P&L Account	Amount paid to Landlord
		Rs.	Rs.	Rs.	Rs.	Rs.

1.5 Journal entries in the books of lessee

There may be three types of situations in order to pass Journal entries in the books of lessee:-

1. When minimum Rent is more than Royalty.
2. When minimum Rent is equal to Royalty.
3. When minimum Rent is less than Royalty.

Ind Case

When Minimum Rent and Royalty are equal

- (i) When Royalty is due :-

Royalty A/c Dr.

To Landlord A/c

(Being Royalty due)

- (ii) When payment is made:-

Landlord A/c Dr.

To Cash/Bank

(Being Payment made to Landlord)

- (iii) For closing Royalty A/c at the end of the year

Profit & Loss A/c Dr.

To Royalty A/c

(Being Royalty Account transferred to Profit & Loss a/c.)

Ist Case

When Minimum Rent is more than Royalty :-

- (i) When Royalty is due :-

Royalty A/c Dr.

Shortworkings A/c Dr.

To Landlord A/c

(Being Royalty and Shortworkings due to Landlord)

- (ii) When payment is made :-

Landlord A/c Dr.

To Cash/Bank

(Being Cash paid to Landlord)

- (iii) Closing entry at the end of the year :-

Profit & Loss A/c Dr.

To Royalty A/c

(Being Royalty Account transferred to Profit & Loss A/c.)

IIIrd Case

When Minimum Rent is less than Royalty and Shortworking recouped.

- (i) For Royalty due

Royalty A/c Dr.

To Landlord A/c

(Being Royalty due to Landlord)

(ii) For payment & recouped of shortworking

Landlord A/c Dr.

To Cash/Bank

To Shortworking (Recouped)

(Being payment made to landlord and shortworking recouped)

(iii) For closing Royalty a/c and unrecouped shortworking :-

Profit & Loss A/c Dr.

To Royalty A/c

To Shortworking (Unrecouped)

(Being Royalty & Unrecouped shortworking transferred to Profit & Loss A/c.)

Kinds of Royalties

1. Royalties in Connection with mines
2. Royalties regarding oil –wells
3. Royalties regarding Brick Making
4. Royalties regarding patents
5. Royalties regarding copyright

Problem : 1

Ram Goal Ltd., leased in a colliery on 1st Jan 2001 at a minimum rent of Rs.15000 merging into a royalty of Re.1 per ton with a right to recoup shortworking over the first three years of the lease. The output for the first four years of the lease was 8000,13000, 21000 and 18000 tones respectively. Show the necessary ledger accounts

Solution

Calculation Table

Year	Output	Royalty	Minimum Rent	Short Workings	Short Workings Recouped	Unrecouped S.W transfer to P & L A/C.	Paid to Landlord
2001	8,000	8,000	15,000	7,000	-	-	15,000
2002	13,000	13,000	15,000	2,000	-	-	15,000
2003	21,000	21,000	15,000	-	6,000	3,000	15,000
2004	18,000	18,000	15,000	-	-	-	18,000

1.6 Conclusion

Royalty accounting involves unique concepts such as minimum rent, short workings, and recoupment, all of which are governed by specific contractual clauses. Both lessor and lessee must maintain accurate records. Subleases add another layer of complexity but follow similar principles of accrual and payment tracking.

Check Your Progress

1. Define royalty and give two examples.
2. What is minimum rent? How does it differ from royalty?
3. Explain the meaning of short workings with an example.
4. How is recoupment of short workings accounted for?
5. Mention the accounting entries in the books of a lessor.
6. What is a sublease in royalty accounting?

Let Us Sum Up

In this unit, we learned about the accounting treatment of royalty transactions involving lessors and lessees. We covered key terms like **minimum rent**, **short workings**, and **recoupment**, and studied how subleases are handled. The understanding of these concepts ensures proper financial reporting in contracts involving intellectual property or natural resources.

Glossary of Terms

- **Royalty:** Payment for the use of rights or assets
- **Minimum Rent:** Guaranteed minimum payment to lessor
- **Short Workings:** Difference between minimum rent and actual royalty
- **Recoupment:** Adjustment of short workings against future surplus royalties
- **Sublease:** Secondary lease arrangement by lessee to another party

Answers to Check Your Progress

1. Royalty is a payment for use of resources; examples: book publishing, mining.
2. Minimum rent is a fixed guaranteed payment; royalty may vary with usage/output.
3. If royalty = ₹8,000 and minimum rent = ₹10,000 → short working = ₹2,000
4. Recoupment is adjusting previous short workings against future excess royalty.
5. Lessee A/c Dr To Royalty A/c (when earned); Bank A/c Dr To Lessee A/c (when received)
6. A sublease is when the lessee grants rights to a third party under a new contract.

Suggested Reading

1. R.L. Gupta & Radhaswamy – *Advanced Accountancy*
2. T.S. Grewal – *Double Entry Bookkeeping – Volume 2*
3. Jain & Narang – *Advanced Accounting*
4. ICAI Study Materials on Royalty Accounting
5. M.C. Shukla – *Advanced Accounts*

HIRE PURCHASE AND INSTALMENT SYSTEMS

Structure

- Overview
- Learning Objectives
- 1.1 Hire Purchase System – Meaning
- 1.2. Nature of Hire Purchase Agreement
- 1.3. Features of Hire Purchase Agreement
- 1.4. Hire Purchase transactions are characterized by the following features
- 1.5. Distinction between hire-purchase and instalment system
- 1.6. Various Types of Calculation of interest:
- 1.7. Conclusion
- Check Your Progress
- Let Us Sum Up
- Glossary of Terms
- Answers to Check Your Progress
- Suggested Reading

Overview

The Hire Purchase and Instalment Systems are two popular credit purchase mechanisms. This unit explores how assets are bought and paid for in instalments, focusing on accounting entries, interest calculations, and treatment of defaults and repossession under the hire purchase method. It also introduces the instalment system and highlights the differences between the two.

Learning Objectives

After completing this unit, learners will be able to:

- Understand the concept and features of the hire purchase system
- Calculate interest in hire purchase agreements
- Pass relevant journal entries in the books of both buyer and seller

- Account for complete and partial repossession
- Explain the instalment purchase system
- Distinguish between hire purchase and instalment systems

1.1 Meaning

Hire Purchase System allows a buyer to take possession of goods by paying an initial amount (down payment) and the remaining in periodic installments. Ownership is transferred only after the final installment is paid. Installment Payment System is similar but ownership transfers immediately on signing the agreement.

1.2. Nature of Hire Purchase Agreement

In a hire purchase arrangement, the buyer (known as the hire purchaser) is allowed to take possession and use the goods right from the beginning. The payment for these goods is made in agreed-upon installments over a fixed period. However, legal ownership of the goods stays with the seller (hire vendor) and is transferred to the purchaser only after all installments have been fully paid. Every installment paid by the hire purchaser is considered as a charge for using the asset. If the purchaser fails to pay any installment—even the final one—the seller (hire vendor) has the right to repossess the goods. In such a case, the vendor is not obligated to refund any portion of the amount already received from the purchaser up to the date of default.

1.3. Features of Hire Purchase Agreement

1. **Possession:** Under a hire purchase agreement, the seller (hire vendor) hands over possession of the goods to the buyer (hire purchaser) immediately after the agreement is signed, while ownership remains with the vendor.
2. **Down Payment:** It is common for the purchaser to make an initial payment—known as the down payment—at the time of entering into the agreement.
3. **Repossession:** If the purchaser defaults on any installment, including the final one, the vendor has the legal right to reclaim the goods without offering any refund for the payments already made.

1.4. Hire Purchase transactions are characterized by the following features:

- (a) The buyer pays for the goods in periodic installments.
- (b) Each installment is considered a hire charge. If there is a default at any stage, even in the final payment, the seller can repossess the goods without compensating the buyer.
- (c) Ownership of the goods is transferred to the buyer only after all installments have been successfully paid.

1.5. Distinction between hire-purchase and instalment system

S.No	Basis	Hire Purchase System	Installment System
1	Nature of Agreement	It is essentially a lease agreement with an option to purchase the asset	It is a direct sale agreement involving deferred payment
2	Ownership Transfer	Ownership shifts to the hirer only after the final installment is cleared	Ownership is passed to the buyer at the time the contract is signed
3	Terminology for Parties	The purchaser is referred to as the hirer, and the seller is the hire vendor or owner	The individuals involved are known as the buyer and seller
4	Legal Relationship	The hirer and the hire vendor have a bailor-bailee relationship	The buyer and seller have a debtor-creditor relationship until full payment is made
5	Risk of Damage or Loss	The hirer is not liable for damage or loss if due care has been taken	The buyer bears the risk of loss since ownership lies with them
6	Right to Sell	The hirer cannot transfer ownership until the final payment is made	The buyer has the freedom to resell the asset, even if installments are pending
7	Recovery of Goods	If payments are not made, the owner has the right to reclaim the asset	The seller cannot reclaim the goods but may initiate legal action for recovery
8	Cancellation of	The hirer can opt out of the	The agreement is binding and

S.No	Basis	Hire Purchase System	Installment System
	Contract	agreement by returning the item	cannot be cancelled unilaterally
9	Installment Composition	Each payment includes both a rental charge and a portion of the principal price	Each payment consists of interest along with part of the principal amount
10	Governing Law	Regulated by the Hire Purchase Act of 1972	Governed under the Sale of Goods Act

1.6. Various Types of Calculation of interest:

The hire purchase price is typically higher than the cash price of the goods. This is because it includes an additional charge, often referred to as interest, which compensates the seller for two main factors:

1. The delay in receiving full payment, and
2. The potential risk that the buyer might default on future payments.

Interest in a hire purchase arrangement represents the cost of allowing the buyer to pay in parts after the goods have already been handed over. Generally, the interest rate applied in such transactions is higher than what would be charged on a standard loan or advance. This is because it incorporates not only the time value of money but also a risk premium — an extra amount added to account for the possibility that the buyer may miss payments, leading the seller to recover the goods in potentially used or damaged condition.

In hire purchase agreements, this risk charge is built into the interest component and not shown separately, as doing so would conflict with the basic nature of a hire purchase transaction.

From an accounting perspective, the difference between the hire purchase price and the cash price is considered the interest or finance charge. Since every installment includes this interest element, which affects financial income or expense, it becomes important to accurately determine the interest involved.

Interest included in each installment can be calculated under the following situations:

1. When the interest rate, cash price, and installment amounts are known.
2. When the interest rate is not provided.
3. When the total cash price is unknown.
4. When the installment amount or total installment price is not specified.
5. When the cash price is determined using the annuity method.

1.7. Conclusion

Hire purchase and instalment systems provide alternatives for credit purchases. While hire purchase involves conditional transfer of ownership, the instalment system offers ownership upfront. Proper understanding of accounting treatments helps in accurate recording and reporting of such transactions.

Check Your Progress

1. What is meant by hire purchase?
2. How is interest calculated under the hire purchase system?
3. What journal entry is passed in the books of the buyer for down payment?
4. What is complete repossession?
5. List two key differences between hire purchase and instalment systems.
6. What happens in partial repossession?

Let Us Sum Up

This unit covered the fundamentals of hire purchase and instalment purchase systems, including their accounting treatment, interest calculation, and handling of defaults. Special emphasis was laid on repossession and the legal/accounting distinctions between the two systems.

Glossary of Terms

- **Hire Purchase:** A system of credit sale where ownership passes after all payments
- **Instalment System:** A sale where ownership transfers immediately
- **Repossession:** Seller taking back goods due to default
- **Interest:** Additional payment for credit use

- **Depreciation:** Reduction in asset value over time

Answers to Check Your Progress

1. It is a credit purchase system where goods are hired, and ownership is transferred after final instalment.
2. On outstanding balance of cash price $\times$ rate $\times$ time
3. Hire Vendor A/c Dr To Bank A/c
4. Seller takes back the entire asset due to default
5. Ownership transfer timing, right to repossess
6. Seller takes back only part of the asset

Suggested Reading

1. R.L. Gupta & Radhaswamy – *Advanced Accountancy*
2. Jain & Narang – *Advanced Accounting*
3. T.S. Grewal – *Double Entry Bookkeeping*
4. ICAI Study Materials
5. M.C. Shukla – *Advanced Accounts*

Problem 1 Sundaram and Co. Calculate interest

- Cash Price: ₹69,000
- Down Payment: ₹23,000
- 3 Annual Instalments: ₹17,250 each
- Interest Rate: 10% p.a.

Problem 2 Machine Purchase on H.P. Calculate interest

- Cash Price: ₹1,15,000
- Down Payment: ₹28,750
- 3 Annual Instalments: ₹34,500 each
- Interest Rate: 8% p.a.

Problem 3 Vijay Ltd. Calculate interest

- Cash Price: ₹92,000

- Down Payment: ₹23,000
- 3 Equal Instalments: ₹27,600 each
- Interest Rate: 10% p.a.

Problem 4 Refrigerator on H.P. Calculate interest

- Cash Price: ₹1,38,000
- Down Payment: ₹34,500
- 3 Annual Instalments: ₹40,250 each
- Interest Rate: 10% p.a.

Problem 5 Ravi Traders Calculate interest

- Cash Price: ₹1,72,500
- Down Payment: ₹57,500
- 2 Instalments: ₹69,000 each
- Interest Rate: 10% p.a.

BRANCH ACCOUNTING

Structure

- Overview
- Learning Objectives
- 4.1 Meaning and Definition
- 4.2 Objectives of Branch Accounts
- 4.3 Features of Branches
- 4.4 Types of Branches
- Let Us Sum Up
- Check Your Progress
- Glossary

Overview

In modern business, organizations often expand by opening branches in various locations. Proper accounting of each branch's transactions helps in monitoring performance and ensuring control. This unit lays the groundwork for understanding the core principles of branch accounting.

Learning Objectives

By the end of this unit, learners will be able to:

- Understand the definition and need for branch accounts
- Distinguish between types of branches
- Recognize the special features of dependent branches
- Comprehend the objectives of maintaining branch accounts

4.1 Meaning and Definition

A branch is an extension of the head office operating in a different location but engaging in similar business activities. According to Section 29 of the Companies Act, 1956, a branch refers to any location where the company conducts operations similar to the head office.

4.2 Objectives of Branch Accounts

- To ascertain individual branch profit or loss
- To monitor branch-wise financial status
- To evaluate and compare performance across branches
- To regulate branch activities
- To assess inventory and fund needs
- To aid in legal compliance and internal control

4.3 Features of Branches

- Physically separate from the head office
- May operate under direct control or with independence
- Revenue and expenses are usually handled centrally
- Profits are remitted to the head office

4.4 Types of Branches

1. **Dependent Branches** – No separate books maintained; all records kept by the head office
2. **Independent Branches** – Maintain full set of accounts and have autonomy in operations

Let Us Sum Up

This unit covered the definition, objectives, and classification of branches and their relevance in financial reporting.

Check Your Progress

1. What is the meaning of a branch as per the Companies Act?
2. Mention any three objectives of maintaining branch accounts.
3. What are the key features of a dependent branch?
4. Differentiate between dependent and independent branches.

Glossary

- **Branch:** A physically separate business unit functioning under the main office
- **Head Office:** Central administrative unit of an organization
- **Dependent Branch:** Branch whose records are fully maintained by the H.O.
- **Independent Branch:** Branch that maintains its own books of accounts

Problem 1:

Loyal Shoe Company opened a branch at Madras on 1-1-2006. Prepare the Madras Branch Account for the years 2006 and 2007.

Particulars	2006	2007
Goods sent to branch	₹15,000	₹45,000
Rent	₹1,800	₹1,800
Salaries	₹3,000	₹5,000
Other expenses	₹1,200	₹1,600
Cash received from branch	₹24,000	₹60,000
Stock (31st Dec)	₹2,300	₹5,800
Petty Cash (31st Dec)	₹40	₹30

Problem 2

Kanpur Shoe Company opened a branch at Delhi in 1998. Prepare Delhi Branch Account for the year.

Item	Amount (₹)
Goods sent to branch	15,000
Cash sent for expenses	6,000

Item	Amount (₹)
Cash received from branch	24,000
Stock (31-12-1998)	2,300
Petty cash in han	40

Problem 3: From the following particulars prepare Branch Accounts

Item	Value (₹)
Opening stock	41,000
Opening debtors	12,500
Opening petty cash	1,000
Opening creditors	10,000
Cash purchase (branch)	12,500
Payment to creditors	45,000
Goods sent to branch	75,000
Credit sales	40,000
Cash sales	75,000
Cash received from debtors	45,000
Allowances	50
Discount	100
Bad debts	150
Salaries (by H.O.)	6,000
Rent for year (paid by H.O.)	1,200
Insurance (upto 31.3.2004)	750

Item	Value (₹)
Furniture (purchased by branch)	2,000
Petty expenses (by branch)	250
Closing stock	1,00,000
Closing creditors	27,500

Problem 4:

From the following particulars prepare the Branch Accounts for Salem Branch Goods invoiced at cost + 20%

Particulars	Amount (₹)
Goods sent to branch	2,11,872
Total sales	2,06,400
Cash sales	1,10,400
Cash from branch debtors	88,000
Opening stock (invoice price)	7,680
Closing stock (invoice price)	13,440
Opening debtors	24,000

Problem 5:

From the following particulars prepare the Branch Accounts for Madras Branch

Item	Amount (₹)
Opening stock	21,000
Closing stock	19,500
Opening debtors	37,800
Closing debtors	29,400
Opening petty cash	600
Closing petty cash	300
Goods sent to branch	78,000
Goods returned to H.O.	3,000
Cash sales	52,500
Credit sales	85,200
Returns by customers	1,500
Cash received from debtors	85,500
Allowances	600
Discounts	4,200
Bad debts	1,800
Salaries & wages	1,860
Advertisement	2,400
Rent & rates	3,600
Petty expenses	300

Prepare:

- Branch Stock A/c

- Branch Debtors A/c
- Branch Expenses A/c
- Branch Profit & Loss A/c

Problem 6:

Stock and Debtors System – Invoice Price P.O. Ltd. Calcutta – Bombay Branch (Goods at cost + 20%)

Item	Amount (₹)
Cost of goods sent	50,000
Goods received by branch (invoice price)	54,000
Credit sales	58,000
Debtors (closing)	20,800
Bad debts & discount	200
Cash remitted to H.O.	43,000
Cash in hand (closing)	2,000
Cash sent by H.O.	3,000
Closing stock (invoice price)	6,000
Branch expenses	12,000

DEPARTMENTAL ACCOUNTING

Structure

- Overview
- Learning Objectives
- 4.5 Meaning and Concept
- 4.6 Objectives of Departmental Accounting
- 4.7 Difference Between Department and Branch
- 4.8 Basis of Departmental Accounting
- 4.9 Expense Allocation Methods
- 4.10 Types of Departments
- 4.11 Interdepartmental Transfers
- 4.12 Departmental Accounting Illustration Summary
- Let Us Sum Up
- Check Your Progress
- Glossary

Overview

Departmental Accounting is a method of tracking financial performance by different functional areas within a business. Each department's profitability is assessed independently to aid managerial decision-making, performance comparisons, and strategic planning.

Learning Objectives

By the end of this unit, learners will be able to:

- Define departmental accounting and its significance
- Understand the key objectives and benefits of maintaining department-wise records
- Distinguish between branch and departmental accounting
- Apply expense allocation techniques for different departments
- Prepare departmental trading and profit & loss accounts
- Make adjustments for interdepartmental transfers

4.5 Meaning and Concept

A **department** is a specialized section within an organization, often structured based on the nature of activities (e.g., sales, manufacturing, clothing). **Departmental Accounting** refers to the process of maintaining separate financial records for each department, helping in analyzing their performance individually.

4.6 Objectives of Departmental Accounting

- Evaluate the performance of each department
- Identify profitable and non-performing departments
- Aid in resource allocation and managerial decisions
- Assist in planning for expansion or closure of departments
- Ensure transparency for internal and external stakeholders

4.7 Difference between Department and Branch

Basis	Departmental Accounting	Branch Accounting
Location	Same premises	Different geographical locations
Accounts	Centrally maintained	Maintained at H.O.; sometimes partial at branch
Allocation	Common expenses allocated	Less need for allocation
Currency	No currency conversion	Foreign branches may require conversion
Reconciliation	Not needed	Reconciliation may be necessary

4.8 Basis of Departmental Accounting

Two primary approaches:

1. **Columnar Books:** Separate columns for each department in main books
2. **Separate Books:** Full accounts maintained per department

4.9 Expense Allocation Methods

Expense Type	Allocation Basis
Rent, Insurance	Floor area
Lighting, Heating	Number of light points
Selling Commission, Discounts	Sales ratio
Depreciation	Value of fixed assets
Labour-related costs	Number of employees

4.10 Types of Departments

- **Dependent Departments:** Outputs of one department serve as inputs for another.
Example: Fabric to Garment department.
- **Independent Departments:** Operate independently without major interdependence.

4.11 Interdepartmental Transfers

- **At Cost:** No adjustment required
- **At Invoice/Selling Price:** Adjustment made for unrealised profit using Stock Reserve

4.12 Departmental Accounting Illustration Summary

- Allocate common expenses using logical basis
- Adjust for internal transfers and depreciation
- Prepare separate Trading and Profit & Loss Accounts
- Use stock reserve to eliminate unrealised profits in closing stock
- Consolidate departmental results if needed

Let Us Sum Up

This unit explained the concept, objectives, and structure of departmental accounting. Emphasis was placed on the differences from branch accounting, proper allocation of expenses, and the importance of adjusting for interdepartmental transfers.

Check Your Progress

1. What is departmental accounting and why is it important?
2. Mention two bases for allocating shared expenses between departments.
3. How are interdepartmental transfers treated in departmental accounts?
4. List three differences between branch and departmental accounting.

Glossary

- **Department:** A division of a business handling a specific task or product
- **Expense Allocation:** Dividing common expenses logically among departments
- **Stock Reserve:** Adjustment account for unrealised profit in interdepartmental stock
- **Interdepartmental Transfers:** Movement of goods/services between departments
- **Columnar Book:** Book with separate columns for department-wise recording

Problem: 1

Prepare:

- Departmental Trading and Profit & Loss Account for year ending 31st March 1998
- Balance Sheet as on that date

Particulars	Dept. X (₹)	Dept. Y (₹)
Opening Stock	3,910	3,335
Purchases	8,257	6,946
Sales	15,134	11,788
Wages	1,886	621
Transfer to other Dept.	115	97
Closing Stock	3,850	2,772
Carriage Inwards (split)	360	180
Depreciation, etc. – increased in all cases by 15% (as per instructions)		

Particulars	Dept. X (₹)	Dept. Y (₹)
Shared expenses split in 2:3 ratio		

Problem: 2

Cloth & Ready-Made Garments

Prepare:

- Departmental Trading and Profit & Loss A/c
- General Profit & Loss A/c (with stock reserve)

Particulars	Cloth (₹)	Garments (₹)
Opening Stock	6,90,000	1,15,000
Purchases	46,00,000	34,500
Sales	50,60,000	10,35,000
Transfer to Garments Dept.	6,90,000	–
Manufacturing Expenses	–	1,38,000
Selling Expenses	46,000	13,800
Closing Stock	4,60,000	1,38,000
General Expenses	2,53,000	

Problem: 3**Prepare:**

- Departmental Trading and Profit & Loss A/c
- Combined Income Statement

Particulars	Dept. X (₹)	Dept. Y (₹)
Opening Stock	92,000	—
Purchases	4,60,000	46,000
Wages	23,000	2,300
Goods Transfer (X to Y)	—	1,15,000
Sales	4,60,000	1,63,300
Closing Stock	69,000	23,000
Admin & Selling Exp.	₹34,500 total (shared in 4:1 ratio)	

FIRE INSURANCE CLAIMS IN ACCOUNTING

Structure

- Overview
- Learning Objectives
- 1.1 Introduction to Fire Insurance Claims
- 1.2 Principles of Indemnity and Stock Valuation
- 1.3 Computation Procedures
- 1.4 The Average Clause and Its Application
- 1.5 Illustrative Problems
- 1.6 Conclusion
- Check Your Understanding
- Let Us Sum Up
- Glossary of Key Terms
- Suggested Readings

Overview

This unit introduces learners to the concept of fire insurance accounting, focusing on how businesses recover stock and profit losses due to fire-related incidents. The content explores the calculation of claim amounts, use of trading accounts, and the significance of policy clauses like the average clause.

Learning Objectives

By the end of this unit, learners will be able to:

- Understand how fire insurance policies compensate for stock and profit loss.
- Apply the average clause in calculating admissible claims.
- Prepare memorandum trading accounts for estimating stock loss.
- Analyze scenarios involving salvaged stock, underinsurance, and damaged goods.
- Compute insurance claims using real-life accounting problems.

1.1 Introduction to Fire Insurance Claims

Fire incidents can result in major financial disruptions for businesses. To mitigate these losses, businesses often take fire insurance policies. These policies offer financial recovery for damaged or destroyed stock, provided the policyholder adheres to the terms and maintains adequate coverage.

1.2 Principles of Indemnity and Stock Valuation

Insurance contracts operate on the principle of indemnity, which ensures that the insured is reimbursed only for the actual amount **of loss** incurred. The value of stock lost due to fire is usually computed using a Memorandum Trading Account that estimates the stock as on the date of fire.

1.3 Computation Procedures

Two types of losses can occur:

- Total Stock Loss: When all stock is destroyed.
- Partial Stock Loss: When only part of the stock is damaged or salvaged.

If the policy contains an average clause, the claim amount is computed as:

$$\text{Claim Amount} = \left(\frac{\text{Loss} \times \text{Insured Amount}}{\text{Total Stock Value}} \right) \text{Claim Amount} = (\text{Total Stock Value} \times \text{Loss} \times \text{Insured Amount})$$

1.4 The Average Clause and Its Application

The average clause prevents overcompensation when the stock is underinsured. If the sum insured is less than the actual stock value at the time of fire, the insurer will pay a proportionate amount based on the insured value.

1.5 Problems 1

A fire broke out in Mr. Bookworm's shop on 17th June 2013.

- Insured Value: ₹81,750
- Opening Stock (31st Dec 2012): ₹91,015
- Purchases till 17th June 2013: ₹1,22,080
- Sales during this period: ₹1,67,860
- Gross Profit Margin: 25% on sales
- Salvaged Stock:
 - Undamaged: ₹12,208
 - Damaged: ₹11,336

Determine the value of stock destroyed and compute the insurance claim.

Problems 2

Fire damaged the business premises on 15th September 2017.

- Policy Coverage: ₹54,500
- Opening Stock (1st April 2017): ₹21,800
- Purchases up to date: ₹81,750
- Sales: ₹1,14,450
- Profit Rate: 30%
- Recovered Stock: ₹10,900

Problems 3

A fire incident occurred on 20th August 2018 at a warehouse.

- Policy Amount: ₹98,100
- Stock on 1st Jan 2018: ₹59,950
- Purchases till fire: ₹1,30,800
- Sales: ₹1,74,400
- Gross Profit Rate: 25%
- Salvaged Stock: ₹16,350

Calculate the admissible claim amount using the memorandum method.

Problems 4

On 10th July 2019, a portion of the stock was affected by fire.

- Opening Stock (1st Jan 2019): ₹70,850
- Purchases till date: ₹1,03,550
- Sales: ₹1,41,700
- Gross Profit Rate: 20%
- Stock Salvaged: ₹8,720
- Sum Insured: ₹81,750

Compute the amount claimable under the fire insurance contract.

1.6 Conclusion

Understanding the principles behind fire insurance accounting ensures that a business can receive fair compensation during crises. Proper documentation, timely reporting, and correct valuation methods are essential for lodging valid claims.

Check Your Understanding

1. What is the purpose of using the memorandum trading account in fire claims?
2. When is the average clause applied in claim computation?
3. How is salvage value treated in calculating stock loss?
4. Explain how gross profit rate influences the claim amount.

Let Us Sum Up

- Fire insurance reimburses actual loss based on policy terms.
- The average clause adjusts claims in underinsurance cases.
- Estimation techniques like memorandum trading accounts are key tools.
- Salvage value must be deducted from the total loss.

Glossary of Key Terms

- **Indemnity:** Compensation for actual loss, no profit element.
- **Average Clause:** Pro-rata adjustment when stock is underinsured.
- **Salvaged Stock:** Recoverable stock that reduces claim value.
- **Gross Profit Rate:** Percentage used to estimate profit component in loss.
- **Policy Amount:** The maximum amount an insurer is liable to pay.

Suggested Reading

- ICAI Material on Insurance Claims Accounting
- Shukla & Grewal: Advanced Accounts
- M.N. Mishra: Principles and Practice of Insurance
- AS 29 – Provisions, Contingent Liabilities and Contingent Assets