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Year – II
Semester – III
Paper - II

Advanced Accountancy - I

Centre for Distance and Online Education

श्रीचन्द्रशेखरेन्द्रसरस्वतीविश्वमहाविद्यालयः

Sri Chandrasekharendra Saraswathi Viswa Mahavidyalaya

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Enathur, Kanchipuram 631561.

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Chief Editor

Dr. B. Balaji Srinivasan

Director, CDOE

Programme Co-ordinator

Dr. K.S.Sivakumar

Course Co-ordinator

Dr. P.Balaji

Course Writer

Dr. P.Balaji

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Centre for Distance and Online Education (CDOE)
Sri Chandrasekharendra Saraswathi Viswa Mahavidyalaya,
Enathur,Kanchipuram-631561.
Tamil Nadu, India
Phone: 044 – 2726 4301; Mail Id: onlineprograms@kanchiuniv.ac.in ;

Advanced Accountancy I

Objective

To train the students in preparing the Royal Account and Hirepurchae and Instalment Purchase systems and Branch and Department Accounts

Unit – I

Accounting as an 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.

Text Book

1. Advanced Accountancy - VOL-I - T.S.Reddy, A.Murthy Revised Edition,2017 ,Margham publications, 24, Rameshwaram Road, T.Nagar, Chennai -17
2. Financial Accounting - - T.S.Reddy, A.Murthy Revised Edition,2016 ,Margham publications, 24, Rameshwaram Road, T.Nagar, Chennai -17

Reference Books

1. Advanced Accountancy - Vol-I - R.L.Gupta& M. Radaswamy, Revised edition – 2016 S.Chand& Company Ltd, Ram Nagar, New Delhi-110 055
2. Financial Accounting - S.P.Jain& J.L. Narang, Revised Edition 2007, Kalyani Publishers, B-I/1292, Rajinder Nagar, Ludhiana

ACCOUNTING STANDARDS

Structure

- Overview
- Learning Objectives
- 1.1 Introduction to Accounting as an Information System
- 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
- Suggested Reading

Overview

"Accounting goes beyond merely recording financial transactions; it functions as a vital information system that supports informed decision-making. This unit examines the fundamental concepts underlying Accounting provides stakeholders with essential and understandable information for evaluating an organization's performance. 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

- Understand accounting as an information system
- Identify various users of accounting information
- Explain the concept and types of accounting standards
- Examine the advantages and drawbacks of establishing accounting standards
- Discuss the process and bodies involved in accounting standard setting in India

1.1 Introduction to Accounting as an Information System

Accounting standards are formally established guidelines created by professional accounting bodies, government agencies, or regulatory authorities. They provide direction on how financial transactions should be recognized, measured, presented, and disclosed in financial statements. These standards form the structural basis for producing dependable and consistent financial reports. Their purpose is to reduce inconsistencies in accounting practices by promoting uniform methods and policies. By limiting excessive flexibility in accounting choices—while still allowing reasonable judgment—standards accounting standards make it possible to compare the financial statements of different organizations in a clear and consistent manner. This uniformity helps users of financial reports obtain reliable and useful information. These standards also outline the fundamental accounting principles and explain how they should be implemented when preparing and presenting financial data. Supporting the production of statements that present a true and fair view. As a result, transparency is enhanced, financial discipline is strengthened, and regulatory bodies are better equipped to evaluate the accuracy and credibility of reported information.

1.2 Meaning of Accounting Standards:

According to the Institute of Chartered Accountants of India (ICAI), accounting standards are formal guidelines that direct how financial information should be recorded and reported. They consist of rules, methods, and procedures issued by a recognized accounting authority, regulatory body, or government institution. These standards provide a framework for accounting practices, covering how transactions are identified, measured, recorded, presented, and disclosed in financial statements. In essence, accounting standards serve as a regulatory framework that ensures uniformity and consistency in accounting practices.

Accounting standards focus primarily on:
a.Identifying and recording financial transactions and events in the accounting system;
b. Quantifying and assessing these transactions and events to determine their financial impact;
c. Organizing and presenting financial data in a clear, well-structured format that users can easily interpret; and
d. Including all necessary disclosures to enhance transparency, allowing stakeholders—such as the public and potential investors—to understand the financial reports correctly and make well-informed decisions.

1.3. Need for Accounting Standards:

a) To reduce discrepancies between accounting theories and practical application, ensuring consistency across the various accounting methods employed by different organizations.

b) Consistent accounting methods are crucial to ensure that companies' financial results can be compared in a meaningful and reliable way. For instance, if one firm values inventory using FIFO and another uses LIFO, their financial outcomes cannot be directly compared. Standardized methods allow for accurate evaluation.

c) To establish uniform methods for preparing financial reports, ensuring their reliability and allowing users to compare financial information with confidence.

d) To ensure fairness, transparency, and uniformity in accounting practices, thereby building trust among users of financial reports.

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

f) Accounting standards restrict the range of permissible accounting methods within reasonable limits, enhancing the comparability of financial reports across organizations and minimizing disputes among stakeholders.

g) To harmonize accounting policies and practices across businesses, facilitating the standardization of diverse accounting treatments for various elements of financial reporting.

1.4 Objectives of Accounting Standards:

- To promote uniformity in accounting methods and procedures across organizations.
- To minimize inconsistencies that can limit the comparability of financial statements.
- To enhance the trustworthiness and dependability of financial reporting.

*To enhance the accuracy and reliability of the amounts presented in financial statements.

• To enable users to easily interpret the accounting rules and techniques used in preparing the financial reports.

• To create a uniform structure for accounting practices, covering valuation approaches and necessary disclosures.

1.5. Importance and uses of Accounting Standards

1. Accounting standards help investors assess potential returns and risks by allowing them to compare investment opportunities across different companies and even across countries..
2. These standards serve as authoritative guidelines for professional accountants, including Chartered Accountants in India, when preparing financial statements. They help ensure that financial reports are accurate and impartial, while also promoting accountability and ethical behavior within the accounting profession. Accounting standards also help improve the quality of audits, supporting auditors in delivering precise and reliable assessments of financial statements.
3. Government bodies, tax departments, and other regulatory agencies view financial reports prepared under recognized standards as credible and trustworthy.
4. Such standardized financial statements serve as dependable resources for analysts, researchers, and consultants, facilitating economic analysis, forecasting, and strategic planning.

1.6. Limitations and Shortcomings of Accounting Standards

1. Some accounting issues can be handled through multiple valid methods, each supported by reasonable justification, making it challenging to identify the most appropriate approach for a specific case.
2. Applying accounting standards may sometimes create rigidity, limiting flexibility in responding to unique circumstances, as they tend to promote a more standardized 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. The Indian Perspective on Accounting Standards:

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) and works in consultation with the National Advisory Committee on Accounting Standards (NACAS).To promote consistency among the diverse accounting methods and policies used across the country, the ICAI set up the Accounting Standards Board on April 21, 1977.

1.8. Functions and Areas of Focus of the ASB

a. To develop Accounting Standards for formal approval and issuance by the Institute's Council, while considering applicable laws, prevailing business practices, customs, and the economic environment of the country.
b. To maintain consistency with the goals of the International Accounting Standards Committee (IASC), of which the Institute is a member, by reviewing global standards and adapting them to suit Indian requirements when appropriate.
c. To promote awareness and encourage the effective adoption of these standards among all parties involved in preparing and presenting financial statements.
d. To issue guidance notes and provide clarifications on issues related to the interpretation and application of Accounting Standards.
e. To review and update Accounting Standards periodically, ensuring they remain current and suitable for changing conditions.

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. How is accounting defined as an information system?
2. Who primarily uses accounting information?
3. Explain the Concept of Accounting Standards and the Various Types That Are Recognized
4. List any three benefits of accounting standards.
5. What are the major challenges in setting accounting standards?
6. What is the Scope and and Key Functions of the 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 that outline how financial statements should be prepared and presented.

GAAP: A set of commonly accepted accounting principles that ensure uniformity in accounting practices.

IFRS: Internationally recognized financial reporting standards applied across the globe.

Ind AS: India's version of accounting standards, designed to be in line with IFRS.

ICAI: The professional body that regulates the accounting profession in India.

NFRA: The authority responsible for monitoring and enforcing accounting and auditing standards in the country.

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
- 2.1 Meaning of Royalty
- 2.2 Difference Between Rent And Royalty
- 2.3 Important Terms In Connection With Royalty
- 2.4 Accounting Procedure
- 2.5 Accounting Records in the Books of the Lessor and Lessee
- 2.6 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 entitlement to utilize assets such as patents, copyrights, and 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

• Describe the meaning of royalty and associated terms like minimum rent and short workings.
• Explain how short workings are recovered, along with the procedure involved.
• Record royalty-related entries in the accounts of both the lessor and the lessee.
• Understand the accounting treatment applicable when a sublease arrangement exists.

2.1 Meaning of Royalty

Royalty is a periodic payment made, typically based on production or sales, in return for the right to use a particular asset or benefit.. 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. As a nominal account, royalty is recorded as an expense (debited) in the lessee's books and as income (credited) in the lessor's books. At the close of each financial year, the balance in the royalty account is transferred to the Profit and Loss Account to complete the accounting cycle.

2.2. 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.

2.3. 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 legal right to utilize it in exchange for a royalty payment. The owner who provides this usage right is known as the *lessor*.
2. **Lessee:**

   The entity that makes royalty payments in exchange for the Permission to utilize an asset is called the lessee.
3. **Minimum Rent / Dead Rent / Fixed Rent:**

   This represents the minimum payment the lessee is obligated to make to the lessor, This applies even when no actual 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 Rs.4,000 in the first year and Rs.9,500 in the second year, the shortworking will be Rs.6,000 and Rs.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 manage this issue, lease contracts may contain clauses for recovering such deficits. The different approaches include:

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:

Certain lease agreements define a specific timeframe—such as the initial 3, 4, or 5 years—during which the lessee is allowed to recover shortworkings. For example, if a coal mine is leased Effective from 1st January 2000, for a

period of 10 years, and the contract allows recoupment only within the first 4 years, then shortworkings can be recovered only up to 31st December 2003. Any shortworkings remaining after this period are recorded as an expense in the Profit and Loss Account.

(i) Over a Specific Number of Subsequent Year

Under this provision, the shortworking of each year can be recovered within a specified number of years following the year in which it arises. For instance, if a mine lease begins on 1st January 1990 for 20 years and the agreement allows a 3-year recovery period for each year's shortworking, then the shortworking from 1990 can be recovered until 1993, from 1991 until 1994, and so forth. Any portion not recovered within the allowed period is charged to the Profit and Loss Account in the year when the recovery right expires.

2.4 Accounting Procedure

Before preparig the Royalty Accounts, the following details should be recorded:

1. Name of the Landlord and Lessee
2. Lease period
3. Start date of the agreement
4. Royalty rates
5. Minimum rent
6. Right to recover shortworkings
7. Method of payment to the Landlord

It is helpful to prepare a calculation table prior to making journal entries, as it simplifies the process. The table can be structured in the following format:

A calculation table can be prepared before recording journal entries to simplify the process. The table can be organized in the following

format:

Year	Output	Royalty	Short working	Shortwor- ing recou- ped	Unrecouped shortworkings transferred to P&L Account	Amount paid to Landlord
		Rs.	Rs.	Rs.	Rs.	Rs.

2.5 Journal Entries in the Books of the Lessee

Journal entries in the lessee's books can arise under three possible scenarios:

1. When the minimum rent exceeds the royalty
2. When the minimum rent is equal to the royalty
3. When the minimum rent is less than the royalty

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.)

IInd 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.)

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.)

Types of Royalties

1. Royalties related to mining operations
2. Royalties associated with oil wells
3. Royalties for brick-making activities
4. Royalties concerning patents
5. Royalties linked to copyrights

Illustration 1:

Ram Goal Ltd. leased a colliery on 1st January 2001 with a minimum rent of Rs. 15,000, along with a royalty of Re. 1 per ton. The lease agreement included a provision to recoup shortworkings within the first three years. The production for the first four years of the lease was 8,000, 13,000, 21,000, and 18,000 tons, respectively. Prepare the relevant ledger accounts.

Solution

Calculation Table

Year	Output	Royalty	Minimum Rent	Short Workings	Short Workings Recouped	Unrecoued 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

Problem: 1

The Bengal Mines Co. Ltd. entered into a 25-year lease agreement with Mr. Dass starting from 1st January 1986. According to the lease terms, the company was required to pay a royalty of Rs. 5 for every tonne of mineral extracted, a minimum (dead) rent of Rs. 20,000, and had the provision to recover any short workings incurred during the initial years of the lease..

Year	1986	1987	1988	1989	1990
Tonnes	2000	3000	4000	4500	5000

Calculate royalty.

Problem: 2

Ramu acquired a lease for a mine for 20 years, agreeing to pay a royalty of Rs. 1 per tonne along with a minimum annual rent of Rs. 12,000. The lease allowed for the recovery of shortworkings within the first three years. The production during this period was as follows:

Year	1990	1991	1992	1993
Output in tonnes	Nil	4000	20000	40000

Give journal entries, shortworking account and landlord's account in the books of ramu.

Problem: 3

A obtained the rights to manufacture and sell locks from B on 1st January 1995. A is required to pay a royalty of Rs. 5 per lock, subject to a minimum annual payment of Rs. 50,000, with settlements to be made on 31st December each year.

Annual period	95	96	97	98
Number of Locks	8000	9000	11000	18000

Calculate royalty.

Problem: 4

Assam Coal Company leased a mine for 30 For a period commencing on 1st January 2002 under the following terms: a royalty of Re. 0.75 per tonne of coal produced is payable. The minimum rent for the first year is Rs. 10,500, increasing by Rs. 500 each year until it reaches Rs. 12,000, which shall be fixed for the duration of the remaining years. Any shortworkings in a given year can be recovered within the next two years.

The quantity produced for the first 6 years were as follows:

YEAE	02	03	04	05	06	07
Output generated	4000	8000	14000	22000	28000	35000

Calculate royalty.

Problem: 5

X Ltd. leased its coal mine to Z Ltd. The agreement stipulated a royalty of Rs. 10 per tonne of coal extracted. The minimum annual rent is Rs. 80,000, and any shortworkings are to be recovered within the first two years of the lease. The production for the first three years is as follows:

Year	2006	2007	2008

Quantity produced	5000	9000	8000

Calculate royalty.

2.6 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 meant by minimum rent? How does it differ from royalty?
3. Explain the meaning of short workings with an example.
4. Explain the accounting treatment for the recoupment of shortworkings.
5. Describe the accounting entries to be recorded by the 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 involves offsetting past shortworkings against excess royalty earned in subsequent periods.
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
- 3.1 Hire Purchase System – Meaning
- 3.2. Nature of Hire Purchase Agreement
- 3.3. Features of Hire Purchase Agreement
- 3.4. Hire Purchase transactions are characterized by the following features
- 3.5. Distinction between hire-purchase and instalment system
- 3.6.Various Types of Calculation of interest:
- 3.7.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 Variations between the two

Learning Objectives

- Understand the concept and features of the hire purchase system
- Calculate interest in hire purchase agreements
- Record the appropriate journal entries in the accounts of both the buyer and the seller.

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

3.1 Meaning

Under the Hire Purchase system, a buyer can take possession of goods by paying an initial down payment and settling the remaining amount through scheduled instalments, with ownership transferring only after the last instalment is paid. In the Instalment Payment system, however, ownership is acquired by the buyer immediately upon signing the agreement, even though the payment is made in parts.

3.2. 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 instalments over a fixed period. However, Legal title to the goods stays with the seller (hire vendor) and is conveyed to the purchaser only after all instalments have been fully paid. Every instalments paid by the hire purchaser is considered as a charge for using the asset. If the purchaser fails to pay any instalments—even the final one—the seller (hire vendor) is authorized to repossess the goods. Under these circumstances, the vendor is not obligated to refund any portion of the amount already received from the purchaser up to the date of default.

3.3. Key Features of a Hire Purchase Agreement

1. **Possession:** Under a hire purchase agreement, the seller (hire vendor) delivers the goods to the buyer (hire purchaser) immediately after signing the agreement. However, legal ownership of the goods remains with the vendor until all payments are fully made.
2. **Down Payment:** The buyer typically makes an initial payment, called the down payment, at the time of entering into the agreement.
3. **Repossession:** If the buyer fails to pay any instalment, including the final one, the vendor has the legal right to repossess the goods without being obliged to return any amount already paid.

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

(a) The buyer pays for the goods in scheduled instalments over an agreed period.

b) Each instalment under a hire purchase agreement is treated as a hire charge. If the buyer defaults on any payment, including the final instalment, the seller is entitled to repossess the goods without refunding any payments already made.

c) The buyer acquires legal ownership of the goods only after all instalment payments have been fully completed.

3.5. Distinction between hire-purchase and instalment system

S.No	**Basis**	**Hire Purchase System**	**Instalment 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 instalment 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

S.No	**Basis**	**Hire Purchase System**	**Instalment System**
5	Risk of Damage or Loss	The hirer is not responsible for any loss or damage	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 instalments are pending
7	Recovery of Goods	If payments are not made, the owner has the right to reclaim the asset	The seller is not entitled to repossess the goods but can pursue legal action to recover the payment.
8	Cancellation of Contract	The hirer can opt out of the agreement by returning the item	The agreement is binding and cannot be cancelled unilaterally
9	Instalment 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

3.6. 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.

3. In a hire purchase agreement, interest represents the cost of permitting the buyer to pay for the goods in instalments while taking immediate possession. The interest rate is typically higher than that of a standard loan, reflecting both the time value of money and an added risk premium.

This premium accounts for the possibility that the buyer may default, forcing the seller to repossess goods that could be used or damaged.

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 instalment includes this interest element, which affects financial income or expense, it becomes important to accurately determine the interest involved.

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

1. When the interest rate, cash price, and instalment amounts are known.
2. When no interest rate has been mentioned
3. When the total cash price is unknown.
4. When the instalment amount or total instalment price is not specified.
5. When the cash price is determined using the annuity method.

Illustration: 1 (Model when rate of interest, total cash price and instalments are given)

On 01.01.2013 Raman purchased an Air conditioner from TVS Ltd. Chennai. Under Hire purchase system. Its cash price was Rs.62700. its other things are as follows:

- The buyer is required to make an upfront payment of Rs. 18,000 at the time of signing the agreement.
- The outstanding amount will be settled through three equal annual instalments of Rs. 18,000 each.
- The seller applies an interest rate of 10% on the financed amount.
- Calculate the total interest that the buyer will owe to the seller.

Solution

Date of payment	Instalment	Actual Cash price	Interest@10%	Actual instalment amount paid
01.01.2013	18000	62700	-	18000

31.12.2014	18000	62700-18000=44700	44700*10/100=4470	13530
31.12.2015	18000	44700-13530=31170	31170*10/100=3117	14883
31.12.2016	18000	Last instalment payable 18000 but cash price due (31170-14483)= difference is interest that is 18000-16287	18000-16287=1713	16287
Total	72000		9000	62700

Illustration: 2 (Rate of interest is Not given)

Mr. Karthik of Balaji purchased an LED TV from a TV merchant under a Hire Purchase Agreement. The cash price of the TV was Rs. 162,000 on 01.01.2015, and The total amount is to be paid in 12 equal partsmonthly instalments of Rs. 20,000 each, starting from 31.01.2016. Calculate the portion of each instalment that represents interest and the portion that represents repayment of the cash price.

Solution:

Working Note: Calculation of total interest payable under HP agreement.

Particulars	Working	Rs.
HPP	20000*12	240000
CP	As given	162000
Total interest	HPP- CP	78000

Statement of Apportionment of Total Interest of Rs.78000 & Cash Price of Rs.162000

Month	No of Month from inception	HPP outstanding	HPP outstanding Ratio	Amount Payable Per instalment	Working	Interest	Cash Price
JANUARY	12	240000	12	20000	78000*12/78	12000	8000
FEBRUARY	11	220000	11	20000	78000*11/78	11000	9000

MARCH	10	200000	10	20000	78000*10/78	10000	10000
APRIL	9	180000	9	20000	78000*9/78	9000	11000
MAY	8	160000	8	20000	78000*8/78	8000	12000
JUNE	7	140000	7	20000	78000*7/78	7000	13000
JULY	6	120000	6	20000	78000*6/78	6000	14000
AUGUST	5	100000	5	20000	78000*5/78	5000	15000
SEPTEMBER	4	80000	4	20000	78000*4/78	4000	16000
OCTOBER	3	60000	3	20000	78000*3/78	3000	17000
NOVEMBER	2	40000	2	20000	78000*2/78	2000	18000
DECEMBER	1	20000	1	20000	78000*1/78	1000	19000
		1560000	78	240000		78000	162000

Illustration: 3 (Cash price is Not given)

Mr. Madhavan entered into a Hire Purchase agreement to buy a car from a dealer by making a down payment of Rs. 100,000 on 1st January 2014. He agreed to pay the remaining Rs. 510,000 the payment will be made in three equal yearly instalments, with an annual interest rate of 5%. Determine the portion of each instalment that goes toward the principal and the portion that represents interest.

that represents interest and the portion that goes toward the cash price of the car.

Solution

Note 1 Give hire purchase price is Rs.610000 (Down payment +Balance payable). As per the agreement balance of Rs.510000 is payable in 3 annual instalment of Rs.170000 each (510000*3) combining payment for cash price and interest?

Note 2 the hire purchase instalment always includes amount payable an account of interest and cash price, here the rate of interest is 5% on cash price of 100% and therefore the HIP =105% so interest = HPI/105*5

Table showing calculation of interest and Cash price

Year	Due date	Instalment	Calculation inverse method (starting from last instalment)	Interest	Cash Price
	1	2	3	4	5=2-4
III	31.12.2016	170000	170000*5/105	8095	161905
II	31.12.2015	170000	161905+170000*5/105	15805	154195
I	31.12.2014	170000	161905+154195+170000*5/105	23148	146852
0	31.12.2014	100000	No part of interest on the down payment	-	100000
		610000		47048	562952

Illustration: 4 (When Hire purchase instalment Not given)

Ragu Transport Ltd. purchased three vans from TATA Motors at Rs. 1,500,000 each under a hire purchase agreement. A down payment of Rs. 300,000 per van was made, and the remaining amount was to be paid in three equal annual instalments, with interest at 12% per annum. Calculate the interest component for each year.

Solution:

Statement of interest and HPI Calculation

Particulars	Cash Price	Interest	HPI
Cash price Less: down payment	1500000 300000	-	300000
Outstanding balance of the cash price after the first annual instalment.	1200000 400000	144000	544000
Outstanding balance of the cash price after the second annual instalment.	800000 400000	96000	496000
Outstanding balance of the cash price after	400000		

the third annual instalment.	400000	48000	448000
Total		288000	1708000

Note: The outstanding cash price is calculated by subtracting the down payment from the total cash price. This remaining amount is to be paid in three equal annual instalments. For example, Rs. 1,200,000 ÷ 3 = Rs. 400,000 per instalment.

Illustration: 5 (Annuity method)

Mr.Sakthi a sole trader purchased a motor van for his business under hire purchase system payable Rs.30000 annually, for 10 years. The rate of interest is 5%. Gives the present value of annuity of Rs.1 for 10 years at 5% is Rs.7.7217. Calculate cash price.

Solution:

Note: Cash Price = instalment * Annuity factor given

- Since on Rs.1 annuity (instalment) for 10 year at 5% present worth that is . cash price is Rs.7.7217
- Hence on Rs.300000 annuity that is, instalment for 10 years at 5 % intrest. Present worth = Rs. 7.7217 * Rs.30000= Rs. 231651

Illustration: 6

Malan purchased machinery under a hire purchase agreement on 1st January 2013. The payment terms are four annual instalments of Rs. 12,690 each, payable at the end of every year, with interest charged at 5% included in the instalments. Prepare the Machinery Account and Hire Vendor Account in the books of Malan, assuming he defaults on the third instalment, after which the vendor repossesses the machinery. Depreciation on the machinery is provided at 10% per annum on the reducing balance..

Calculation of cash price and interest

No of instalment	Amount of instalment (Rs.)	Interest	Net cash price(Rs.)

4th	12690	12690 x 5/105 = 604	12086
3rd	12690	(12690+12086) x 5/105 = 1180	11510
2nd	12690	(12690+12860+11510) x 5/105=1728	10962
1st	12690	(12690+12860+11510+10962) x 5/105 = 2250	10440
	50760	5762	44998

In the books of Malan (Buyer)

Machinery A/C

1-1-13	To Hire vendor A/c	Rs. 44998	31-12-13	By Depreciation	Rs. 4500
				By balance C/D	40498
		44998			44998
1-1-14	To Balance B/D	40498	31-12-14	By Depreciation	4050
				By Balance C/D	36448
		40498			40498
1-1-15	To Balance B/D	36448	31-12-15	By Depreciation	3645
				By Hire vendor	24776
				By profit & loss- loss	8027
		36448			36448

Hire vendor A/c

		Rs.			Rs.
31-12-13	To Bank (1st)	12690	1-1-13	By machinery	44998
	To Balance C/D	34558	31-12-13	By interest	2250
		47248			47248
31-12-14	To Bank (2nd)	12690	1-1-14	By balance B/d	34558
	To Balance C/D	23596	31-12-14	By interest	1728
		36286			36286
31-12-15	To Machinery A/c	24776	1-1-15	By balance C/d	23596
			31-12-15	By interest	1180
		24776			24776

Problem 1

Raman purchased a motor car from Bharathan on 1st January 2003, with a cash price of Rs. 56,000. He made an initial down payment of Rs. 15,000, and the remaining balance is to be paid in three equal annual instalments of Rs. 15,000 each. The interest rate is 5% per annum. Calculate the interest component included in each instalment.

Problem 2

The Madras Trading Company purchased a motor car from Bombay Motor Company under a hire purchase agreement on 1st January 1990. An initial payment of Rs. 10,000 was made in cash, with the balance to be paid in three annual instalments of Rs. 10,000 each on 31st December of every year. The cash price of the car is Rs. 37,250, and Bombay Motor Company charges interest at 5% per annum.

Problem 3

On 1st January 1986, X purchased machinery under a hire purchase agreement. A down payment of Rs. 4,000 was made at the time of signing the contract, with the remaining balance to be paid in three annual instalments of Rs. 4,000 each. The cash price of the machinery is Rs. 14,900, and interest is charged at 5% per annum. Calculate the interest component included in each instalment.

3.7. Conclusion

HP and IP 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 should the buyer record in their books for the down payment?
4. What is complete repossession?
5. State two primary distinctions between hire purchase and installment purchase arrangements.
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 credit-based purchase system in which ownership of the goods is transferred only after all payments are completed.
- **Instalment System:** A purchase system where ownership of the goods is transferred to the buyer immediately, even though payment is made in instalments**.**
- **Repossession**: Seller taking back goods due to default
- **Interest**: Additional payment for credit use
- **Depreciation**: Reduction in asset value over time

Solutions for "Check Your Progress" Exercises

1. This is a system of credit purchase where goods are taken on hire, and legal ownership is acquired only upon completion of the last instalment.
2. On outstanding balance of cash price × rate × 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*

Structure

- Overview
- Learning Goals
- 4.1 Introduction
- 4.2 Difference Between Departments and Branches
- 4.3 Aims of Maintaining Branch Accounts
- 4.4 Characteristics of Branches
- 4.5 Categories of Branches
- **Summary**
- **Self-Assessment**
- 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 provides a foundation for grasping the fundamental concepts of branch accounting.

Learning Objectives

- 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 Introduction

A branch is a part of the head office that operates from a different location while carrying out similar business activities. According to Section 29 of the Companies Act, 1956, a branch is any site where the company conducts operations akin to those of the head office.

For businesses operating in a limited local area, serving customers from a single office is manageable. However, as a business grows and expands into multiple regions, managing all operations from one central office becomes challenging and costly. To overcome this, part of the business is separated from the main office and set up at another location; this unit is called a branch, while the original office remains the head office.

Similarly, Section 2(9) of the Companies Act, 1956 defines a branch office as any unit that performs functions similar to the head office or engages in production, processing, or manufacturing activities. Large enterprises, such as banks, insurance companies, manufacturers, and trading firms, often maintain several branches both domestically and internationally.

This lesson outlines the fundamental accounting methods used to record and manage the financial activities of such branches.

4.2. Departments vs. Branches

Although both are organizational divisions, departments and branches have notable differences:

1. **Location**

   Departments usually function within the same building or premises as the head office, whereas branches are located in different places, often at considerable distances. Due to this geographical separation, branches are sometimes referred to as Departments functioning at a separate location

2. **Control and Supervision**

   Since departments are located near The main office, their activities can be constantly supervised and effectively controlled. However, It is challenging for the main office to keep close supervision over distant or overseas branches. Control may be strong for nearby branches but weak for far-off ones.

3. **Nature of Activities**

Departments usually concentrate on particular functions or specialize in certain areas, such as production, marketing, or finance. In comparison, branches generally perform operations similar to those of the head office, such as sales or manufacturing. For example, Bata Shoe Ltd. has multiple

retail branches that carry out the same activities. In contrast, Delhi Cloth and General Mills Ltd. operates branches engaged in diverse operations, including textiles, sugar, chemicals, and machinery.

4.3 Goals of Maintaining Branch Accounts

- To ascertain individual revenue or Deficit of the Branch
- 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

4.4. Features of Branches

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

4.5 Categories of Branches

'Branches' may vary in their type, scale, and the level of autonomy they possess. Therefore, different accounting systems are used depending on the type of branch. Generally, branches are classified according to two main factors:

1. **Based on Location**

   - ✓ **Home Branches** – Branches located within the same country as the head office.
   - ✓ **Foreign Branches** – Branches established outside the home country.

2. **Based on the Level of Autonomy**

Dependent Branches: These branches do not keep separate accounting records; the head office manages all significant accounting entries.

Independent Branches: These branches maintain their own books, handle local purchases, and manage day-to-day transactions independently.

Foreign Branches: Located in another country, these branches are generally treated as independent and maintain complete accounting records.

Branches can also be classified based on the nature of activities they perform.

- Some branches only sell goods (like retail shops).
- Others deal in wholesale trade.
- Certain large branches may even …be involved in manufacturing. For instance, Delhi Cloth & General Mills Limited. operates several branches that manufacture textiles, sugar, oils, fertilizers, and other products. Such large units are often called *divisions* due to their high level of independence.

The extent of accounting work done by a branch depends on how much responsibility the head office gives it. Generally, the more autonomy a branch has, the more accounting records it maintains.

Major Classes of Branches

Branches are commonly divided into the following five categories:

1. **Cash-Only Branches**

These branches purchase goods solely from the head office and sell them for cash. All cash collected is remitted to the head office, which also provides the funds required to meet the branch's expenses.

2. **Cash and Credit Branches**

   These branches get their goods exclusively from the head office and sell them for both cash and on credit. Cash collections are sent back to the head office, which also provides the funds needed to cover the branch's expenses.

3. **Branches Selling for Cash and Credit**

   These branches obtain their goods solely from the head office and sell them for cash as well as on credit. All cash collected is forwarded to the head office, which also provides funds to cover the branch's operating expenses.

4. **Branches Invoiced at Selling Price**

   In this type, the head office dispatches goods to the branch at their selling price instead of the cost price. The accounting treatment differs slightly, as the profit element (referred to as loading) is accounted for separately at a later stage.

5. **Independent Branches**

   These branches handle purchases, sales (both cash and credit), and other operations independently. They maintain their own complete set of books and periodically send Sending account statements to the head office for consolidation.

6. **Foreign Branches**

   These are autonomous branches situated in other countries. They keep their own accounting records in the local currency and prepare independent financial statements, which are later converted and integrated into the head office's accounts.

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:** A branch whose accounts are completely managed by the head office.
- **Independent Branch:** A branch that keeps and manages its own set of books.

Illustration 1:

Chennai Ltd. supplies goods to its Madurai Branch at cost price. The head office covers all expenses directly, except for small petty cash expenditures, which are managed by the branch manager.

Assets / Receipts:

- Opening Stock: 2,100
- Opening Petty Cash: 50
- Opening Furniture: 250
- Goods Supplied by Head Office: 7,800
- Goods Returned to Head Office: 300
- Cash Sales: 15,250

Expenses / Liabilities:

- Salaries and Wages: 1,860
- Advertisement: 240
- Rent and Rates: 360
- Closing Stock: 1,950
- Closing Petty Cash: 30
- Closing Furniture: 230

Illustration 2:

Ram Co., based in Kanchipuram, operates a branch in Chennai. The head office supplies goods to the branch at an invoice price that includes a 25% markup on cost. All expenses related to the branch are paid by the head office. Using the following information, prepare the branch account in the head office's books:

Details:

- **Opening Balances:**
  - Stock at invoice price: Rs. 11,000
  - Debtors: Rs. 1,700
  - Petty Cash: Rs. 100
- **Goods Sent to Branch:** Rs. 20,000 (at invoice price)
- **Branch Expenses Paid by Head Office:**
  - Rent: Rs. 600
  - Wages: Rs. 200
  - Salaries and other expenses: Rs. 900
- **Remittances to Head Office:**
  - Cash sales: Rs. 2,650
  - Cash collected from debtors: Rs. 21,000
  - Goods returned by the branch at invoice price: Rs. 400
- **Closing Balances:**
  - Stock at invoice price: Rs. 13,000
  - Debtors: Rs. 2,000
  - Petty Cash: Rs. 25

Ram Ltd. (H.O.) – Chennai Branch Account

(Prepared with Goods Recorded at Cost Price)

Debit (Rs.)		Credit (Rs.)
To Opening Balances		By Cash:
Stock	8,800	Cash Sales
Debtors	1,700	Cash Collected from Debtors
Petty Cash	100	By Goods Sent to Branch A/C (at cost)
To Goods Sent to Branch A/C (at cost)	16,000	
To Bank Expenses:		By Closing Balances:
Rent	600	Stock (at cost)
Wages	200	Debtors
Salaries	900	Petty Cash
To Net Profit Transferred to General P&L A/C	8,905	
Total Debit	36,395	**Total Credit**

Problem 1:

Loyal Shoe Company established a branch in Madras on 1st January 2006. Prepare the branch account for the Madras branch in the head office's books for the years 2006 and 2007.

Particulars	2006	2007
Goods received from HO	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: Prepare the Branch Accounts based on the following information.

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 Received from HO	75,000
Credit sales	40,000
Cash sales	75,000
Cash 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
Furniture (purchased by branch)	2,000
Petty expenses (by branch)	250
Closing stock	1,00,000
Closing creditors	27,500

Problem 3

Kanpur Shoe Company established a branch in Delhi in 1998. Prepare the Delhi Branch Account for that year.

Item	Amount
Goods Received from HO	15,000
Branch expenses	6,000
Cash from Debtors	24,000
Stock (31-12-1998)	2,300
Petty cash	40

Problem 4:

Using the details provided below, prepare the branch accounts for the Salem branch, where goods are invoiced at cost plus 20% profit.

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

Problem 5:

Subramani & Co., Chennai, sends goods to its Karaikudi branch at cost plus 25%. All cash collected by the branch is sent to the Head Office, and all branch expenses are paid from Chennai. Using the following details, prepare the branch account in the head office books:

Details:

- **Opening Balances:**
  - Stock on 1.1.1999 (invoice price): Rs. 12,500
  - Debtors on 1.1.1999: Rs. 12,000
- **Closing Balances:**
  - Stock on 31.12.1999 (invoice price): Rs. 15,000
  - Debtors on 31.12.1999: Rs. 32,500
- **Goods Invoiced from Chennai:** Rs. 60,900
- **Remittances to Chennai:**
  - Cash sales: Rs. 16,000
  - Cash received from debtors: Rs. 29,500
  - Goods returned to H.O.: Rs. 2,400
- **Cheques Received from Chennai for Expenses:**
  - Wages and salaries: Rs. 11,000
  - Rent: Rs. 3,000
  - Sundry expenses: Rs. 510

Problem 6:

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

Item	Amount
Cost of goods sent	50,000
Goods sent to branch	54,000
Credit sales	58,000
Debtors (closing)	20,800
Bad debts & discount	200
Amount transferred to Head Office	43,000

Item	Amount
Closing Cash	2,000
H O Sent to Cash	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 Foundations 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:

- Explain the concept of departmental accounting and its importance
- Recognize the main objectives and advantages of keeping records for each department
- Differentiate between branch accounting and departmental accounting
- Implement methods to allocate expenses across various departments
- Prepare trading and profit & loss accounts for individual departments
- Adjust for transactions and transfers between departments

4.5 Meaning and Concept

A department is a distinct segment within an organization, typically organized according to the type of activity it performs (for example, sales, production, or apparel). Departmental accounting involves keeping separate financial records for each department, enabling an individual assessment of their performance.

4.6 Goals of Departmental Accounting

- Find out 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 Distinction Between Branch Accounts and Department Accounts

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 Foundations 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	Total light outlets
Selling Commission, Discounts	Sales ratio
Depreciation	Book value of fixed assets

Expense Type	Allocation Basis
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

Illustration 1:

A company operates two departments: Cloth and Ready-Made Garments. The garments are produced internally using cloth provided by the Cloth Department at its selling price. Using the data given below, prepare the Departmental Trading and Profit & Loss Accounts for the year 1997.

Particulars	**Cloth Department**	**Ready-made Garments**
Opening Stock on 1.1.1997	6,00,000	1,00,000
Purchases	40,00,000	30,000
Sales	44,00,000	9,00,000
Transfer to Ready-made Garments Department	6,00,000	-
Expenses - Manufacturing	-	1,20,000
Selling -Expenses	40,000	12,000
Stock on 31.12.1997	4,00,000	1,20,000

The closing stock in the Ready-Made Garments Department can be treated as comprising 75% cloth and 25% other costs. The Cloth Department earned a profit of 15% in 1996. The total general business expenses amounted to Rs. 2,20,000.

Solution

Departmental Trading and Profit and Loss A/c for the year ending Dec 31, 1997

Particulars	**Cloth (Rs)**	**Readymade Garments (Rs)**	**Total**	**Particulars**	**Cloth (Rs)**	**Readymade Garments (Rs)**	**Total**
To Opening Stock	6,00,000	1,00,000	7,00,000	By Sales	44,00,000	9,00,000	53,00,000
To Purchases	40,00,000	30,000	40,30,000	By Transfer to Ready-made Garments Dept.	6,00,000		6,00,000
To Transfer from Cloth Dept.		6,00,000	6,00,000	By Closing Stock	4,00,000	1,20,000	5,20,000
To Mfg. Exp.		1,20,000	1,20,000				
To Gross Profit c/d	8,00,000	1,70,000	9,70,000				
	54,00,000	10,20,000	64,20,000		54,00,000	10,20,000	64,20,000
To Selling Exp.	40,000	12,000	52,000	By Gross Profit b/d	8,00,000	1,70,000	9,70,000
To Net Profit c/d	7,60,000	1,58,000	9,18,000				
	8,00,000	1,70,000	9,70,000		8,00,000	1,70,000	9,70,000

To Gen. Exp.			2,20,000	By Net Profit b/d			9,18,000
To Stock Reserve (cl. stock)			14,400	By Stock Reserve (op. stock)			11,250
To Net Profit			6,94,850				
			9,29,250				9,29,250

Illustration 2:

A company operates two departments: Cloth and Ready-Made Garments. The garments are manufactured internally using cloth supplied by the Cloth Department at its selling price. Using the data provided below, prepare the Departmental Trading and Profit & Loss Accounts for the year 1997.

The following figures pertain to the business of **Mr. Siva Rama Associates** for the year ending 31st December 2007:

Particulars	Department	
	X	Y
Stock (lst Jan, 2007)	8 0,000	--
Purchases from outside	4,0 0,000	40,000
Wages	20,000	2,000
Transfer of Goods from Dept. X	--	1,00,000
Stock at Cost (31st December, 2007)	60,000	20,000
Sales	4,0 0,000	1 42,000

The closing stock of the Ready-Made Garments Department can be assumed to consist of 75% cloth and 25% other costs. The Cloth Department earned a profit of 15% in 1996. The total general business expenses for the year amounted to Rs. 2,20,000.

Solution

Particulars	**X (Rs)**	**Y (Rs)**	**Particulars**	**X (Rs)**	**Y (Rs)**
To Opening Stock	80,000	--	By Transfer of Goods to Y	1,00,000	---
To Purchases	4,00,000	40,000	By Sales	4,00,000	1,42,000
To Wages	20,000	2,000	By Closing Stock	60,000	20,000
TO Goods from X	--	1,00,000			
To Gross Profit c/d	60,000	20,000			
	5,60,000	1,62,000		5,60,000	1,62,000
To Adm. & Selling Expenses	24,000	6,000	By Gross profit b/d	60,000	20,000
To Net Profit	36,000	14,000			
	60,000	20,000		60,000	20,000

Illustration 3:

A company operates two departments: Cloth and Ready-Made Garments. The garments are produced internally using cloth provided by the Cloth Department at its normal selling price. Using the data provided below, prepare the Departmental Trading and Profit & Loss Accounts for the year ending 31st March 2014.

`Particulars	**Cloth**	**Readymade**
Opening sock	300000	50000
Purchases	2000000	15000
Sales	2200000	450000
Transfer to readymade	300000	-
Manufacturing expenses	-	60000
Selling expenses	20000	6000
Closing stock	200000	60000

The closing stock in the Ready-Made Garments Department can be treated as comprising 75% cloth and 25% other costs. The Cloth Department earned a gross profit of 15% in 2013–14. The total general business expenses amounted to Rs. 1,10,000.

Solution

Departmental Trading and profit & loss A/C for the year ending 31.3.2014

	Cloth Rs.	**Readymade Rs.**		**Cloth Rs.**	**Readymade Rs.**
To Opening stock	3,00,000	50,000	By sales	22,00,000	4,50,000
To purchases	20,00,000	15,000	By transfer to		
To Transfer from			Readymade department	3,00,000	-
Cloth department	-	3,00,000		2,00,000	60,000
To manufacturing expenses	-	60,000	By closing stock		
To gross profit c/d (departmental)	4,00,000	85,000			
	2700000	510000		2700000	510000
To selling expenses	20,000	6,000	By gross profit b/d	4,0,000	85,000
To net profit c/d (departmental)	3,80,000	79,000			
	400000	85000		400000	85000

General P & L A/c for the year ending 31.3.2014

	Rs.		Rs.
To general expenses	1,10,000	By net profit b/d (3,80,000 + 79,000)	4,59,000
To stock reserve (closing) (60,000x75%x 16%)	7,200	By stock reserve (opening) (50,000x75%x15%)	5,625
To net profit (bal figure)	3,47,425		
	465625		664625

Working Note

Stock reserve has been calculated as follows:

Gross profit percentage on the Cloth Department's sales = 4,00,000/2500000*100=16%

Cloth component in the closing stock of Ready-Made Garments =60000*75%=45000

Reserve required for unrealized profit in closing stock = 45000*16%= Rs.7200

Reserve already existing in opening stock = 50000*75%*15%=5625

Illustration 4:

Mehta Ram of Ram Nagar purchased goods for three departments as follows:

- **Department A:** 200 units
- **Department B:** 1,400 units
- **Department C:** 400 units

The total cost of purchases amounted to Rs. 5,100.

Sales for the departments were:

- **Department A:** 180 units at Rs. 15 each
- **Department B:** 1,500 units at Rs. 18 each
- **Department C:** 450 units at Rs. 6 each

The opening stock for the departments was:

- **Department A:** 100 units
- **Department B:** 400 units
- **Department C:** 60 units

Mehta Ram has informed that the gross profit rate is uniform across all departments. Prepare the **Departmental Trading Accounts** for the three departments.

Solution

1. Calculation of closing stock

Opening stock + Purchases – Sales

Department	Opening stock	Purchases	Sales	Closing stock
X	100	200	180	120
Y	400	1400	1500	300
Z	60	400	450	10

2. Calculation of Gross Profit Ratio

Department X 200*15 = 3000

Department Y 1400*18 = 25200

Department Z 400*6 = 2400

30600

Less: Total Cost 5100

Gross Profit 25500

Gross Profit ratio = gross profit/sales*100

25500/30600*100 = 83.33%

3. Calculation of Cost per units

Department X 15-15*83.33/100=12.50 = 2.50

Department Y 18- 18*83.33/100= 15 = 3

Department Z 6 – 6*83.33/100 = 5 =1

4. Calculation of amount of opening stock (Cost Price)

Department	Opening stock	Cost Price	Amount
X	100	2.50	250
Y	400	3	1200
Z	60	1	60

5. Calculation of amount of Purchases (Cost Price)

Department	Purchases	Cost Price	Amount
X	200	2.50	500
Y	1400	3	4200
Z	400	1	400

6. Calculation of amount of closing stock (Cost Price)

Department	closing stock	Cost Price	Amount
X	120	2.50	300
Y	300	3	900
Z	10	1	10

7. Calculation of amount of Sales (Selling Price)

Department	Sales	Selling Price	Amount
X	180	15	2700
Y	1500	18	27000
Z	450	6	2700

Departmental Trading Account

Particulars	**X**	**Y**	**Z**	**Particulars**	**X**	**Y**	**Z**
To Open Stock	250	1200	60	By Net Sales	2700	27000	2700
To Purchases	500	4200	400	By Closing Stock	300	900	10
To Gross Profit B/F	**2250**	**22500**	**2250**				
	3000	27900	2710		3000	27900	2710

Problem: 1

The following purchases were made by a business house having three departments.

Dept. A – 1,000 units

Dept. B – 2,000 units {at a total cost of Rs.1, 00,000)

Dept. C – 2,400 units

Opening Stock Were:

Dept. A –120 units

Dept. B – 80 units

Dept. C –152 units

Sales Were:

Dept. A – 1,020 units at Rs. 20 each

Dept. B – 1,920 units at Rs.22.50 each

Dept. C – 2,496 units at Rs. 25 each

Assuming the gross profit rate is the same for all departments, prepare the Departmental Trading Account.

Problem: 2

The following purchases were made by a business house having three departments.

Dept. A – 1,500 units

Dept. B – 1,000 units {at a total cost of Rs. 92 000)

Dept. C – 2000 Units

Opening Stock Were:

Dept. A –200 units

Dept. B – 300 units

Dept C - 150

Selling price

Dep A Rs.200

Dep B Rs. 25

Dep C Rs. 30

Assuming the gross profit rate is the same for all departments, prepare the Departmental Trading Account.

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
- 5.1 Introduction to Fire Insurance Claims
- 5.2 Principles of Indemnity and Stock Valuation
- 5.3 Computation Procedures
- 5.4 The Average Clause and Its Application
- 5.5 Illustrative Problems
- 5.6 Conclusion
- Check Your Understanding
- Summary
- Glossary of Key Terms
- Reference Materials

Overview

This unit familiarizes learners with fire insurance accounting, emphasizing how businesses compensate for losses in stock and profits caused by fire incidents. It covers the computation of claim amounts, the role of trading accounts, and the importance of policy provisions such as 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.

5.1 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.

5.2 Principles of Indemnity and Stock Valuation

Insurance contracts are according to the principle of indemnity, which guarantees that the insured is compensated only for the actual loss suffered. In cases of fire, the value of lost stock is typically determined using a Memorandum Trading Account, which estimates the stock value as of the fire's date.

5.3 Computation Procedures

Two types of losses can occur:

- Total Stock Loss: When all stock is destroyed.
- Partial Stock Loss: When only a portion of the stock is damaged or can be salvaged.

5.4 The Average Clause and Its Use

The average clause ensures that the insured does not receive excess compensation when stock is underinsured. If the sum insured is lower than the actual stock value at the time of fire, the insurer pays only a proportionate amount relative to the insured value.

Illustration 1:

- On 17th June 2013, a fire occurred at the premises of Mr. Bookworm, a bookseller, resulting in the destruction of the majority of his stock. The value of the stock that could be salvaged was Rs. 11,200, while additional damaged stock was recovered and valued at Rs. 10,400. The following information was gathered from the accounts:
- Stock as of 31st December 2012: Rs. 83,500
- Purchases from 01-01-2013 to 17-06-2013: Rs. 1,12,000

- Sales during the same period: Rs. 1,54,000
- Based on the past three years, the average gross profit is 25% of sales

Solution:

Memorandum Trading A/c (From 01-01-2013 to 17-06-2013)

Particulars	Amount	Particulars	Amount
To Open Stock	83,500.00	By Sales	154,000.00
To Purchase	112,000.00		
To Gross Profit (1,54,000 x 25/100)	38,500.00		80,000.00
	234,000.00	By Closing Stock - B/F	234,000.00

Calculation of loss

Date of fire in Stock	80000
Less: Saved value	21600

Loss	58400

1.5 Problem 1

How can the claim amount be determined under loss of profit insurance?

A fire broke out on **1st September 1993** in the warehouse of Mr. Ganesan. Using the details provided below, calculate the amount that should be claimed under the loss of profit insurance policy.

Stock on 01.01.1993 25300

Purchases from 1.1.93 to date of fire	50400
Sales from 1.1.93 to date of fire	156000
Manufacturing expenses and wages	60000
Goods withdrawn by Ganesan at cost	2500
rate of gross profit on cost is	30%
Value of salvaged stock	3600

Problem 2

On **1st October 1992**, a merchant's premises caught fire, resulting in damage to his stock. The stock was **fully insured**. The merchant prepared his accounts **annually, up to 31st December**. The following information is available to calculate the insurance claim.

Stock on 31.12.91	26544
Stock on 31.12.90	19228
Purchases from 1.1.92 to the date of fire	70000
Purchases up to 31.12.91	90516
Sales up to 31.12.91	104000
Sales from 1.1.92	100000

Additional information

- ✓ In May 1992 goods costing Rs.5000 were given as free samples for advertising purpose. No entry was made in the books.
- ✓ During 1992, a clerk **misappropriated unrecorded cash sales** amounting to Rs. 2,000.
- ✓ The **gross profit rate remained constant** throughout the year.
- ✓ the **value of stock salvaged after the fire** was Rs. 1,500.

Problem 3

A fire broke out in the godown of Mr. Agni on 15-07-2012 and entire stock of goods was destroyed. Mr. Agni had insured the stock fully. From the following particulars, calculate the amount of claim.

Stock on 01-04-2012- Rs.88,000.

Purchases from 01-04-2012 to 15-07-2012- Rs.2,00,000.

Sales from 01-04-2012 to 15-07-2012- Rs.1,92,000.

Mr. Agni earns a GP of 20% on turnover normally.

Problem 4

A fire broke out in the business premises. of Mr. Indra on 10-10-2011 and Rs.21,500 worth of stock was saved from fire. Stock as per Trading A/c as on 31-03-2011 was Rs.1,80,000.

Purchases from 1-4-2011 to 10-10-2011 amounted to Rs.2,23,000. Sales from 1-4-2011 to 10-10-2011 amounted to Rs.2,60,000.

Using the average gross profit of 25% from the past three years, determine the total insurance claim amount.

Problem 5

Mr. Chandra had insured his goods fully. A fire broke out in his godown resulting in a heavy loss of goods on 21-09-2012. Goods of the value of Rs.10,000 were saved. From the following information, calculate the amount of claim.

Stock on 1-4-2012 Rs.46,000, Purchases from 1-4-2012 to 21-09-2012 Rs.4,00,000, Sales from 1-4-2012 to 21-09-2012 Rs.3,60,000, Returns during the year– Sales- Rs.8,000, Purchases- Rs.6,000.

On the observation of past records the GP for the preceding 3 years were 15%, 20% and 25%. The expenses incurred to extinguish fire amounted to Rs.2,000.

Problem 6

Mr. Surya had insured his stock-in-trade with United Insurance Co. A fire broke out on 12-12-12 destroying most part of his godown and stock saved was worth Rs.4,000. Stock on 1-4-12 was Rs.1,90,000, Purchases from 1-4-12 to 12-12-12 was Rs.2,80,000, Sales from 1-4-12 to 12-12-12 was Rs.4,60,000.

The opening stock was overvalued by Rs.10,000 and sales includes Rs.16,000 being sale of furniture. Mr. Surya normally enjoyed a gross profit of 25% on his sales. Find out the amount of claim.

Problem 7

A fire broke out in the godown of Mr. Rahu on 24-08-2009 and goods worth Rs.16,000 was saved. From the following information, calculate the amount of claim.

Purchases during 2008-09 Rs.1,80,000, Sales during 2008-09 Rs.2,55,000, Purchases from 1-4-2009 to 24-08-2009 Rs.60,000, Sales from 1-4-2009 to 24-08-2009 1,05,000, Stock on 1-4-2008 Rs.80,000, Stock on 31-03-2009 Rs.1,00,000, Stock on 31-03-2009 was overvalued by Rs.5,000.

Problem-8

On **20th May 2009**, a fire damaged Mr. Kethu's godown. Stock with a value of **Rs. 35,000** was recovered, and the remaining information was gathered from the preserved books and records.

Purchases for the period ended 31-12-2008 Rs.3,60,000. Sales for the period ended 31-12-2008 Rs.5,65,000.

Purchases from 01-01-2009 to 19-05-2009 Rs.1,25,000.

Sales from 01-01-2009 to 19-05-2009 Rs.1,90,000.

Stock on 31-12-2007 Rs.1,60,000 and on 31-12-2008 Rs.1,90,000.

Opening stock on 01-01-2008 was overvalued by Rs.10,000. Closing stock on 31-12-2008 was undervalued by Rs.10,000.

Find out the amount of claim.

Problem-9

On 10th July 2010, a fire broke out at Mr. Budha's premises, destroying the entire stock except for Rs. 22,500. The stock was fully insured. Based on the following information, determine the amount of the insurance claim:

- **Stock on 01-04-2010:** Rs. 1,25,000
- **Purchases from 01-04-2010 to 10-07-2010:** Rs. 5,10,000
- **Sales from 01-04-2010 to 10-07-2010:** Rs. 5,90,000
- **Rate of gross profit on sales for the past four years:** 30%, 32%, 30%, and 32%

Problem-10

Mr. Guru had insured his stock-in-trade for Rs. 80,000 under a fire insurance policy. On 31st December 2008, a fire destroyed the stock, except for Rs. 21,000. The following details are available:

- **Opening Stock on 01-04-2008:** Rs. 30,000
- **Purchases from 01-04-2008 to 31-12-2008:** Rs. 1,37,500
- **Carriage Inwards:** Rs. 5,000
- **Sales from 01-04-2008 to 31-12-2008:** Rs. 90,000
- **Average Gross Profit Rate:** 33⅓%
- **Insurance Policy:** Subject to Average Clause

Based on this information, calculate the **stock loss** and the **amount of claim**.

5.6 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 objective of preparing a memorandum trading account in the context of fire insurance 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

INVESTMENT ACCOUNT

Structure

- 5.7 Meaning of Investment
- 5.8 Nature of Investment
- 5.9 Importance of Investment
- 5.10 Investment vs. Speculation vs. Gambling
- 5.11Classification of Investments
- 5.12: Objectives of Investment
- 5.13: Accounting for Investments
- 5.14Journal Entries
- 5.15 Accounting Standards
- 5.16 Types of Investment Accounts
- 5.17: Investment Ledger
- 5.18 Valuation Methods
- 5.19 Investment in Shares
- 5.20: Investment in Bonds and Debentures
- 5.21: Investment in Mutual Funds
- 5.22: Risk and Return Analysis
- 5.23: Investment Policy and Strategy
- 5.24: Investment Accounting in Financial Statements
- 5.25: Limitations of Investment Accounting
- 5.26: Investment Portfolio Management
- 5.27: Conclusion

5.7 Meaning of Investment

Investment is the allocation of funds to one or more assets with the aim of earning income or achieving capital growth. It entails foregoing present consumption to gain future advantages. In accounting terms, investments are treated as assets since they are resources capable of providing future economic benefits.

5.8 Nature of Investment

Investments can be tangible (land, buildings, machinery) or intangible (shares, bonds, mutual funds). They are made with the objective of earning returns and ensuring capital growth.

5.9 Importance of Investment

- Generates income and wealth.
- Promotes capital formation and economic development.
- Provides financial security and stability.
- Enables diversification of risk.
- Acts as a hedge against inflation.

5.10 Investment vs. Speculation vs. Gambling

Basis	Investment	Speculation	Gambling
Objective	Regular income and capital appreciation	Profit from price fluctuations	Quick gain without analysis
Risk	Moderate	High	Very high
Decision Basis	Research and analysis	Market trends	Chance or luck
Time Horizon	Long-term	Short-term	Instantaneous

5.11 Classification of Investments

1 Based on Duration

1. **Short-term Investments:** Held for less than one year; examples include treasury bills and short-term deposits.
2. **Long-term Investments:** Held for more than one year; examples include shares, bonds, and real estate.

2 Based on Nature

- **Fixed Income Securities:** Provide fixed returns (e.g., bonds, debentures).
- **Variable Income Securities:** Returns fluctuate (e.g., equity shares).

3 Based on Purpose

- **Trade Investments:** Made for business control or strategic purposes.
- **Non-trade Investments:** Made for earning income or appreciation.

4 Based on Ownership

- **Individual Investments:** Owned by individuals.

Institutional Investments: Held by entities such as banks, insurance firms, or mutual fund companies.

5.12: Objectives of Investment

1. **Safety of Principal:** Ensuring the invested capital is secure.
2. **Liquidity:** Ability to convert investments into cash easily.
3. **Income Stability:** Earning regular returns through interest or dividends.
4. **Capital Appreciation:** Increase in the value of investments over time.
5. **Tax Benefits:** Certain investments provide tax deductions or exemptions.
6. **Control and Influence:** Acquiring shares to gain control over another company.

5.13: Accounting for Investments

1 Meaning

Investment accounting involves recording, classifying, and valuing investments in financial statements.

2 Initial Recognition

Investments are recorded at **cost**, which includes purchase price, brokerage, commission, and other incidental expenses.

3 Valuation of Investments

- **Current Investments:** Valued at lower of cost or market value.
- **Long-term Investments:** Valued at cost unless there is a permanent decline in value.

4 Income Recognition

- **Interest on Bonds/Debentures:** Recognized on an accrual basis.
- **Dividends on Shares:** Recognized when the right to receive payment is established.

5 Disposal of Investments

When investments are sold, the difference between the sale proceeds and the carrying amount is treated as profit or loss.

5.14Journal Entries

Transaction	**Journal Entry**
Purchase of investment	Investment A/c Dr. To Bank A/c
Receipt of income	Bank A/c Dr. To Interest/Dividend A/c
Sale of investment	Bank A/c Dr. To Investment A/c (Cost) To Profit on Sale A/c
Reduction in value from investment sale	Loss on Sale A/c Dr. To Investment A/c

5.15 Accounting Standards

1. AS 13 – The Accounting for the Investments

AS 13, issued by the (ICAI), lays down the principles for recognizing, classifying, and valuing investments.

Key Provisions:

- **Investments are categorized as either current or long-term.**
- **Current investments are recorded at the lower of their cost or fair market value.**
- **Long-term investments are usually recorded at cost, except in cases where their value has permanently declined..**

2 Ind AS 109 – Financial Instruments

This standard aligns with IFRS 9 and provides a comprehensive framework for recognition and measurement of financial assets and liabilities.

5.16 Types of Investment Accounts

1 Individual Investment Account

Used by individuals to manage personal investments.

2 Joint Investment Account

Operated jointly by two or more persons.

3 Institutional Investment Account

Maintained by organizations such as banks, insurance companies, or mutual funds.

4 Portfolio Investment Account

Used to manage a diversified portfolio of securities.

5.17: Investment Ledger

An investment ledger records all transactions related to investments. It includes details such as date of purchase, cost, income received, and sale proceeds.

Format:

Date	Particulars	Nominal Value	Cost	Interest/Dividend	Balance

5.18 Valuation Methods

1. Cost Method
Investments are initially recorded at their purchase cost and are carried in the books at the same value unless there is a permanent decline in value.

2. Market Value Method
Investments are reported at their current market price as on the balance sheet date.

3. Lower of Cost or Market Value (LCMV) Method
The carrying value of investments is taken as the lower of their original cost or current market price.

Cum-Interest / Cum-Dividend
The purchase price includes any interest or dividend accrued up to the date of acquisition.

Ex-Interest / Ex-Dividend
The purchase price excludes any interest or dividend accrued.

Adjustment:
Any interest or dividend that accrued before the date of purchase is subtracted from the total income received.

5.19 Investment in Shares

1 Equity Shares

Represent ownership in a company and provide voting rights.

2 Preference Shares

Provide fixed dividends and have preferential rights over equity shares in dividend payment and capital repayment.

3 Accounting Treatment

- Purchase recorded at cost.
- Dividend income recognized when declared.
- Sale recorded at selling price with profit or loss adjustment.

5.20: Investment in Bonds and Debentures

1 Bonds

Debt instruments issued by governments or corporations to raise funds.

2 Debentures

Long-term debt instruments issued by companies, usually carrying a fixed rate of interest.

3 Accounting Treatment

- Interest accrued is recognized periodically.
- Premium or discount on purchase is amortized over the life of the bond.

5.21: Investment in MF

MFs collect capital from multiple investors and invest it in a variety of assets to create a diversified portfolio.

1. Types of Mutual Funds:

- **Equity Funds** – Invest primarily in stocks.
- **Debt Funds** – Focus on fixed-income securities like bonds.
- **Balanced Funds** – Combine investments in both equity and debt.
- **Index Funds** – Track and replicate the performance of a specific market index.

2 Accounting Treatment

Investments in mutual funds are recorded at cost and valued at market value at the end of the accounting period.

5.22: Risk and Return Analysis

1 Types of Risk

- Market Risk
- Credit Risk
- Liquidity Risk
- Interest Rate Risk

- Inflation Risk

2 Measurement of Return

Return = (Income + Capital Gain) / Investment × 100

5.23: Investment Policy and Strategy

An investment policy defines the framework for making investment decisions.

1 Components

- Investment objectives
- Risk tolerance
- Asset allocation
- Monitoring and review

5.24: Investment Accounting in Financial Statements

1 Balance Sheet Presentation

- Long-term investments under “Non-current assets.”
- Short-term investments under “Current assets.”

2 Income Statement Presentation

- Interest and dividend income under “Other Income.”
- Profit or loss on sale of investments under “Other Gains/Losses.”

5.25: Limitations of Investment Accounting

- Market value fluctuations affect reliability.
- Valuation methods differ across entities.
- Subjectivity in determining permanent decline in value.
- Complexities in fair value measurement.

5.26: Investment Portfolio Management

Portfolio management involves selecting and managing a mix of investments to achieve specific financial goals.

1 Objectives

- Risk minimization
- Return maximization
- Liquidity maintenance
- Diversification

2 Techniques

- Fundamental analysis
- Technical analysis
- Modern portfolio theory

5.27: Conclusion

Investment accounting forms a vital part of financial management and reporting. It ensures accurate representation of an entity's financial position and performance. For commerce students, mastering the theoretical and practical aspects of investment accounts is essential for careers in accounting, finance, and investment analysis.

A comprehensive understanding of investment principles, accounting standards, and valuation methods enables informed decision-making and contributes to sound financial planning and economic growth.