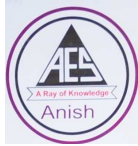


Varun

CPT Key Points

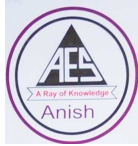
Fundamentals of Accounting

1. An economic event that involves transfer of money or money's worth is **financial transaction**.
2. Drawing represents cash withdrawn for personal use and goods withdrawn **or personal use**.
3. A person who owes money of the firm is a **debtor**.
4. Financial statement is the part of **accounting**.
5. Financial Accounting, Management Accounting, Cost Accounting, Social Responsibility Accounting, Human Resource Accounting are the sub field of accounting.
6. Fundamental accounting assumption as per AS-1 is **Going Concern, Consistency & Accrual**.
7. Economic life of an enterprise is artificially split into periodic intervals in accordance with **Periodicity Principle**.
8. Materiality principle is an **exception to the Full disclosure principle**.
9. When stock is valued at cost in one accounting period and at lower of cost and NRV in another period Prudence principle conflict with consistency principle.
10. Accrual means recognition of revenue as it is earned and expenses when they are incurred.
11. **Prudence principle** is an exception to the consistency.
12. Personal transactions are distinguished from business transaction, in accordance with **accounting entity principle**.
13. The principle which treats all rupee a like whether it is rupee of 1957 or 2007 is **money measurement principle**.



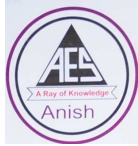
Varun

14. Appending notes to the financial statement is in accordance with **full disclosure principle.**
15. Revenue from sale of products, is generally realized in the period in which sale is made.
16. Fixed assets are held in the business for the purpose of **earning revenue.** Purchase of machinery for cash retains total assets unchanged.
17. AS in India are issued by the **ICAI.** 32 AS are issued by the ICAI and 31 AS are in force, AS 8 was replaced by AS 26.
18. It is essential to standardize the accounting principle and policies in order **to ensure Transparency, Consistency, and Comparability.**
19. Accounting Policies refer to specific accounting principles and method of applying those principles.
20. The major consideration governing the selection and application of accounting policies are **prudence, substance over form and materiality.**
21. A change in accounting policy is justified to **comply with AS, to ensure more appropriate presentation of financial statement of the enterprise and to comply with law.**
22. In double entry system of book keeping every business transactions affects two accounts.
23. Debit means an increase in asset or any expense.
24. Journal is the book of **original entry.**
25. Ledger is the book of **secondary entry.**
26. The process of recording a transaction in the journal is called **journalizing.**
27. L.F in the journal is filled at the time of **posting.**
28. The process of transferring the transactions relating to changes in a particular item at one place in the form of an account is called **posting.**



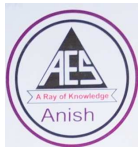
Varun

29. Nominal accounts are **never balanced**; these are **directly transferred to P&L A/c** by passing **closing entry**
30. Purchase of furniture is an asset.
31. Salary account is **nominal account**.
32. Prepaid salary a/c is a **personal a/c**.
33. Outstanding salary a/c is a **personal a/c**.
34. Interest received a/c is a **nominal a/c**.
35. Accrued interest is a **personal a/c**.
36. Interest receivable is a **personal a/c**.
37. Cash A/c is a **real a/c**.
38. Bank A/c is a **personal a/c**.
39. Advance to employee is a **personal a/c**.
40. Advance to suppliers is a **personal a/c**.
41. Goodwill is a **real a/c**.
42. Patent, Copyright, Trademark are **real a/c**.
43. Bad debt and Bad debt recovered are **nominal a/c**.
44. A free sample a/c is **nominal a/c**.
45. Cash book is a type of **subsidiary book** but treated as **principal book of a/c**.
46. Cash book is used to record **all receipts and payment of cash**.
47. Bank column of the cash book may show **either Dr. Balance or Cr. Balance**.
48. Single column cash book will show only debit balance.



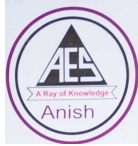
Varun

49. A cheque which is payable across the bank counter is a **bearer cheque.**
50. The balance in petty cash book represents **an asset.**
51. Purchase book is used to record all **Credit purchase of goods.**
52. Sale book is used to record all **credit sales of goods.**
53. B/R book is a **part of journal.**
54. Purchase book, sale book is a **part of journal.**
55. Goods taken by proprietor for personal use will be recorded in **journal proper.**
56. Total of sales book is posted to **sales a/c.**
57. When a customer returns the good a **credit note** is sent to him.
58. When the goods are sent to supplier a **debit note** is sent to him.
59. Credit purchase of stationary by a stationary dealer is to be recorded in **purchase book.**
60. BRS is prepared by a **customer of bank.**
61. BRS is statement showing the causes of differences **between the cash book and pass book.**
62. Debit balance in the cash book means credit balance as per pass book.
63. Installation charges of machinery purchased is **capital expense.**
64. Expense incurred on trial run of machine is **capital expenditure.**
65. Repair of second hand machinery before put to use is **capital expense.**
66. Annual maintenance fee of machine is **revenue expense.**



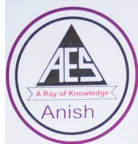
Varun

67. Cost of ring & pistons of an engine changed to get better fuel efficiency is **capital expense.**
68. Interest on term loan for purchase of machinery where the commercial production has not begun till the last day of accounting year is **capital expense.**
69. Premium received on issue of shares is **capital receipts.**
70. Scrap value of machinery is **capital receipt.**
71. Insurance claim for machinery damaged by fire is **capital receipt.**
72. Cash received from debtors is **revenue receipt.**
73. Fine imposed is **revenue expenditure.**
74. Purchase of goodwill is **capital expense.**
75. Import duty on purchase of material is **revenue expense.**
76. Loss on sale of machinery is **revenue loss.**
77. Festival advance to employee is **prepaid expense.**
78. Cost incurred on dismantling a machine worn out part is **revenue expense.**
79. Amount spent on repainting an old building for first time on purchase is **capital expense.**
80. Amount spent on annual repainting of building is **revenue expense.**
81. Contingent assets usually arises from unplanned or unexpected event that given rise to the possibility of an inflow of economic benefits to the business entity.
82. In the financial statement contingent assets and liabilities are **not recognized.**
83. In the financial statement provisions are **recognized and adjusted.**
84. The trial balance checks the **arithmetical accuracy** of the books of account.



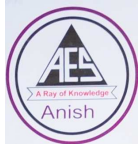
Varun

85. The object of opening suspense account is to avoid the delay in preparation of financial statement.
86. The inventory of finished goods is valued at cost or NRV **which is lower.**
87. Damaged inventory is valued at **net realizable value.**
88. Under inflationary condition, FIFO method will show **highest value of closing stock.**
89. Under inflationary condition, LIFO method will show **lower value of closing stock.**
90. Under inflationary condition, FIFO method will show **lowest value of cost of goods sold.**
91. Under inflationary condition, LIFO method will show **highest value of cost of goods sold.**
92. Closing Stock = Opening Stock + Purchase - Cost of goods sold or,
Opening Stock + Purchase = Goods available for sale or,
Cost of goods sold = Sale - Gross Profit Margin
93. If Opening stock is understated profit will increase.
94. Entry for goods in transit ---
Goods in Transit Dr xxx
To Purchase a/c xxx
95. Depreciation is related to **all tangible fixed assets (Except Land)**
96. Depreciation accounting is **a process of allocation of the cost of fixed assets.** Depreciation is a non cash operating expense.
97. Fixed assets are stated in Balance Sheet at **Cost – Depreciation till date.**
98. The factors affecting the amount of depreciation include physical wear & tear, Passage of time, change in economic residual value.
99. Land is usually assumed to be **not depreciated.**



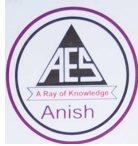
Varun

100. The number of production or similar units expected to be obtained from the use of an asset by an enterprise is called as unit life
101. The portion of the acquisition cost of assets yet to be allocated is known as **WDV**.
102. For depreciating goodwill the suitable method is **SLM**.
103. For depreciating mine the suitable method is **depletion**.
104. Amortization is same like depreciation.
105. For depreciating leases the suitable method is **Annuity method**.
106. In case of downward revaluation of an asset which is for first time revalued, the account to be **debited in P/L a/c**.
107. Trading a/c is prepared to ascertain **gross Profit**.
108. P/L a/c is closed by transferring its balance to **capital a/c**.
109. Provision is a **charge against the profit**.
110. P/L a/c shows the **financial performance** for an accounting period.
111. Balance sheet shows the **financial position** at a particular date.
112. Reserve for discount on creditor has **debit balance**.
113. Wages and salaries appearing in trail balance are shown on the **debit side of trading a/c**.
114. Outstanding wages appearing in trail balance is shown on the **liabilities side of balance sheet**.
115. Prepaid insurance appearing in trail balance is shown on the **assets side of balance sheet**.
116. Closing stock appearing in trail balance is shown on the **assets side of balance sheet**.



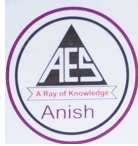
Varun

117. Capital work in progress is **tangible asset**.
118. Drawings are **deducted from capital**.
119. The provision for discount on debtor is calculated after deducting provision for doubtful debts from debtors.
120. Provision for discount on debtors is **debited to P/L a/c**.
121. The debit balance in the P/L a/c is a **loss**.
122. The value of human resources is generally not shown in balance sheet as per **money measurement concept**.
123. Accrued income is shown as a **current asset**.
124. Unaccrued income is shown as a **current liability**.
125. A promissory note is an **unconditional promise** to pay.
126. In case of Promissory note, **there are 2 parties**.
127. A bill of exchange is an **unconditional order** to pay.
128. In case of bill of exchange there are **3 parties**.
129. The term of bill after sight commences from the date of **acceptance of the bill**.
130. The term of bill after date commences from the date of **drawing a bill**.
131. When the bill is honoured at the maturity date, the drawee debits **B/P a/c**.
132. In case of dishonour of a discounting bill, noting charges are initially paid by Banker.
133. When an accommodation bill is discounted and amount received is shared by the two parties, the discount is borne by the drawer and drawee in agreed ratio.
134. A bill given to a creditor is called B/P.



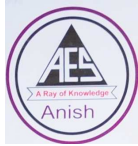
Varun

135. Discount at the time of retirement of a bill is a **gain for the drawee.**
136. Noting charges are borne by the **drawee** in the event of dishonour of bill.
137. If the due date is a public holiday the **preceding day** will be the due date of the bill
138. The purpose of accommodation is when both parties are in **need of funds.**
139. The promissory note should be **signed by promisor.**
140. Fees paid in cash to notary public is charged by **holder of bill of exchange.**
141. The law relating to partnership firms is contained in the partnership Act 1932 which came in to force on 1.10.1932; it applies to whole of India excluding J&K.
142. Mutual Agency is conclusive evidence of partnership.
143. Sharing of profits is prima facie evidence of partnership.
144. Registration of a firm is **optional.**
145. A partnership at will is one which does not provide for how long the business will continues.
146. A partner act **Agent** for a firm.
147. An incoming partner is liable for all the acts of the firm done after his admission.
148. Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their **sacrificing Ratio.**
149. P/L on revaluation of assets & liabilities is shared by **old partners in their old PSR.**



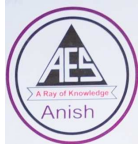
Varun

150. Accumulated P/L & Reserve are shared by the **old partners in their old PSR.**
151. In case Revaluation a/c is prepared, the assets and liabilities appear in the books of reconstituted firm at their **Revalued figure.**
152. A partner may retire with the consent of all other partners.
153. A partner can retire in accordance with the partnership deed.
154. Public notice of retirement must be given by retiring partner or any of the other partners.
155. Death of partner has the effect of dissolving the firm.
156. Retiring partner's share of goodwill is debited to remaining partner in their **gaining ratio.**
157. JLP is taken by the firm on the life of all the partners jointly or all the partners severally.
158. At the time of retirement of a partner, Firm gets **surrender value** from the insurance company against JLP policy for all the partners.
159. At the time of retirement of a partner, Firm gets **surrender value** for all the partners from insurance company against JLP taken severally for each partner.
160. Unless otherwise agreed upon, a retiring partner can carry on competing business.
161. Common point between the consignment and sale is the **stock outflow.**
162. The person who send the goods to be sold on consignment is known as **consignor**
163. The person to whom goods are sent to be sold on consignment is known as **consignee.**
164. The relationship between the consignor and consignee is of **principal and agent.**



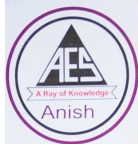
Varun

165. Risk of goods remains with the **consignor**.
166. The profit or loss on consignment belongs with the **consignor**.
167. An account sale is a statement sent by the **consignee to the consignor**.
168. A Performa invoice is sent by the **consignor to the consignee**.
169. Del-credere commission is an additional commission paid by the consignor to consignee for bearing the loss on account of bad debt arising due to credit sale. If such commission is offered the consignee will bear the bad debt.
170. Consignment account is a **nominal account**.
171. Goods sent on consignment are transferred to **Trading Account**.
172. Closing stock of consignment includes promotional share of **all direct expenses**.
173. A company has a separate legal entity from its member.
174. An authorized capital refers to that amount which is stated in the **capital clause of the memorandum of association** as share capital.
175. Reserve capital is not disclosed in the balance sheet of the company.
176. Equity shares can be issued with the differential rights as to **dividend and voting**.
177. **Prospectus** of a company is an invitation to make an offer to subscribe the share or debenture of the company.
178. As per section 69(3) of the Co. Act 1956, the amount payable on application on each share must be at least **5% of the nominal amount of share**.
179. As per SEBI Guidelines, the amount payable on application on each share must be at least **25% of the issue amount of shares**.



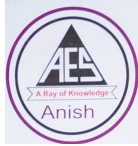
Varun

180. As per Table A, the amount of call on a share must not exceed **25% of the nominal amount of share.**
181. A company can issue share at premium **even in the absence of any express authority in its articles.**
182. The maximum rate of interest which can be charged on calls in arrears (As per Table-A) is **5% P.a.**
183. The maximum rate of interest which can be paid on calls in advance (As per Table-A) is **6% P.a.**
184. If shares are forfeited, share capital account is debited with the amount of **called up value of shares.**
185. If shares are forfeited, forfeited shares account is credited **with the amount received (Excluding Securities Premium)**
186. The securities premium account appears under the head **Reserve & Surplus.**
187. On the approval from Central Govt. the rate of discount on issue of share can be **10% of the nominal value of shares.**
188. Calls in arrears **should be deducted** from the share capital to find out the paid up capital.
189. Capital Reserves are created out of **capital profits.**
190. As per Schedule VI of the Co. Act 1956, **forfeited share account will be added up to the paid up capital.**
191. Underwriting commission can not exceed **5% in case of shares and 2.5% in case of debentures.**
192. According to Companies Act, a company can not proceed to allot shares unless minimum subscription is received by the company which is **90% as per guidelines of SEBI.**
193. If the company does not receive the minimum subscription, the entire subscription shall be refunded to the applicants within **42 days from the date of closure of issue.**



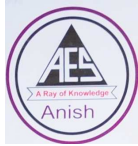
Varun

194. The companies Act, requires that the period of **at least one month** must be there between two calls.
195. A company can not issue any preference shares that are **irredeemable.**
196. Preference Share can be redeemed only if these are **fully paid.**
197. Preference Share can be redeemed **out of divisible profits or proceeds of fresh issue of SHARES.**
198. The premium if any payable on redemption must be provided out of **securities premium or ANY PROFIT.**
199. A transfer to Capital Redemption Reserve is required u/s 80 **when the preference shares are redeemed out of divisible profit.**
200. Redemption of preference share **does not constitute reduction of authorized share capital.**
201. Capital Reserve is **not divisible profit.**
202. Debenture is a written instrument acknowledging a debt written by a co.
203. Debenture interest is payable **whether there are profits or not.**
204. Debenture trust deed is created by the company.
205. Debenture trustees are to be appointed in case of issue of debenture with maturity of **more than 18 Months.**
206. A company can not issue **debenture with voting rights.**
207. Debentures are classified in Balance Sheet at liabilities side **under the head Secured loan.**
208. Interest accrued and due appears under the head **Secured loan** in liabilities.



Varun

209. Interest accrued but not yet due appears under the head **current liabilities** in liabilities.
210. Debenture account is **personal account**.
211. Discount on issue of debenture and loss on issue debenture are **nominal accounts**.
212. In Balance Sheet Debenture Premium account appears under the head **Reserve & Surplus**.
213. Debenture Redemption Premium account is **personal account**.
214. In Balance Sheet Loss on issue of debenture account appears under the head **Misc Exp.**
215. Non Convertible debenture which are redeemable **on or after 18 months** are secured by a charge.
216. A fixed charge is a charge which is created on some **specific assets**
217. A floating charge is a charge which is generally created on **all the assets of the company including the future assets also**.
218. A partnership firm carrying on banking business is **not eligible to be appointed as Debenture Trustees**.
219. Joint venture is a **temporary partnership** between two or more persons.
220. **Going concern assumption is not applicable** in case of joint venture.
221. **A minor can not be a co-venturer** as he is incompetent to contract.
222. There is **no specific Act** for joint venture.
223. Joint bank account is prepared **when separate set of books are maintained** for joint venture transaction.



Varun

224. In Memorandum Joint Venture Account Method, each co-venture records only those transactions **which are effected by him only.**
225. There is **no restriction for maximum number of co-venturer** in case of joint venture.
226. Loss of joint venture uninsured goods is **not recorded in joint venture.**
227. When a transaction is recorded in contravention of account principles it indicates **error of principle.**
228. Trial balance is not an account, it is a **statement,** it is prepared on a **particular date.**
229. Any difference in trial balance is adjusted through **Suspense Account;** this account may either have debit balance or credit balance.

Accounts By

G. C. RAO

Accounting Principles

1. MEANING OF 'GENERALLY ACCEPTED ACCOUNTING PRINCIPLES' (GAAP)

1. Generally Accepted Accounting Principles may be defined as those rules of action or conduct which are derived from experience and practice and when they prove useful. They become accepted as principles of accounting.
2. According to the American Institute of Certified Public Accountants (AICPA), the principles which have substantial authoritative support become a part of the generally accepted accounting principles.
3. The general acceptance of the accounting principles or practices depends upon how well they meet the following three criteria.
 - (a) **Relevance:** A principle is relevant to the extent it results in information that is meaningful and useful to the user of the accounting information.
 - (b) **Objectivity:** Objectivity connotes reliability and trustworthiness. A principle is objective to the extent the accounting information is not implies verifiability which means that there is some way of ascertaining the correctness of the information reported.
 - (c) **Feasibility:** A principle is feasible to the extent it can be implemented without much complexity or cost.
4. These criteria often conflict each other, for instance, information about the value of anew product to the inventor is indeed relevant but the best estimate of the value of a new product made by the management is highly subjective. Accounting, therefore does not attempt to record such values. It sacrifices essential problem is to achieve a trade-off between relevance on one hand and objectivity and feasibility on the other.

2. ACCOUNTING PRINCIPLES

Basic principles of accounting are essentially, the general decision rules which govern the development of accounting techniques. These principles guide how transactions should be recorded and reported.

3. ACCOUNTING ENTITY (OR BUSINESS ENTITY PRINCIPLE)

1. **Meaning:** According to this principle, a business is treated as a separate entity that is distinct from its owner (s) and all other accounting entities and hence a distinction should be made between (i) personal transactions and business transactions, and (ii) transactions of one business entity and those of another business entity. For example, in case of a proprietary concern, though the legal entity of the business and its proprietor is the same, for the purpose of accounting, they are to be treated as separate from each other.

2. **Effect:** If this assumption is not followed, true financial position and true financial performance of a business entity cannot be ascertained. For example, if the household expenses (Rs 10,000) of a proprietor are shown as business expenses, the profits of a business will be understated to the extent of Rs 10,000.

4. MONEY MEASUREMENT PRINCIPLE

1. **What is recorded:** According to this principle, only those transactions which are capable of being expressed in terms of money are included in the accounting records.

2. **What is not recorded:** In other words, the information which cannot be expressed in terms of money is not included in accounting records. For example, if the sales director is not on speaking terms with the production director, the enterprise is bound to suffer. Since, monetary measurement of this information is not possible, this fact is not recorded in accounting records.

3. **Advantage:** By expressing all transactions in terms of money, the different transactions expressed in different units are brought to a common unit of measurement (i.e. money).

4. **Limitations:** Besides ignoring the non-monetary facts or attributes. This assumption also ignores the changes in the purchasing power of the monetary unit. In other words, this assumption treats all rupees alike, whether it is a rupee of 1950 or 2007. Hence, now-a-days, it is considered to provide additional data showing the effect of price level changes on the reported income, assets and liabilities of the business.

5. ACCOUNTING PERIOD PRINCIPLE (PERIODICITY PRINCIPLE):-

Meaning: It is also known as periodicity principle or time period principle. According to this principle, the economic life of an enterprise is artificially split into periodic intervals which are known as accounting periods, at the end of which an income statement and position statement are prepared to show the performance and financial position.

Implication: The use of this assumption further requires the allocation of expenses between capital and revenue. That portion of capital expenditure which is consumed during the

current period is charged as an expense to income statement and the unconsumed portion is shown in the balance sheet as an asset for future consumption.

Estimate and Not Actual Income: Truly speaking, measuring the income following the concept of accounting period is more an estimate than factual since, actual income can be determined only on the liquidation of the enterprise.

Reporting Period: It may be noted that the custom of using twelve month period is applied only for external reporting. For internal reporting, accounts can be prepared even for shorter periods, say monthly, quarterly or half yearly.

6. GOING CONCERN PRINCIPLE

Meaning: It is also known as continuity assumption. According to this assumption, the enterprise is normally viewed as a going concern that is, continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations.

Implications: It is because of the going concern assumptions:

- (i) That the assets are classified as current assets and fixed assets.
- (ii) The liabilities are classified as short-term liabilities and long-term liabilities.
- (iii) The unused resources are shown as unutilized costs (or unexpired costs) as against the break-up values as in case of liquidating enterprise. Accordingly, the earning power and not the break-up value evaluate the continuing enterprise.

Requirements of AS-1: According to Accounting Standard (1) issued by the Institute of Chartered Accountants of India, if this fundamental assumption is followed, this fact need not be disclosed in the financial statements since its acceptance and use are assumed. In the financial statement together with reasons.

7. ACCRUAL PRINCIPLE [REVENUE RECOGNITION PRINCIPLE]:-

Meaning: According to Accrual principle, all revenues and costs are recognized as they are earned or incurred (and not as money is received or paid).

Meaning of Revenue: Revenue is the gross inflow of cash, receivables or other considerations arising in the course of ordinary activities of an enterprise from the sale of goods, rendering of services and use of enterprise resources by others yielding interests, royalties and dividends. It excludes the amount collected on behalf of third parties such as certain taxes. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash, receivables or other considerations.

8. CONSISTENCY PRINCIPLE:-

Meaning: According to this principle, whatever accounting practices (whether logical or not) are selected for given category of transactions, they should be followed on a horizontal basis from one accounting period to another to achieve compatibility.

Need: The consistency principle is applied when alternative methods of accounting are equally acceptable.

Examples: If the inventory is valued on LIFO basis, this basis should be followed year after year and if a particular asset is depreciated according to WDV method, this method should be followed year after year.

Effect of not observing: If this principle of consistency is not followed, the intra-firm comparison (i.e. comparison of actual figures of one period with those of another period for the same firm), Inter-firm comparison (i.e. comparison of actual figures of one firm with those of another firm belonging to the same industry) and Pattern comparison (i.e. comparison of actual figures of one firm with those of industry to which the firm belongs) can not be made.

Differs from Uniformity: The consistency should not be confused with mere uniformity or inflexibility and should not be allowed to become an impediment to the introduction of improved accounting policies unchanged when more relevant and reliable alternatives exist.

Disclosure: The users should be informed of the accounting policies employed in the preparation of the financial statements, any change in these policies and the effects of such changes.

9. PRUDENCE PRINCIPLE (OR CONSERVATISM PRINCIPLE)

Meaning: According to this principle, the principle of 'anticipate no profit but provide for all probable losses' should be applied. In other words, the principle of conservatism requires that in the situation of uncertainty and doubt, the business transactions should be recorded in such a manner that the profits the business transactions should be recorded in such a manner that profits and assets are not overstated and the losses and liabilities are not understated.

Examples: the valuation of stock-in-trade at a lower of cost or net realizable value and making the provisions for doubtful debts and discount on debtors are the applications of this principle.

Conflicts with Consistency: when the stock is valued at cost in one accounting period and at a lower of cost or net realizable value in another accounting period, this principle conflicts with the principle of consistency.

Conflicts with Full Disclosure: When excessive provisions for doubtful debts and depreciation are charged, it leads to the creation of secret reserves, and thus, this principle conflicts with the principle of full disclosure.

Conflict with Objectivity: The estimation of probable losses is a subjective judgment and thus, this principle conflicts with the principle of objectivity. The practices of making provisions for doubtful debts and the like implies lesser charges in the following accounting periods. In other words, it reduces the current income and raises the future income and thus it conflicts with the matching principle. Nowadays, the conservatism principle is being replaced by the prudence principle which requires that the conservatism principle should be applied rationally only in circumstances in which great uncertainty and doubt exists as the over-conservatism may result in misrepresentation.

10. FULL DISCLOSURE PRINCIPLE:-

According to this principle, the financial statements should act as means of conveying and not concealing.

The financial statements must disclose all the relevant and reliable information which they purport to represent, so that the information may be useful for the users.

For this, it is necessary that the information is accounted for and presented in accordance with its substance and economic reality and not merely with its legal form.

Example: The practice of appending notes to the financial statements has developed as a result of the principle of full disclosure.

The disclosure should be **full, fair** and **adequate** so that the users of the financial statements can make correct assessment about the financial performance and position of the enterprise.

11. MATERIALITY PRINCIPLE:-

This principle is basically an **exception to the Full Disclosure Principle**.

The full disclosure principle requires that all facts necessary to ensure that the financial statements are not misleading, must be disclosed, whereas the materiality principle requires that the items or events having an insignificant economic effect or not being relevant to the user's need not be disclosed.

According to the materiality principle, all relatively relevant items, the knowledge of which might influence the decision of the users of the financial statements, should be disclosed in the financial statements.

Which information is more relevant than others is largely a matter of judgment. For instance, accounting and recording of a small calculator as an asset in the balance sheet may not be justified due to the excess of cost of recording over the benefits in terms of usefulness of recording and the accounting of calculators as assets.

The materiality depends not only upon the amount of item but also upon the size of business, level and nature of information, level of the person/department who makes the judgment about materiality, for instance a worker reporting to his foreman about the production in grams (e.g. part of kilogram), a foreman to his supervisor in kilograms, a supervisor to his production manager in quintals and the production manager to the top management in tonnes, may be justified with regard to the circumstances. It hardly makes any difference if the production manager reports to the top management that the production is 1, 99,000.90 kilograms or simply 200 tonnes (nearly).

It is desirable to establish and follow uniform policies governing material or non-material items can be ignored on uniform basis.

This principle of materiality is to be applied even if the cost of its application exceeds its benefits.

12. HISTORICAL COST PRINCIPLE

According to this principle, an asset is ordinarily recorded in the accounting records at the price paid to acquire it at the time of its acquisition and the cost becomes the basis for the accounts during the period of acquisition and subsequent accounting periods.

Accordingly, if nothing is paid to acquire an asset; the same will not be usually recorded as an asset, e.g. a favorable location and increasing reputation of the concern will remain unrecorded though these are valuable assets.

The justification for the use of the cost concept lies in the fact that it is objectively verifiable. This does not mean that the asset will always be shown at cost. The cost of an asset is systematically reduced from year to year by charging depreciation and the asset is shown in the balance sheet at book value (i.e. cost less depreciation). It may be noted that the purpose of depreciation is to allocate the cost of an asset over its useful life and not to adjust its cost so as to bring it close to the market value.

13. MATCHING PRINCIPLE

According to this principle, the expenses incurred in an accounting period should be matched with the revenues recognized in that period. That is, if revenue is recognized on all goods sold during a period, cost of those goods sold should also be charged to that period. It is wrong to recognize revenue on all sales, but charge expenses only on such sales as are collected in cash till that period.

This concept is basically an accrual concept since, it disregards the timing and the amount of actual cash inflow or cash outflow and concentrates on the occurrence (i.e. accrual) of revenue and expenses. This concept calls for adjustment to be made in respect of prepaid expenses, outstanding expenses, accrued revenue and unaccrued revenues.

Matching does not mean that expenses must be identifiable with revenues. Expenses charged to a period may or may not be related to the revenue recognized in that period, for example, cost of goods sold and commission to salesmen are directly related to sales whereas rent, interest, depreciation accruing with the passage of time and stock lost by fire are not directly related to sales revenue, yet they are charged to the accounting period to which they relate. Thus, appropriate costs have to be matched against the appropriate revenues for the accounting period.

14. DUALITY PRINCIPLE

Two fold aspect of a transaction is called dual aspect or duality of a transaction. This duality is the basis of double entry records.

As the name implies, the entry made for each transaction is composed of two parts-one for debit and another for credit.

The double entry system may be compared with the Newton's law of motion, viz, to every action there is always an equal and contrary reaction. Every debit has equal amount of credit. So the total of all debits must be equal to the total of all credits.

Examples

Example I. Mr. X sold goods for cash Rs 1,000 to Mr. Y. In this case the dual aspects of this transaction for Mr. X and Mr. Y are as follows:

<i>Dual Aspects for Mr. X</i>	<i>Dual Aspects for Mr. Y</i>
-------------------------------	-------------------------------

1. Receipt of cash Rs 1,000	1. Payment of Cash Rs 1,000
2. Foregoing of goods of Rs 1,000	2. Receipt of goods of Rs 1,000

Example II. Mr. X sold goods for Rs 1,000 to Mr. Y on credit. In this case the dual aspects of this transaction for Mr. X and Mr. Y are as follows:

<i>Dual Aspects for Mr. X</i>	<i>Dual Aspects for Mr. Y</i>
1. Acquisition of right to recover Rs 1,000	1. Assumption of obligation to pay Rs 1,000
2. Foregoing of goods of Rs 1,000	2. Receipt of goods of Rs 1,000

15. OBJECTIVITY PRINCIPLE

According to this principle, the accounting data should be definite, verifiable and free from personal bias of the accountant.

In other words, this principle requires that each recorded transaction/event in the books of accounts should have an adequate evidence to support it.

In historical cost accounting, the accounting data are verifiable since, the transactions are recorded on the basis of source documents such as vouchers, receipts, cash memos, invoices, and the like. These supporting documents form the basis for their verification by auditors afterwards, for items like depreciation and the provisions for doubtful debts where no documentary evidence is available, the policy statements made by management are treated as the necessary evidence.

At the same time in Historical Cost Accounting the accounting data is 'bias free' since the accounting data are neither subject to the bias of the management nor the accountant who prepares the accounts.

On the other hand, in Value-based Accounting (e.g. current cost accounting) accounting data is not bias-free because value may mean different things for different persons.

16. Timeliness Principle

Meaning: According to this principle, timely information (though less reliable) should be made available to the decision makers. If the quarterly reports are made available on half-

yearly basis, the information contained in the quarterly report would not be very useful to the decision makers since, the information has lost its capacity to influence the decision during the period of half year, after the expiry of which the quarterly report had been submitted.

Effect of Delays: If there is undue delay in reporting the information, it may lose its relevance. To provide information on a timely basis, it may often be necessary to report before all aspects of a transaction or other events are known. In India there is a provision for publishing half-yearly financial report of the listed companies (listed in the stock exchanges). This provides timely information to investors and potential investors to make their investment decisions. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to the users who have had to make decisions in the interim period.

17. SUBSTANCE OVER FORM

Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.

18. VARIATION IN ACCOUNTING PRACTICES

The peculiar characteristics of an industry may require departure from the accounting guidelines discussed above. For example, in case of the agricultural industry, it is a common practice to disclose the crops at market value rather than at a cost since it is costly to obtain accurate cost figures of individual crops.

19. COST-BENEFIT PRINCIPLE

According to this principle, the cost of applying an accounting principle should not be more than its benefits. If the cost is more, this principle should be modified. The balance between benefit and cost is pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it.

In India often it is stated that many investors are not using the information contained in the annual report of a company. So there is a provision for giving abridged accounts to the shareholders. However, those who are interested in full information can get full annual

reports by requesting the company. In this process the company saves the expenditure relating to publication of annual reports to some extent.

20. **FUNDAMENTAL ACCOUNTING ASSUMPTIONS**

The Accounting Standard (AS-1) 'Disclosure of Accounting Policies' issued by Institute of Chartered Accountants of India, which states that there are three fundamental accounting assumptions:

Going concern The enterprise is normally viewed as a going concern, i.e. as continuing operations for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or curtailing materially its scale of operations. If an enterprise is not a going concern. Valuation of its assets and liabilities on historical cost becomes irrelevant and as a consequence its profit/loss may not give reliable information.

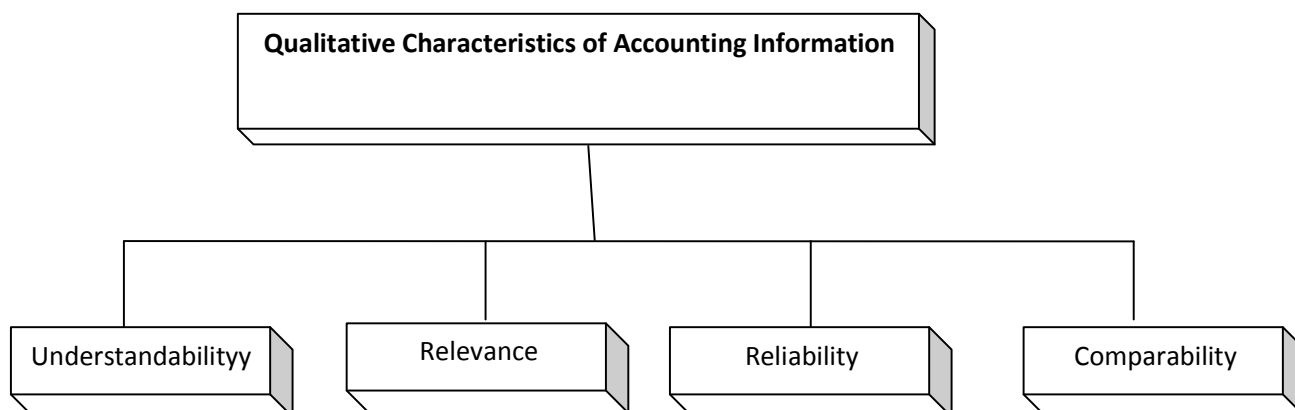
Consistency It is assumed that accounting policies are consistent from one period to another. This adds the virtue of comparability to accounting data. If comparability is lost, the relevance of accounting data for users' judgment and decision making is gone.

Accrual Revenues and costs are accrued, that is, recognized as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. This assumption is the core of accrual accounting system. For companies it is mandatory to keep accounts on accrual basis under the Companies Act, 1956.

Disclosure requirements If the fundamental accounting assumption, viz. going Concern, Consistency, and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

21. **QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION**

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are:



Let us discuss these Qualitative Characteristics one by one:

1. **Understandability:** The information provided in financial statements must be readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the decision making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

2. **Relevance:** To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of the users by helping them to evaluate past, present or future event or confirming or correcting their past evaluation. The productive and confirmatory roles of information are interrelated. For example, information about the current level and structure of asset-holding has value to users when they endeavor to predict the ability of the enterprise to take advantage of opportunities and its ability to react adverse situations. The same information plays a confirmatory role in respect of past prediction about, for example, the way in which the enterprise would be structured or the outcome of planned operations.

Materiality: The relevance of information is affected by its nature and materiality. Information is material if its omission or mis-statement could influence the economic decisions of users made on the basis of financial statements. Materiality depends on the size of the item or error judged in the particular circumstance of its omission or mis-statement. Thus, materiality provides a threshold or a cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

3. **Reliability:** To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent. Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading and so it becomes useless. Reliability of the financial statements is dependent on the following :-

(i) **Faithful Representation** - To be reliable, information must represent faithfully the transactions and other events which either purports to represent or could reasonably be expected to represent. Most financial information is subject to some risks to being less than faithful representation of that which it purports to portray. This is not due to bias, but rather to enhance difficulties either in identifying the transactions or other events to be measured in devising or applying measurements and presentation techniques that can convey messages that correspond with those transactions and events.

(ii) **Substance over Form** - If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely by their legal form. The substance of transactions or other events is not always consistent with that which is apart from their legal or contrived form.

(iii) **Neutrality** - To be reliable the information contained in financial statements must be neutral. Financial statements are not neutral if by selective presentation of information, they influence the making of a decision or judgment in order to achieve a predetermined result of outcome.

(iv) **Prudence** - The preparers of financial statements have to contend with uncertainties that inevitably surround many events and circumstances. Such uncertainties are recognized by the disclosure of their nature and extent and by exercise of prudence in the financial statements. Prudence is the inclusion of a degree of caution. In the exercise of judgment needed in making the estimate required under conditions of uncertainties so that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income or deliberate overstatement of liabilities or expenses.

(v) **Completeness** - To be reliable the information in the financial statements must be complete within the bounds of materiality and cost. An omission can

cause information to be false or misleading and thus, unreliable and deficient in terms of its relevance.

4. **Comparability:** The financial statements of an enterprise should be comparable. For this purpose users should be informed of the accounting policies, any changes in those policies and the effects of such changes. This qualitative characteristic requires pursuance of consistency in choosing accounting policies. Lack of consistency may disturb the comparability quality the financial statement information. Accordingly, accounting standard on disclosure of accounting policies consider consistency as a fundamental accounting assumption along with accrual and going concern.

Accounting Standards

1.0 INTRODUCTION

Accounting as a ‘language of businesses communicates the financial performance and position of an enterprise to various interested parties by means of financial statements which have to exhibit a ‘true and fair’ view of financial results and its state of affairs. Like an another language, accounting has its own complicated set of rules. The basic conventions or rules used in preparing financial statements had evolved over many years as a product of the collective experience of practicing accountants. As a result a wide variety of accounting methods were used by different companies. It was, then, felt that there should be some standardized set of rules and accounting principles to reduce or eliminate confusing variations in the methods used to prepare financial statements. However, such accounting rules should have a reasonable degree of flexibility in view of specific circumstances of an enterprise and also in line with the changes in the economic environment, social needs, legal requirements and technological developments. In order to suggest rules and criteria of accounting measurements several accounting standard setting bodies were established in developed and developing countries. The setting of accounting standards is a social decision. Standards place restrictions on behavior and therefore they must be accepted by affected parties.

2.0 MEANING OF ACCOUNTING STANDARD

An accounting standard is a selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. Standards conform to applicable laws, customs, usage and business environment. So there is no universally acceptable set of standards.

3.0 OBJECTIVE OF ACCOUNTING STANDARD

The main objective of accounting standards is to harmonize the diverse accounting policies and practices at present in use in India. However, harmonization does not mean that accounting standards should become very rigid. In fact, harmonizations of accounting standards do permit flexibility to make the necessary adjustments to suit their purpose.

4.0 SIGNIFICANCE OF ACCOUNTING STANDARDS

1. The adoption and application of accounting standards ensures uniformity, comparability and qualitative improvement in the preparation and presentation of financial statements.
2. The accounting standards seek to describe the accounting principles, the valuation techniques and the methods of applying the accounting principles in the preparation and presentation of financial statements so that they may give a true and fair view.
3. The ostensible purpose of the standard setting bodies is to promote the dissemination of timely and useful financial information to investors and certain other parties having an interest in companies' economic performance.

5.0 ADVANTAGES OF SETTING ACCOUNTING STANDARDS

1. **Reduction in Variations:** Standards reduce to a reasonable extent or eliminate altogether confusing variations in the accounting treatments used to prepare financial statements.
2. **Disclosure Beyond that Required by Law:** There are certain areas where important information is not statutorily required to be disclosed. Standards may call for disclosure beyond that required by law.
3. **Facilitates Comparison:** The application of accounting standards would, to a limited extent. Facilitate comparison of financial statements of companies situated in different parts of the world and also of different companies situated in the same country. However, it should be noted in this respect that differences in the institutions, traditions and legal systems from one country to another give rise to differences in accounting standards practiced in different countries.

6.0 ARGUMENTS AGAINST SETTING ACCOUNTING STANDARDS

However there are some arguments against setting accounting standards:

1. **Restriction on Choice of Alternative Treatments:** Alternative solutions to certain accounting problems may each have arguments to recommend them. A standard which insist on one particular solution may be unduly restrictive. This can sometimes be avoided either by allowing a permitted choice between different accounting treatments, or by defining closely the circumstances where different treatments may be appropriate.

2. **Rigidity** There may be a trend towards rigidity in applying the accounting standards. Michael Alexander, Director of Research and Technical Activities at the Financial Accounting Standards Board (FASB) said, 'the demand for standards comes largely from an insatiable appetite for rules. The reliance on judgment in technical accounting matters seems to have gone'.

3. **Cannot Override the Statute** Accounting standards cannot override the statute. The standards are required to be framed within the ambit of prevailing statutes.

7.0 DEVELOPMENT OF ACCOUNTING STANDARDS

1. Prior to the 1970s, few academics paid much attention to the standard-setting process in accounting. Beginning in the 1970s, however, it became clear that standard setting was a fascinating process that had become intertwined with the economic self-interests of affected parties. Currently, standard-setting boards or committees are active in a number of countries, including the United States, United Kingdom, Australia, Canada, New Zealand, the Netherlands, Japan and India.

2. **At International level** In 1972 International Accounting Standards Committee (IASC). Was formed for developing International Accounting Standards (IASS). The IASC comprises the professional accountancy bodies of over 75 countries (including The Institute of Chartered Accountants of India). During these three decades the IASC has issued 40 IASs through a due process involving the world wide accountancy profession, the prepares and users of financial statements and the national standard-setting bodies. However the IASs are not accepted worldwide.

3. In 1978, another professional body. The International Federation of Accountants (IFAC) was established.

8.0 ACCOUNTING STANDARDS BOARD OF INDIA [ASB]

1. Formation of the Accounting Standards Board: The Institute of Chartered Accountants of India, recognizing the need to harmonise the diverse accounting policies and practices at present in use in India, constituted an Accounting Standards Board (ASB) on April 21, 1977.

2. Scope and function of Accounting Standards Board

- (a) The main function of ASB is to formulate accounting standards so that such standards may be established by the Council of the Institute in India.
- (b) While formulating the accounting standards, ASB will take into consideration the applicable law, customs, usages and business environment.
- (c) The Institute is one of the members of the International Accounting Standards Committee (IASC) and has agreed to support the objectives of IASC.
- (d) While formulating the accounting standards, ASB will give due considerations to International Accounting Standards issued by IASC and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.
- (e) The accounting standards will be issued under the authority of the Council. ASB has also been entrusted with the responsibility of propagating the accounting standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statements.
- (f) ASB will issue guidance notes on the accounting standards and give clarifications on issues arising therefrom.
- (g) ASB will also review the accounting standards. Broadly, the following procedure will be adopted for formulating Accounting Standards:

Step1→	To determine the broad areas in which accounting standards need to be formulated and the priority in regard to the selection thereof.
Step2→	To hold a dialogue with the representatives of the government, public sector undertakings, industry and other organizations for ascertaining.
Step3→	On the basis of the work of the study groups and the dialogue with the representatives. To prepare and issue the exposure of draft to the proposed standard for comments by members of the institute and the public at large.
Step4→	To finalize the draft of the proposed standard after taking into consideration the comments received.
Step5→	To submit the final draft of the proposed standard to the Council of the Institute.

The Council of the Institute will consider the final draft of the proposed standard, and if found necessary, modify the same in consultation with ASB. The accounting standard on the relevant

3. Accounting Standards issued so far

- (a) In India, The Council of the Institute of Chartered Accountants of India has so far issued 29 Accounting Standards but effectively there are 28 AS at present since AS-8 has been withdrawn consequent to the issuance of AS 26 on 'Intangible Assets'.
- (b) Some of these standards are mandatory.
- (c) These accounting standards are mandatory in the sense that these are binding on the members of the Institute.
- (d) These standards are as follows:

S. No.	Title	Recommendatory or Mandatory	Mandatory from accounting period beginning on or after
AS – 1	Disclosure of Accounting Policies	Mandatory	1.4.93
AS – 2	Valuation of Inventories (Revised)	Mandatory	1.4.99
AS – 3	Cash Flow Statement (Revised)	Mandatory	1.4.2001
AS – 4	Contingencies and Events Occurring After the Balance Sheet Date (Revised)	Mandatory	1.4.95
AS – 5	Net Profit or Loss for the period, Prior Period and Extra-ordinary items and Changes in Accounting Policies (Revised)	Mandatory	1.1.96
AS – 6	Depreciation Accounting (Revised)	Mandatory	1.4.95
AS – 7	Accounting for Construction Contracts (Revised)	Mandatory	1.4.03

AS – 8	Accounting for Research and Development	Included in AS 26	
AS – 9	Revenue Recognition	Mandatory	1.4.93
AS – 10	Accounting for Fixed Assets	Mandatory	1.4.93
AS – 11	Accounting for the Effects of Foreign Changes in Exchange Rates (Revised)	Mandatory	1.4.04
AS – 12	Accounting for Government Grants	Mandatory	1.4.94
AS – 13	Accounting for Investments	Mandatory	1.4.95
AS – 14	Accounting for Amalgamations	Mandatory	1.4.95
AS – 15	Accounting for Retirement Benefits in the Financial Statement of Employers	Mandatory	1.4.95
AS – 16	Borrowing Costs	Mandatory	1.4.2000
AS – 17	Segment Reporting	Mandatory	1.4.2001
AS – 18	Related Parties Disclosures	Mandatory	1.4.2001
AS – 19	Leases	Mandatory	1.4.2001
AS – 20	Earning Per Share	Mandatory	1.4.2001
AS – 21	Consolidated Financial Statements	Mandatory	1.4.2001
AS – 22	Accounting for Taxes on Income	Mandatory	1.4.2001
AS – 23	Accounting for Investments in Associates in Consolidated Financial Statements	Mandatory	1.4.2002
AS – 24	Discontinuing Operations	Mandatory	1.4.2004
AS – 25	Interim Financial Reporting	Mandatory	1.4.2002
AS – 26	Intangible Assets	Mandatory	1.4.2003
AS – 27	Financial Reporting of Interests in Joint Venture	Mandatory	1.4.2004

AS – 28	Impairment of Assets	Mandatory	1.4.2004
AS – 29	Provision, Contingent Liabilities and Contingent Assets	Mandatory	1.4.2004

8.5 Compliance with Accounting Standards

- (a) During the period and accounting standard is recommendatory in nature, the members of the Institute should, while discharging their attest function, examine whether the standard has been followed or not. If the same has not been followed, the members should consider whether, keeping in view the circumstances of the case, a disclosure in their audit reports is necessary.
- (b) Once the standard becomes mandatory, it will be the duty of the members of the Institute to examine, while discharging their attest function, whether this accounting standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the accounting standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

Exercises

1. Accounting Standards in India are issued by –
 - (a) The central Govt.
 - (b) The State Govt.
 - (c) The Institute of Chartered Accountants of India.
 - (d) The Reserve Bank of India.
2. Accounting Standards in India are issued by –
 - (a) The Board of Studies – ICAI
 - (b) The Accounting Standard Board – ICAI
 - (c) The Expert Advisory Committee – (IASC)
 - (d) The International Accounting Standards Committee (IASC)
3. How many Accounting Standards have been issued so far by ICAI?
 - (a) 26
 - (b) 27
 - (c) 28
 - (d) 29
4. At present how many AS are in force:
 - (a) 26
 - (b) 27
 - (c) 28
 - (d) 29
5. It is essential to standardize the accounting principles and polities in order to ensure –
 - (a) Transparency.

- (b) Consistency.
 - (c) Comparability.
 - (d) All of the above.
6. Accounting Standards
- (a) Harmonize accounting policies.
 - (b) Eliminate the non-comparability of financial statements.
 - (c) Improve the reliability of financial statements.
 - (d) All of the above
7. All of the following are limitations of a Accounting Standards except
- (a) The choice between different alternative accounting treatments is difficult.
 - (b) There may be trend towards rigidity.
 - (c) Accounting Standards cannot override the statute.
 - (d) All of the above.

Accounting Equation

1.0 MEANING OF ACCOUNTING EQUATION

- 1.1 An accounting equation is a statement of quality between the resources and the sources which finance the resources and is expressed as under:

$\text{Resources} = \text{Sources of Finance}$
--

- 1.2 **Resources mean the assets** The assets refer to the tangible objects (e.g. Land & Building, Plant & Machinery, Furniture, Investments, Stock, Debtors, Bank Balance, Cash Balance) or intangible rights (e.g. Patents, Trademarks, Copyright) owned by an enterprise and carrying probable future benefits.
- 1.3 **Sources of finance mean Equities** and includes Internal Sources (or Internal Equity) (i.e., capital) and External Sources (or External Equity) (i.e. liabilities).

1.4 Capital refers to the amount invested in an enterprise by its owners.

1.5 Liabilities are the financial obligations of an enterprise other than the owners' funds.

1.6 Thus, the aforesaid accounting equation may be expressed as follows:

$$\text{Total Assets} = \text{Total Equities}$$

Or

$$\text{Assets} = \text{Internal Equity} + \text{External Equity}$$

Or

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

1.7 Since, the liability holders have a definite and prior claim against the assets, the capital is also called as a residual of assets over liabilities and may be expressed as follows:

$$\text{Capital} = \text{Assets} - \text{Liabilities}$$

1.8 This equation is fundamental in the sense that it gives foundation to the double entry book keeping. This equation holds good for all transactions and events and at all periods of time since every transaction and event has two aspects.

Journalising, Posting and Balancing

1.0 MEANING OF AN ACCOUNT

An account is a summary of the relevant transactions at one place relating to a particular head. It records not only the amount of transaction but also their effect and direction.

The classification of accounts according to the Traditional Approach is given below:

Classification of Accounts according to the Traditional Approach		
(a) Personal Accounts	These accounts relate to natural persons, artificial persons and representative persons.	Natural—Ram's A/c Artificial—Ram & Co's A/c Representative—Outstanding Salary A/c
(b) Real Accounts	These accounts relate to the tangible or intangible real assets.	Tangible—Land A/c Intangible—Goodwill A/c
(c) Nominal Accounts	These accounts relate to expenses, losses, profits and gains.	Expenses—Purchases A/c Loss—Loss by Fire A/c Profits & Gains—Sales A/c Discount Received A/c

ILLUSTRATION1 Classify the following Accounts

- Capital brought in
- Drawings A/c
- Building purchased
- Purchases A/c
- Sales A/c
- Carriage inwards paid
- Carriage outwards paid
- Cash received
- Cash paid
- Interest paid
- Interest received
- Commission paid
- Commission received
- Discount allowed
- Conveyances charges
- Sales promotion expenses
- Entertainment

expenses, 18. Subscription paid, 19. Subscription received. 20. Light, Power and Electricity. 21. Telephone, Postage and Telegram, 22. Repairs incurred 23. Insurance premium paid, 24. Bad Debts written off, 25. Bad Debts recovered, 26. Discount received. 27. Printing and Stationery bought, 28. Furniture and fixtures purchased 29. Bank A/c, 30. Wages and Salaries paid, 31. Travelling charges, 32. Current A/c of a partner, 33. Loan Account of a partner, 34. Sales Returns, 35. Bank Overdraft, 36. Purchases Returns A/c, 37. Outstanding salary A/c, 38. Prepaid rent A/c, 39. Interest accrued A/c, 40. Interest received in advance A/c.

8.0 DOUBLE ENTRY SYSTEM OF BOOK-KEEPING

8.1 Meaning Double Entry system of Book-keeping refers to a system of accounting under which both the aspects (i.e. debit or credit) of every transaction are recorded in the accounts involved.

8.2 Account The individual record of a person or thing or an item of income or an expense is called an account.

8.3 The terms debit and credit used today have their origin from the terms—Debi to and Credito as used by *Luca fra Pacioli* in his book.

8.4 Every debit has equal amount of credit. So the total of all debits must be equal to the total of all credits.

8.5 Dual Aspect Two fold aspect of a transaction is called dual aspect or duality of a transaction. This duality is the basis of double entry records.

8.6 As the name implies, the entry made for each transaction is composed of two parts—one for debit and another for credit. The double entry system may be compared with the Newton's law of motion, viz to every action there is always an equal and contrary reaction.

8.7 Examples

Example 1. Mr. X sold goods for cash Rs. 1,000 to Mr. Y. In this case the dual aspects of this transaction for Mr. X and Mr. Y are as follows:

<i>Dual Aspects for Mr. X</i>	<i>Dual Aspects for Mr. Y</i>
1. Receipt of cash Rs 1,000	1. Payment of Cash Rs 1,000
2. Foregoing of goods of Rs 1,000	2. Receipt of goods of Rs 1,000

Example2: Mr. X sold goods for Rs 1,000 to Mr. Y on credit. In this case the dual aspects of this transaction for Mr. X and Mr. Y are as follows:

<i>Dual Aspects for Mr. X</i>	<i>Dual Aspects for Mr. Y</i>
1. Acquisition of right to recover Rs 1,000	1. Assumption of obligation to pay Rs 1,000
2. Foregoing of goods of Rs 1,000	2. Receipt of goods of Rs 1,000

9.0 MEANING AND FORMAT OF A JOURNAL

9.1 Meaning of Journal, Journalising and Journal Entry

- (a) A **Journal** is a book in which transactions are recorded in the order in which they occur, I.e., in chronological order. A journal is called a book of prime entry (Also called a book of original entry) because all business transactions are entered first in this book.
- (b) The process of recording a transaction in the journal is called Journalising.
- (c) An entry made in the journal is called a 'Journal Entry'.

9.2 Format of a Journal

The format of a journal is shown below:

Journal

<i>Date</i>	<i>Particulars</i>	<i>L.F.</i>	<i>Debit</i>	<i>Credit</i>
-------------	--------------------	-------------	--------------	---------------

			<i>Amount</i> <i>Rs</i>	<i>Amount</i> <i>RS</i>

- (a) **Date column:** Under this column, the date on which the transaction is entered is recorded. The year and month is written once, till they change.
- (b) **Particular column:** Under this column, first the names of the accounts to be debited, then the names of the accounts to be credited and lastly, the narration (i.e. a brief explanation of the transaction) are entered.
- (c) **L.F. that is, Ledger Folio column:** Under this column, the ledger page number containing the relevant account is entered at the time of posting.
- (d) **Debit amount column:** Under this column, the amount to be debited is entered.
- (e) **Credit amount column:** Under this column, the amount to be credited is entered.

Note: Except the L.F. column, all other columns are recorded at the time of journalizing. The L. F. Column is recorded at the time of posting.

ILLUSTRATION 3

Analyze the following transactions according to the Traditional Approach:

- (a) Ganesh started his business with cash
- (b) Borrowed from Mahesh
- (c) Purchased furniture
- (d) Purchased furniture from Mohan on credit
- (e) Purchased goods for cash
- (f) Purchased goods from Ram on credit
- (g) Returned goods to Ram

- (h) Sold goods for cash
- (i) Sold goods to Shyam on credit
- (j) Shyam returned goods
- (k) Received cash from Shyam
- (l) Paid cash to ram
- (m) Deposited into bank
- (n) Withdrew cash for personal use
- (o) Withdrew from bank for office use
- (p) Withdrew from bank for personal use
- (q) Received a cheque from a customer, Shyam at 3 p.m.
- (r) Deposited Shyam’s cheque next day
- (s) Bank intimated that Shyam’s cheque was dishonored
- (t) Paid Ram by cheque
- (u) Paid salary
- (v) Paid rent by cheque
- (w) Goods withdrawn for personal use
- (x) Paid an advance to suppliers of goods
- (y) Receive an advance from customers
- (z) Paid interest on loan
- (aa) Paid installment of loan
- (ab) Interest allowed by bank

ILLUSTRATION 5

Journalize the following transactions in the books of Shri Ganesh.

20X1 April			Rs
	1	Shri Ganesh started his business with Cash.....	50,000
	2	Purchased goods.....	5,000
	3	Purchased goods for Cash.....	10,000
	4	Purchased goods for Mr. Sun for Cash.....	15,000
	5	Sold	6,000
	6	goods.....	12,000
	8	Sold goods for Cash.....	18,000
	9	Sold goods to Mr. Sky for Cash.....	10,000
	10	Purchased goods from Mr. Moon.....	20,000
	11	Purchased goods from Mr. Star on Credit	12,500
	12	Sold goods to Mr. Sea.....	25,000
	13	Sold goods to Mr. Ocean on Credit.....	2,500
	15	Mr. Sea returned goods.....	2,000
	16	Returned goods to Mr. Moon.....	9,900
		Receive from Mr. Sea.....	100
	17	Allowed him discount.....	7,880
	29	Paid Mr. Moon.....	120
	30	Discount allowed by him.....	1,000
		Withdrew goods for private use	
	31	(Cost Rs 500, Selling Price Rs 600).....	500

	31	Paid Salary to Mr. Sevakram, an employee..... Paid Rent to Mr. Estate, landlord.....	500
--	----	---	-----

ILLUSTRATION 6

-
- 01.01. X1 Bought Goods for Rs 10,000
- 02.01. X1 Purchased Goods from Ram Rs 20,000
- 03.01. X1 Bought Goods from Shyam, for Rs 30,000 against a current-dated cheque
- 04.01. X1 Purchased goods from Sohan of the list price of Rs 30,000 at a trade discount of 10%
- 05.01. X1 Bought goods of the list price of Rs 1,25,000 from Mohan less 20% trade discount and 2% cash discount and paid 40% by cheque.
- 06.01. X1 Rejected and returned 10% of goods supplied by Ram
- 07.01. X1 Rejected and returned 10% of goods supplied by Sohan.
-

ILLUSTRATION 7

-
- 01.01. X1 Sold goods for Rs 10,000
- 02.02. X1 Sold goods to Sachin for Rs 20,000
- 03.01. X1 Sold good to Amit for Rs 30,000 against a current dated cheque
- 04.01. X1 Sold goods to Atul of the list Price of Rs 30,000 at a trade discount of 10%
- 05.01. X1 Sold good to Sunil of the List Price of Rs 1,25,000 less: 20% trade discount and 2% cash discount and received a current dated cheque under a cash discount of 2%
- 06.01. X1 Sold goods to Sahil of the list price of Rs 1,25,000 less: 20% trade discount and 2% cash discount and paid 40% by cheque
- 07.01. X1 Sold goods costing Rs 40,000 to Anita for cash at a profit of 25% on cost less 20% trade discount and charged 8% sales tax and paid cartage Rs 100 (not to be charged from customer)

- 08.01. X1 Sold goods costing Rs 40,000 to Anil at a profit of 20% on sales less 20% trade discount and charged 8% sales tax and paid cartage Rs 100 (to be charged from customer)
- 09.01. X1 Sachin rejected and returned 10% of goods
- 10.01. X1 Atul rejected and returned 10% of goods
-

ILLUSTRATION 8

Journalize the following transactions in the books of Bharat Tulsian:

- (a) Received Rs975 from Hari Krishnan in full settlement of his account for Rs 1,000.
- (b) Received Rs 975 from Shyam on his account for Rs 1,000.
- (c) Receive a first and final dividend of 60 paise in the rupee from the Official Receiver of Mr. Rajan who owed us Rs 1,000.
- (d) Paid Rs 480 to Mohan in full settlement of his account for Rs 500.
- (e) Paid Rs 480 to Sohan on his account for Rs 500.

ILLUSTRATION 9

Journalise the following transactions in the books of Tushar Tulsian:

20X1

- Jan. 16 Withdrawn goods for personal use (sale price Rs 600, cost Rs 500).
- 17 Goods costing Rs 500 given as charity. (Sale price Rs. 600)
- 18 Goods costing Rs 1,000 distributed as free samples. (Sale price Rs 1,200)
- 19 Goods stolen in transit (sale price Rs 1,000 cost Rs 800)
- 20 Goods destroyed by fire (sale price Rs 1,000 cost Rs 800)
- 21 Goods stolen by an employee (sale price Rs 1,000 cost Rs 600)
- 22 Goods used in making of furniture (sale price Rs 2000, cost Rs 1,500)
-

ILLUSTRATION 10

Journalise the following transactions:

-
- 01.01. X1 Paid into bank Rs 11,000 for opening a current account
- 02.01. X1 Withdrew for private expenses Rs 1,000
- 03.01. X1 Withdrew from bank Rs 3,000
- 04.01. X1 Withdrew from bank for private use Rs 1,500
- 05.01. X1 Placed on Fixed Deposit A/c at Bank by transfer from current account Rs 5,000.
-

13.0 COMPOUND ENTRY

13.1 Meaning: When more than two accounts are involved in a transaction and the transaction is recorded by means of a single journal entry instead of passing several journal entries, such single journal entry is termed as 'Compound Journal Entry'.

13.2 A compound entry may also be passed if there are more transactions of the same nature taking place on the same date.

13.3 How to Pass: It may be recorded in the following three ways:

- (a) By debiting one account and crediting two or more accounts; or
- (b) By debiting two or more accounts and crediting one account; or
- (c) By debiting several accounts and crediting several accounts.

ILLUSTRATION 15

On 2.4.20X1 Mohan, a customer, paid cash Rs 950 in full settlement of his account of Rs 1,000. Journalise and post it to the ledger.

14.0 OPENING ENTRY

14.1 Meaning of an 'Opening Entry' A journal entry by means of which the balances of various assets, liabilities and capital appearing in the balance sheet of previous

accounting period are brought forward in the books of the current accounting period, is known as 'opening Entry'.

14.2 Method of Recording an 'Opening Entry' While passing an opening entry, all assets accounts (individually) are debited and all liabilities accounts (individually) are credited and the net worth (i.e. excess of assets over liabilities) is credited to Proprietor's Capital Account (in case of a proprietary concern) or Partners' Capital Accounts (in case of a partnership concern).

14.3 Procedure of Posting an Opening Entry The procedure of posting an opening entry is the same as in case of an ordinary journal entry except that in case of an account which has been debited, the words 'To balance b / f are recorded in the Particulars column on the debit side and in case of an account which has been credited, the words 'By balance b / f are recorded in the Particulars column on the credit side.

ILLUSTRATION 16

Pass the opening entry in the journal of Ram (as on April 1, 20X1) and post the same into the ledger:

Cash in hand Rs 1,000; Cash at Bank Rs 5,000; Stock of Rs 20,000; Land and Buildings Rs 1,00,000; Plant and Machinery Rs 50,000; Furniture and Fixtures Rs 25,000; Owings from X Ltd. Rs 12,500; Prepaid Insurance Rs 500; Interest received in advance Rs 250; Loan from Y Ltd. 10,000; Owing to Z Ltd. Rs 3,750;

15.0 BALANCING OF ACCOUNTS

15.1 Meaning of Balancing of Accounts: After positing into the ledger, the next stage is to ascertain the net effect of all the transactions posted to an account. The process of ascertaining the difference between the total of debits and total of credits appearing in an account is known as 'Balancing of an account'.

15.2 Balance of Account: Balance of an account is the difference between the total of debit and total of credit appearing in an account. It signifies the net a debit balance or a credit balance or a nil balance, depending upon whether the debit or the credit total is higher.

15.3 Types of Accounts that are Balanced: Normally, Personal Accounts and Real Accounts are balanced. Nominal Accounts are not usually balanced but are closed by transferring to Trading and Profit & Loss Account.

15.4 Significance of Balancing: Balancing of an account is necessary to ascertain the net effect of all transactions posted to that account during a given period.

15.5 Procedure for Balancing: The procedure for balancing a ledger account is given below:

Procedure for Balancing a Ledger Account

- Step1** Make a total of both the 'Debit Amount column' and 'Credit Amount column' separately and ascertain the difference in two totals.
- OR
- Step2** If the debit side total exceeds credit side total, put such difference (called debit balance) on the credit side in 'Credit Amount column', write the date on which balancing is being done in the 'Date column' and the words 'By Balance c/d' in 'Particulars column'.
- Step3** Make a total of both the 'Debit Amount column' and 'Credit Amount column' and put the total on both the sides and draw a double line immediately beneath the totals.
- Step4** Enter the date of beginning of next period in 'Date column' and bring down the debit balance on the debit side along with the words 'To Balance b/d' in Particulars column and the credit balance on the credit side along with the words 'By Balance b/d' in 'Particulars column'.

ILLUSTRATION 17

Balance the following ledger accounts on 31st Jan. 20X1.

Dr.

Ram's Account

Folio 8

Cr.

<i>Date</i>	<i>Particulars</i>	<i>Folio</i>	<i>Rs</i>	<i>Date</i>	<i>Particular</i>	<i>Folio</i>	<i>Rs</i>
02.01.X 1	To Sales A/c		1,00,000	05.01.X 1	By Sales Returns		10,000
					By Cash A/c		20,000
				25.01.X 1			30,000
					By Bank A/c		
				31.01.X 1	By Discount A/c		1,000
				31.01.X 1			

Trial Balance, Errors and Their Rectification

1. MEANING OF A TRIAL BALANCE

Trial Balance is a statement which shows either the balance or total amounts of debit items and credit items of all accounts in the ledger and the Cash and bank balances.

A trial balance is a statement and not an account.

A trial balance is prepared on a particular date and not for a particular period.

2. OBJECTIVES OF A TRIAL BALANCE

The main objectives of preparing the trial balance are as under:

To ascertain the arithmetical accuracy of ledger accounts: A tallied trial balance indicates that equal debits and credits have been recorded in the ledger accounts.

To help in locating errors: An untallied trial balance indicates that some error(s) has (have) been committed.

To facilitate the preparation of financial statements: A trial balance can directly be used for preparing the financial statements and need not refer to the ledger. All revenue and expense accounts appearing in the trial balance are transferred to the Trading and Profit & Loss Account and all liabilities, capital and assets are carried over to the Balance Sheet.

3. LIMITATIONS OF A TRIAL BALANCE

A tallied trial balance merely indicates that equal debits and credits have been recorded in the books of account.

A tallied trial balance does not ensure that—

- (a) All transactions have been correctly recorded (i.e. correct book, correct account, correct amount)

- (b) All entries/total (e.g., total of purchases book etc.) have been correctly posed in the ledger, (i.e. posting to correct account on correct side with correct amount.)

A tallied Trial Balance is not a conclusive proof of the accuracy of the books of accounts since certain types of errors remain even when the Trial Balance tallies. The following errors do not affect the Trial balance at all.

- (a) Error of Principle,
- (b) Compensating error,
- (c) Error of complete omission,
- (d) Error of Recording in the books of original entry, and
- (e) Posting a correct amount in the wrong account but on the correct side.

4. METHODS OF PREPARATION OF A TRIAL BALANCE

To verify the correctness of the posting of ledger accounts in terms of the debit and credit amounts periodically, a periodic trial balance may be prepared (say) at the end of a month or quarter or half-year. Though a trial balance may be prepared at any time, but it should be prepared at the close of the accounting period so as to verify the arithmetical accuracy of the ledger accounts before the preparation of the financial statements. It may be noted that a Trial Balance is always prepared on a particular date and not for a particular period. A Trial Balance may be prepared by following either the Balance Method or Total Amount Method.

1. Balance Method: Under this method, the balances of all the accounts (including Cash and Bank Account) are incorporated in the trial balance. It may be noted that a trial balance by this method can be prepared only when all the ledger accounts have been balanced. A format of a Trial Balance by 'Balance Method' is shown below:

Format of a Trial Balance by Balance Method

Trial Balance... (Name of the Enterprise)...

as at ... (date on which the Trial Balance is being prepared) ...

No.	Name of Account	L. F.	Debit Balance		Credit Balance	
			Rs	P	Rs	P
1	Purchases A/c	P-1	XXX	-		
2	Sales A/c	S-1			XXX	-
3	Purchases Returns A/c	P-2			XXX	-
4	Sales Return A/c	S-2	XXX	-		
5	Cash A/c	C-1	XXX	-		
6	Bank A/c	B-1	XXX	-		
7	Capital A/c	C-2			XXX	-
8	Salaries A/c	S-3	XXX	-		
9	Furniture A/c	F-1	XXX	-		
10	Ram's A/c	R-1	XXX	-		
11	Shyam's A/c	S-4			XXX	-
		Total	XXX	-	XXX	-

2. Total Amount Method: Under this method, the total amount of debit items and credit items in each ledger account are incorporated in the trial balance. It may be noted that a

trial balance by this method can be prepared immediately after the completion of posting from the books of original entry to the ledger. A format of a Trial Balance by ‘Total Amount Method’ is shown below:

Format of a Trial Balance by Balance Method

Trial Balance... (Name of the Enterprise)...

as at ... (date on which the Trial Balance is being prepared) ...

S.No.	Name of Account	L. F.	Debit Balance		Credit Balance	
			Rs	P	Rs	P
1	Purchases A/c	P-1	XXX	-		
2	Sales A/c	S-1			XXX	-
3	Purchases Returns A/c	P-2			XXX	-
4	Sales Return A/c	S-2	XXX	-		
5	Cash A/c	C-1	XXX	-		
6	Bank A/c	B-1	XXX	-		
7	Capital A/c	C-2			XXX	-
8	Salaries A/c	S-3	XXX	-		
9	Furniture A/c	F-1	XXX	-		
10	Ram's A/c	R-1	XXX	-		
11	Shyam's A/c	S-4			XXX	-
		Total	XXX	-	XXX	-

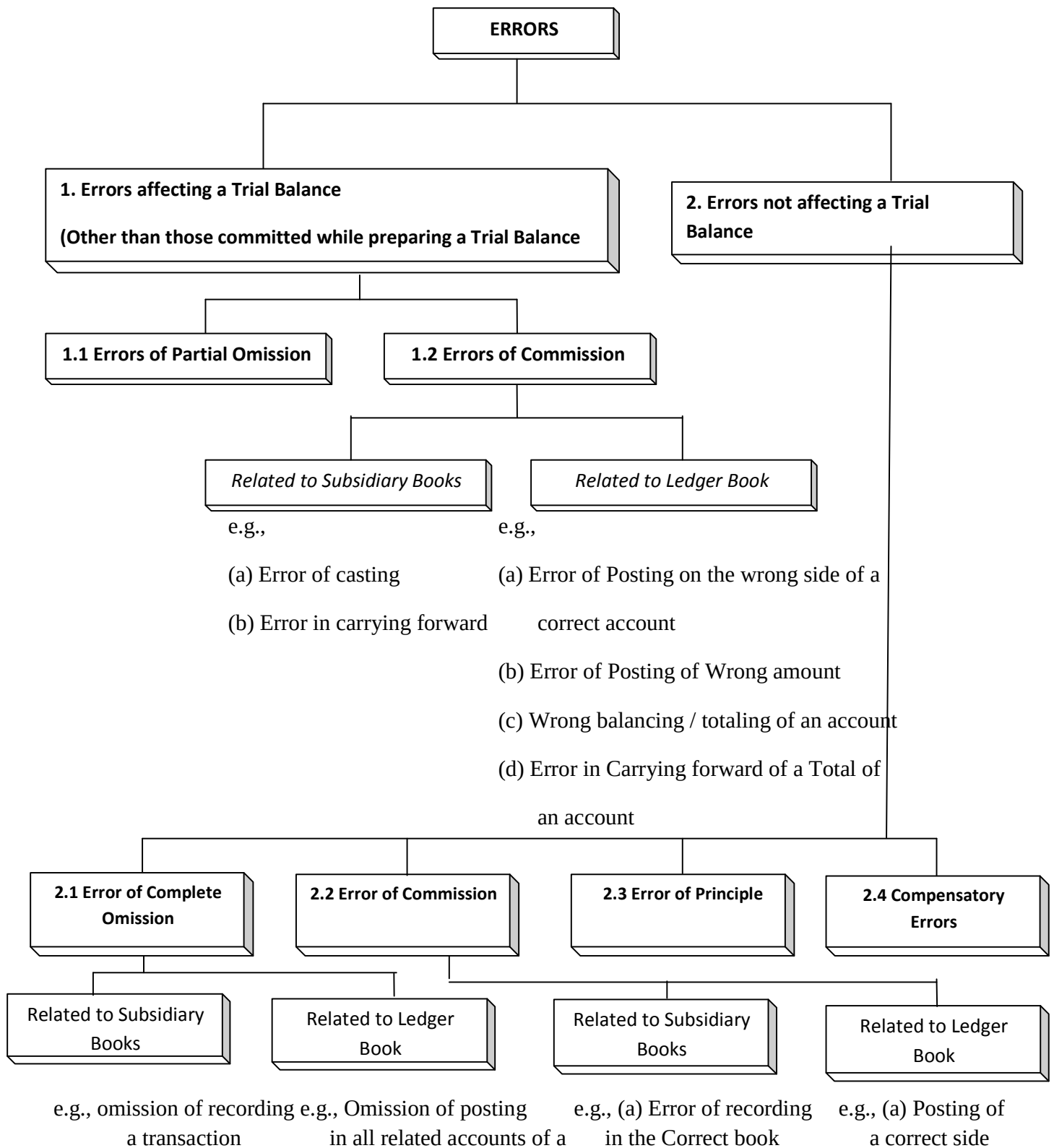
6. TYPES OF ERRORS:

All accounting errors may be classified as follows:

1. On the basis of heir effect on rail Balance:

- (a) Errors affecting the agreement of Trial Balance
- (b) Errors not affecting the agreement of Trial Balance

Such errors have been shown in a chart given on next page.



Transaction

(b) Recording in a wrong
bookof a wrong
account**1. On the basis of Clerical/Principle Errors****(a) Clerical Errors**

(i.e., those errors which arise because of mistakes committed in the ordinary course of the accounting work)

(i) Error of Omission

(ii) Error of Commission

(iii) Compensating Errors

[**Note:** Truly speaking, the compensating errors do not represent separate type of errors but only represent a group of errors. Only for the purpose of discussion, these errors have been shown separately.]

(b) Error of Principle

6.1 Error of Omission: This error arises when a transaction is completely or partially omitted to be (i) recorded in the books of accounts or (ii) Posted to the ledger. Error of omission may be classified as under:

(a) **Error of complete omission:** This error arises when any transaction is not recorded in the books of original entry at all or, the transaction is recorded in General Journal but is not posted in the ledger at all. This error **does not affect agreement of trial balance.**

Example I -- Goods purchase on credit from Ram not recorded in the Purchases Book,

Example II -- Goods sold on credit to Shyam not recorded in the Sales Book.

Example III -- Furniture sold on credit to Mohan recorded in Journal Proper but omitted to be posted.

(b) **Error of partial omission:** An error of omission other than an error of complete omission is called an error of partial omission. This error **affects the**

agreement of trial balance. The examples of errors of partial omission include the following:

- (i) Transaction correctly recorded in the books of original entry (other than Journal Proper) but not posted in the ledger at all; [e.g. A credit sale of goods to Shyam recorded in Sales book but omitted to be posted in Shyam's Account].
- (ii) Omission in carrying forward the total from one page to the other;
- (iii) Omission to balance an account.

6.2 **Error of Commission:** This error arises due to wrong recording, wrong casting, wrong carry forward, wrong posting, wrong balancing etc., Errors of commission may be classified as follows.

- (a) **Error of recording:** This error arises when any transaction is incorrectly recorded in the books of original entry. This error **does not affect the agreement of trial balance.** These errors may be of the following types—

<i>Books of original entry in which the transaction was recorded</i>	<i>Name of the account used in recording</i>	<i>Amount with which the transaction was recorded</i>	<i>Whether affects the Trial Balance</i>
1. Correct	Correct	Wrong	No
2. Correct	Wrong	Correct	No
3. Correct	Wrong	Wrong	No
4. Wrong	Correct	Correct	No
5. Wrong	Correct	Wrong	No
6. Wrong	Wrong	Correct	No
7. Wrong	Wrong	Wrong	No

Example I -- Goods of Rs.500 purchased on credit from Ram are recorded in the Purchases Book for Rs 5,500.

Example II-- Goods of Rs 5,000 purchase on credit from Ram are recorded in the Sales Book.

- (b) **Error of casting:** This error arises when a mistake is committed in totaling. This error **affects the agreement of trial balance.**

Example I -- Purchase Book is totaled as Rs 1,000 instead of Rs 100.

Example II -- Sales Book is totaled as Rs 500 instead Rs 5,000.

- (c) **Error in carrying forward:** This error arises when a mistake is committed in carrying forward a total of one page on the next page. This error **affects the agreement of trial balance.**

Example I -- Total of Purchases Book is carried forward as Rs 1,000 instead of Rs 100.

Example II -- Total of Sales Book is carried forward as Rs 100 instead of Rs 1,000.

- (d) **Error of posting** This error arises when information recorded in the books of original entry are incorrectly entered in the ledger. This error **may or may not affect the agreement of trial balance.** This error may be of the following types:

<i>Account to which the posting was made</i>	<i>Side(debit/credit)on which posting was made</i>	<i>Amount with which the posting was made</i>	<i>Whether affects the Trial Balance</i>
1. Correct	Correct	Wrong	Yes
2. Correct	Wrong	Correct	Yes
3. Correct	Wrong	Wrong	Yes
4. Wrong	Correct	Correct	Yes
5. Wrong	Correct	Wrong	Yes
6. Wrong	Wrong	Correct	Yes
7. Wrong	Wrong	Wrong	Yes

6.3 Compensating Errors

Meaning -- These errors arise when two or more errors are committed in such a way that the net effect of these errors on the debits and credits of accounts involved is mollified. In other words, compensating errors refer to such a group of errors wherein the effect of one error is compensated by the effect of other error or errors.

Effect -- These errors **do not affect the agreement** of the trial balance but may or may not affect the figure of net profit.

Example I -- If the total of Purchases Book is posted in the ledger as Rs 1,000 instead of Rs 100 and at the same time Ram's A/c is credited in the ledger a Rs 1,000 instead of Rs 100, as a result of these errors, there is an excess credit of Rs 900 in Ram's Account and an excess debit of Rs 900 in Purchases Account. Thus, these two errors mollify the effects of each

other. The first error will increase the figure of purchases and consequently will reduce the figure of profit.

Example II-- If the total of Bills Receivable Book is posted in the ledger as Rs 1,000 instead of Rs 100 and at the same time total of Bills Payable Book is posted as Rs 1,000 instead of Rs 100, as a result of these errors, there is excess credit of Rs 900 in Bills Payable Account and an excess debit of Rs 900 in Bills Receivable Account. These two errors will nullify the effect of each other. These errors will not affect the figure of profit in anyway.

6.4 Error of Principle

- Meaning** -- This error arises when the transaction is recorded ignoring the distinction between the capital item and revenue item. In other words, this error involves an incorrect allocation of expenditure or receipt between Capital and Revenue. The correct allocation between Capital and Revenue is of paramount importance because any incorrect allocation would disturb the final results as disclosed by the Financial Statements.
- Effect** -- It may lead to under/over stating of incomes or assets or liabilities.

This error **does not affect the agreement of trial balance.**

Example -- If Freight paid for bringing new machinery is posted to Freight A/c, this error will increase the figure of freight and reduce the figure of depreciation and as a result, the figure of net profit shall be changed by the net effect (i.e., the difference between the amount of freight and amount of depreciation).

Note: The costs incurred on the acquisition, installation and commissioning of a fixed asset up to the point the fixed asset is ready for use represent capital expenditures.

7. SUSPENSE ACCOUNT:

1. **Meaning of Suspense Account:** A Suspense Account is an account in which the amount of difference in the trial balance is put till such time that errors are located and rectified.
2. **Preparation of Suspense Account:** The difference in the trial balance is transferred on the credit side of the Suspense Account (if the debit side of the trial balance exceeds the credit side) or on the debit side of the Suspense Account (if the credit side of the trial balance exceeds the debit side)
3. **Objective of Suspense Account:** The rationale behind the opening of a Suspense Account is to avoid delay in the preparation of financial statements.
4. **Disposal of Suspense Account:** When the errors affecting the Suspense Account are located, they are rectified with the help of the Suspense Account. When all the errors affecting the trial balance are located and rectified, the Suspense Account automatically stands balanced.
5. **Treatment of Balance of Suspense Account:** When the errors affecting the trial balance are still to be located and rectified, the Suspense Account will show outstanding balance. The balance of Suspense Account merely represents the net effect of errors which still remain undetected. Such balance will be shown in the Balance Sheet on the assets side (if debit balance) or on the liabilities side (if credit balance).

8. RECTIFICATION OF ERRORS NOT AFFECTING THE TRIAL BALANCE**1. Examples of Errors not affecting the trial balance (or Two Sided Errors):**

The various errors which do not affect the Trial Balance include the following:

(a) Two sided Errors of Omission

- (i) Error of complete omission

(b) Two sided Errors of Commission

- (i) **Error of Recording** in the books of original entry
- (ii) **Error of Posting** involving the posting to wrong account on correct side with correct amount.
- (iii) **Error of Principle**

(iv) Compensating errors

2. **How to Rectify Two Sided Errors of Omission:** Two sided errors of omission in the books of original entry are rectified simply by the passing the journal entry which was to be passed at the time of transaction but was omitted to be passed.

ILLUSTRATION 4: [Rectification of Errors of Omission]

Pass the necessary journal entries to rectify the following errors:

- (a) A credit sale of Rs 170 to Ram omitted to be recorded in the books.
- (b) A credit sale of old furniture to Rohan for Rs 170 omitted to be posted.
- (c) Goods (Cost Rs 1,000, Sale Price Rs 2,400) distributed as free samples among prospective customers were not recorded anywhere.
- (d) Goods (Cost Rs 2,000, Sale Price Rs 2,400) distributed as free samples among prospective customers were not recorded anywhere.
- (e) Goods (Cost Rs 3,000, Sale Price Rs 3,600) were returned by Ram, a customer and were taken into stock on the same date but no entry was passed in the books.
- (f) Materials from store of Rs 1,000 and Wages Rs 400 had been used in making tools and implements for use in own factory, but no adjustments were made in the books.
- (g) Outstanding Telephone Charges of Rs 660, had been completely omitted.

ILLUSTRATION 5: [Rectification of Errors of Recording]

Pass the necessary journal entries to rectify the following errors in the books of a trader who deals in sarees:

- (a) A credit sale of Rs 170 to Ram was recorded as Rs 710.
- (b) A credit sale of Rs 170 to Krishan was recorded as sale to Krishan.
- (c) A credit sale of Rs 170 to Meenu was recorded as sale to Meen as Rs 710.
- (d) A credit sale of Rs 170 to Mohan was recorded in the Purchases Book.

- (e) A credit sale of old machinery to Sohan for Rs 170 was entered in the Sales Book for Rs 710.
- (f) A credit sale of old furniture to Rohan for Rs 170 posted as Rs 710.
- (h) A Bills Receivable of Rs 170 received from V.P. Singh was entered in Bills payable Book.
- (i) Rs.150 paid to Dinesh posted to Dhir's A/c.

ILLUSTRATION 6: [Rectification of Two sided errors of Posting]

Pass the necessary journal entries to rectify the following errors:

- (a) A credit sale of Rs 170 to Kishan was posted to Krishan's Account.
- (b) A cash sale of Rs 170 to Meenu was posted to the credit of Meenu.
- (c) A credit sale of old Furniture to Babu Ram for Rs 170 was credited to Sales Account.
- (d) A cheque for Rs 128 received from Farid was dishonoured and has been posted to the debit of Sales Returns Account.
- (e) An amount of Rs 572 due from Lalta Prasad, written off as bad in a previous year, was recovered and credited to the personal account of Lalta Prasad.
- (f) A discounted Bill of Exchange receivables for Rs.1,600 returned by the firm's bank had been credited to the Bank Account and debited to Bills Receivable Account. A cheque was received later from the customer for Rs 1,600 and duly paid.
- (g) Rs 4,000 paid for the telephone bill of the telephone at the proprietor's residence was debited to Postage Account.
- (h) An amount of Rs 1,500 withdrawn from bank by the proprietor for his personal use has been charged to Trade Expenses Account.
- (i) An amount of Rs 3,000 withdrawn from Bank by the proprietor for office use has been debited to Drawings Account.
- (j) Rs 1,600 paid as salary to Hari, an employee, debited to Hira.
- (k) Rs 2,000 paid as Rent to Baburam, a landlord, debited to Baburam.

ILLUSTRATION 7 [Rectification of Errors of Principle]

Pass the necessary journal entries to rectify the following errors:

- (a) Rs 3,000 paid as wages for the construction of office building debited to Salaries Account.
- (b) Rs 4,000 spent on the purchases of materials for the construction of office Building debited to Purchases Account.
- (c) Rs 10,000 spent on the extension of bulking was debited to Building Repairs Account.
- (d) Rs 5,000 spent on white washing of building was charged to Building Account.
- (e) Rs 200 paid as Installation Charges for newly purchased second hand Machinery posted to Cartage Account.
- (f) Rs 2,000 paid as repairing charges on the reconditioning of a newly purchased second hand machinery debited to General Expenses Account.
- (g) Rs 1,000 paid as repairing charges of an existing machine in use charged to Machinery Account
- (h) Rs 2,000 paid by cheque for a typewriter was charged to the Office Expenses Account.

9. *RECTIFICATION OF ERRORS AFFECTING THE TRIAL BALANCE*

1. Example of Errors affecting the Trial Balance (or One-sided errors)

The various errors which affect the trial balance include the following:

- (a) Error due to partial omission
- (b) Error of casting
- (c) Error in carrying forward
- (d) Error in totaling or balancing of an account
- (e) Errors of posting (other than an error of posting a correct amount in the wrong account but on the correct side)
- (f) Omission of posting the total of a subsidiary book

- (g) Omission of an account from Trial Balance
- (h) Entering the balance of an account in the wrong amount column of the trial balance
- (i) Wrong totaling of the Trial Balance

Financial Statements

1. MEANING OF FINANCIAL STATEMENTS

1. Basically, Financial Statements are organized summaries of detailed information about the financial position and performance of an enterprise.
2. Traditionally, the term 'Financial Statements' is used to denote only two basic statements which are as under:
 - (a) **Balance Sheet (or Position Statement)** which shows the financial position of an enterprise at a particular point of time,
 - (b) **Trading and Profit and Loss Account (or Income Statement)** which shows the financial performance of business operations during an accounting period.
3. Nowadays, in addition to the aforesaid two basic financial statements, a Statement of Retained Earnings and a Cash Flow Statement, and Value Added Statement are also prepared in practice.

2. USEFULNESS OF FINANCIAL STATEMENTS

1. The information contained in these statements is used by the management, present and potential investors, lenders, short-term creditors, employees, customers, governments and their agencies to satisfy some of their different needs for information.
2. Users can get better insight about the financial strengths and weaknesses of the firm if they properly analyse the information from their own points of view.
3. The usefulness of the financial statements for some of the users is explained follows.

3. TRADING ACCOUNT

After preparing a tallied trial balance at the end of an accounting period, the next step is to prepare Trading Account.

1. **Meaning of Trading Account:** Trading account is one of the financial statements which shows the result of buying and selling of goods and/or services during an accounting period.
2. **Purpose of Trading Account:**
 - (a) Trading account is prepared to ascertain the gross profit or gross losses during the accounting period. The basis for the preparation of this account is the matching of selling prices of goods and services with the Cost of Goods sold and services rendered.
 - (b) **Gross Profit** means excess of operating revenues over direct operating expenses.
3. **Contents of Trading Account:**

A. Items to be shown on the Debit Side of Trading Account -

Trading account is **debited** with the direct expense items such as:

- (a) **Opening Stock** refers to the closing stock of unsold goods at the end of previous accounting period which has been brought forward, through opening entry in the current accounting period.
- (b) **Purchases** refer to those goods which have been bought for resale. Purchases include cash as well as credit purchases. The following items are shown by way of deduction from the amount of total purchases:
 - (i) Purchases Returns or Return Outwards (i.e., goods returned to suppliers)
 - (ii) Goods withdrawn by the proprietor for his personal use.
 - (iii) Goods distributed by way of free samples.
 - (iv) Goods given as charity.
- (c) **Direct expenses** refer to all those expenses which are incurred from the stage of purchase till the stage of making the goods in saleable condition. Such expenses include the following expenses:
 - (i) Freight Inwards (ii) Import Duty (iii) Octroi (iv) Carriage Inwards and Cartage Inwards (v) Wages.

B. Items to be shown on the Credit Side of Trading Account:

Trading Account is **credited** with the directly revenue items such as:

(a) **Sales** refer to the sales of those goods which have been bought for resale. Sales include cash as well as credit sales. Sales Returns or Returns Inwards (i.e., goods returned by customers) are shown by way of deduction from the amount of total sales. If the amount of sales includes the amount of Sales Tax/Value Added Tax, then the amount of Sales Tax/Value Added Tax is deducted from the sales.

(b) **Closing Stock** refers to the stock of unsold goods at the end of the current accounting period. According to Prudence Principle (Conservatism), stock is valued at Cost or Net Realizable Value (NRV) whichever is lower. For example, if cost of closing stock is Rs 50,000 but its Net realizable value is Rs 40,000, closing stock will be taken at Rs 40,000. The rationale behind this practice is to provide for anticipated losses. Closing Stock is accounted for as under:

<i>1.If the Closing Stock appears outside the Trial Balance</i>	The following entry is passed to incorporate the Closing Stock in the book. Dr. Stock A/c To Trading A/c As a result, the Closing Stock appears both on the credit side of the Trading Account and on the Assets side of the Balance Sheet.
<i>II. If the closing Stock appears inside</i>	(a) Closing Stock will not be shown in the Trading Account since the Closing Stock has already been taken into account while computing the Adjusted Purchases/Cost of Goods sold. (b) Closing Stock will be shown in the Balance Sheet.

4. **How to Prepare Trading Account:** The preparation of a Trading Account requires the passing of entries to transfer the balances of accounts of all the concerned items to the Trading Account. The entries required for such transfers are called 'Closing Entries', since such entries will close the accounts of all the concerned items. The following closing entries are passed to give effect to such transfer of balances.

<i>Account(s) to be closed</i>	<i>Accounting Entry to be passed</i>
(a) Purchases Returns Account	Purchase Returns A/c Dr. To Purchases A/c
(b) Opening Stock Account, Purchases Account and Accounts of Direct Expenses(e.g., wages, carriage inwards, freight inwards)	Trading A/c Dr. To Opening Stock A/c To Purchases A/c To Direct Expenses A/c
(c) Sales Returns or Return inwards Account	Sales A/c Dr. To Sales Returns A/c
(d) Sales	Sales A/c Dr. To Trading A/c

5. **How to Close Trading Account:** The Trading Account is closed by transferring its balance to the Profit and Loss Account by passing the following entry:

<i>Account(s) to be closed</i>	<i>Accounting Entry to be passed</i>
(a) In case of Gross Profit (i.e., when the credit side exceeds the debit side)	Trading A/c Dr. To Profit & Loss A/c
(b) In case of Gross Profit (i.e., when the debit side exceeds the credit side)	Profit & Loss A/c Dr. To Trading A/c

6. Format of a Trading Account

A general format of a Trading Account is shown below:

Format of a Trading Account

Dr. Trading Account of for the period ending on Cr			
<i>Particulars</i>	<i>Rs</i>	<i>Particulars</i>	<i>Rs</i>
To Opening Stock	XXX	By Sales	
To Purchases		XXX	XXX
XXX		Less: Return Inwards	
Less: Returns outwards	XXX	XXX	
XXX			XXX
--	XXX	-----	XXX
-----	XXX	By Closing Stock	
To Direct Expenses	XXX	By Abnormal Loss of Stock	XXX
To Wages and Salaries	XXX	By *Gross Loss transferred to	
To Freight Inward	XXX	P & L A/c	
To Carriage Inward	XXX		
To Cartage Inward			
To *Gross Profit transferred to			
	XXX		XXX
P & L A/c			

7. **Format of a Profit & Loss Account**

A general format of a Profit and Loss Account is shown below:

Format of a Profit and Loss Account

Dr. Profit and Loss Account of For the period ending on
Cr

<i>Particulars</i>	<i>Rs</i>	<i>Particulars</i>	<i>Rs</i>
To Opening Stock	XXX	By Sales	XXX
To Gross Loss b/d	XXX	By Gross Profit b/d	XXX
To Salaries & Wages	XXX	By Discount Received	XXX
To Rent, Rates & Taxes	XXX	By Commission earned	XXX
To Fire Insurance Premium	XXX	By Interest on	
To Repairs & Maintenance	XXX	Marketable Securities	XXX
To Depreciation	XXX	By Profit on sale of	
To Audit Fees	XXX	Marketable Securities	XXX
To Bank Charges	XXX	By Operating Loss c/d	XXX
To Legal Charges	XXX		
To Expenses	XXX		
To Carriage Outward	XXX		
To Freight Outward	XXX		
To Commission to Salesmen	XXX		
To Traveling Expenses	XXX		
To Entertainment Expenses	XXX		
To Sales Promotion Expenses			
To Advertising and Publicity			

To Bad Debts	XXX		
To Packing Expenses	XXX		
To Operating Profit c/d	XXX		
	XXX		XXX
To Operating Loss b/d	XXX	By Operating Profit b/d	XXX
To Interest on Loan	XXX	By Rent earned	XXX
To Loss on Sales of Fixed Assets	XXX	By Interest earned	XXX
To* Net Profit transferred to	XXX	By Profit on sale of fixed Assts XXX	
Capital Account	XXX	By Income from investments XXX	
		By Dividend Received XXX	
		By *Net Loss transferred to	
	XXX	Capital Account XXX	XXX

5. BALANCE SHEET [OR POSITION STATEMENT]

After preparing the Profit & Loss Account, the next step is to prepare a Balance Sheet.

1. Meaning of Balance Sheet:

A Balance Sheet is a statement on the financial position of an enterprise at a given date which exhibits its assets, external liabilities, capital and reserves. It is called a Balance Sheet because it is a sheet of balances of those ledger accounts (i.e. Personal Accounts, Real Accounts and Fictitious Assets Accounts) which have not been closed till the preparation of the Trading and Profit and Loss Account.

2. Characteristics of a Balance Sheet:

The characteristics of a Balance Sheet are summarized as follows:

- a. A Balance Sheet is ***only a statement and not an account***. It has no debit side or credit side. The headings of the two sides are 'Assets' and 'Liabilities'.
- b. A Balance Sheet is prepared ***at a particular point of time and not for a particular period***. The information contained in a Balance Sheet is true only at that particular point of time at which it is prepared.
- c. A Balance Sheet is a summary of balances of Personal, Real and fictitious Assets accounts which have not been closed by transfer to the Trading and Profit and Loss Account.
- d. A Balance Sheet shows the nature and value of assets and the nature and the amount of liabilities at a given date.

3. Need for the Preparation of Balance Sheet:

The purposes of preparing a Balance Sheet are as follows:

1. To ascertain the nature and value of assets of a business.
2. To ascertain the nature and amount of liabilities of a business
3. To find out the financial solvency of an enterprise. An enterprise is considered to be a solvent if its assets exceed its external liabilities.

4. When prepared

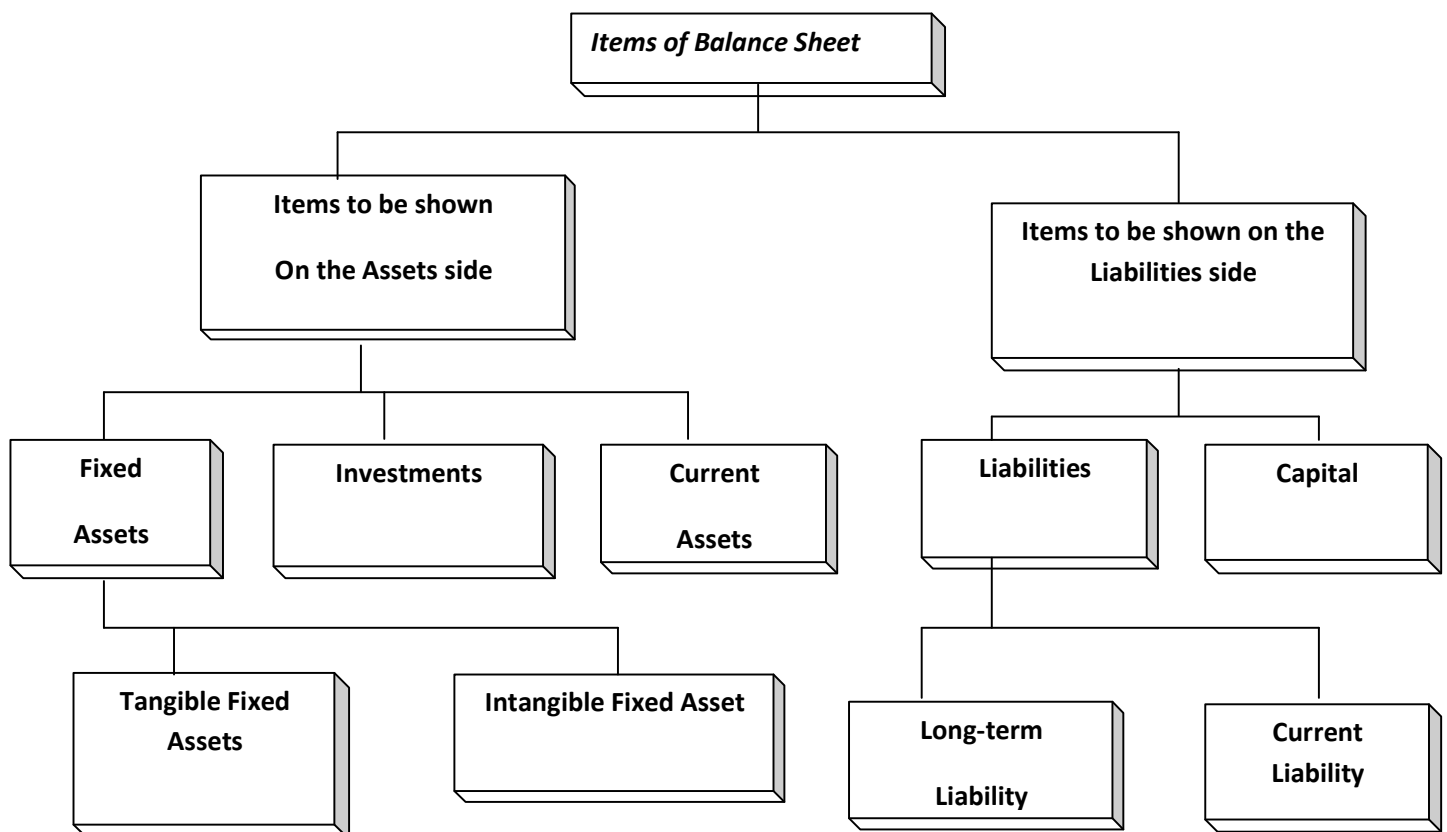
It is prepared only after the preparation of the Profit and Loss account

5. Contents of Balance Sheet

(a) In India the right hand side of Balance Sheet is called the '**Assets**' side and the left hand side is called the '**Liabilities**' side.

(b) In some of the other countries (for example Australia), The right hand side of a Balance Sheet is called the '**Liabilities**' side and the left hand side is called the '**Assets**' side.

(c) The various items which are shown on the assets side and liabilities side are as follows:



6. ITEMS TO BE SHOWN ON THE ASSETS SIDE OF ABALANCE SHEET

The **debit balances** of those ledger accounts which have not been closed till the preparation of the Trading and Profit and Loss Account, are shown on the 'Assets' side of the Balance Sheet.

Assets refer to tangible objects or intangible rights owned by an enterprise and carrying probable future benefits. Usually the following items are included in the Assets:

1. Fixed Assets Fixed assets refer to those assets which are held for the purposes of providing or producing goods or services and those which are not held for resale in the normal course of business. Fixed Assets may be classified as under:

- (i) **Tangible Fixed Assets** refer to those fixed assets which can be seen and touched e.g., Land & Building, Plant & Machinery, Furniture & Fixture, Motor Vehicles.
- (ii) **Intangible Fixed Assets** refer to those fixed assets which can neither seen nor been touched e.g., Goodwill, Patents, Trade Marks.

Note: Fixed assets are usually valued at cost less depreciation.

Distinction between Tangible Assets and Intangible Assets

Tangible Assets differ from Intangible Assets in the following respects:

<i>Basis of Distinction</i>	<i>Tangible Assets</i>	<i>Intangible Assets</i>
1. Physical identity	These assets have physical identity.	These assets do not have physical identity.
2. Depreciation or Amortization	Fixed tangible assets are depreciated .	Intangible assets are amortized .
3. Fixed vs. Current	Tangible assets can be fixed or current asset.	Intangible assets usually fall in the category of fixed assets .
4. Acceptance in security	Lenders accept such as sets as security for a loan given.	Lenders usually do not accept such assets as security for a loan given.
5. Risk of loss due to fire	The assets may be lost due to fire.	These assets cannot be lost due to fire.

2. Investments Investment represent an expenditure on assets to earn interest, dividend, income or other benefit e.g., Sares, Debentures, Bonds, Investment properties.

3. Current Assets Current assets are those assets which are held—

(i) In the form of cash e.g., cash in hand and cash at bank,

(ii) For their conversion into cash e.g., stock of finished goods, debtors, Bills Receivable, Accrued Income,

(iii) For their consumption in the production of goods or rendering of services in the normal course of business e.g., Stock of raw materials, WIP.

Note: Current Assets are usually valued at cost or net realizable value whichever is less on the basis of Prudence (or Conservatism) Principle.

Distinction between Fixed Assets and Current Assets

Fixed Assets differ from Current Assets in the following respects:

<i>Basis of Distinction</i>	<i>Fixed Assets</i>	<i>Current Assets</i>
1. Purposes of holding	These are the assets which are held for the purpose of providing or producing goods or services and those which are not held for resale in the normal course of business.	These are the assets which are held— (a) in the form of cash (b) for their conversion into cash (c) for their consumption in the production of goods or rendering of services in the normal course of business
2. Valuation	Fixed assets are valued at cost less depreciation.	These assets are valued at cost or net realizable value price whichever is lower.
3. Subject to change	These assets are usually not subject to change.	These assets are usually Subject to change.
4. Pledge	These assets cannot be pledged.	These assets can be pledged.

5. Fixed vs. Floating charge	Fixed charge can be created on these assets.	Floating charge can be created on these assets.
6. Nature of profit on sale	Profit on sale of these assets is of capital nature.	Profit on sale of these assets is of revenue nature.
7. Revaluation reserve in case of appreciation in the value	In case of appreciation in the value of such assets, revaluation reserve can be created .	In case of appreciation in the value of such assets, revaluation reserve cannot be created .
8. Source of finance	These assets are financed out of long-term funds	These assets are mainly financed out of short term funds .

7. ITEMS TO BE SHOWN ON THE LIABILITIES SIDE OF A BALANCE SHEET

The credit balances of those ledgers accounts which have not been closed till the preparation of the Trading and Profit & Loss Account are shown on the 'Liabilities' side of the Balance Sheet.

A. Liabilities: Liabilities refer to the financial obligations of an enterprise other than owners' fund. Usually the following items are included in liabilities.

- (i) **Long term Liability** Long term Liability refers to that liability which does not fall due for payment in a relatively short period (i.e., normally not more than 12 months from the date of a Balance Sheet) e.g., loan from a financial institution, Debentures.
- (ii) **Current Liability** Current Liability refers to that liability, which falls due for payment in a relatively short period, (i.e., normally a period not more than 12 months from the date of Balance Sheet). E.g., Bills Payables, Trade Creditors, Outstanding Expenses, Bank Overdraft, Installments of Loan and Deposits payable within 12 months from the date of a Balance Sheet.

B. Capital: Capital is the excess of assets over external liabilities. It refers to the amount invested in an enterprise by the proprietor (in case of a proprietorship concern) or partners (in case of a partnership concern), which is increased by the amount of profit earned and is decreased by the losses incurred and the amount withdrawn (whether in the form of cash or kind).

Note: Drawings Account (which records the amount withdrawn by the proprietor whether in the form of cash or kind) is closed by transferring its balance to the debit side of the Capital Account. Usually, it is shown by way of deduction from the amount of capital in the Balance Sheet.

8. CONTINGENT ASSET AND CONTINGENT LIABILITY

1. Contingent asset:

- (a) **Meaning:** Contingent asset has been defined by Kohler as "An asset, the existence value and ownership of which depend upon the occurrence or non-occurrence of a specific event or upon the performance or non-performance of a specified act contrasts with contingent liability, often growing out of such a liability."
- (b) **Example:** Suppose the firm has filed a suit for some property now in the possession of someone else. If the suit is decided in the firm's favor, the firm will get the property; at the moment it is a contingent asset. Similar would be the position for a patent applied for arising out of the firm's own research effort. Contingent liability in respect of contract for capital expenditure already entered into will give rise to an asset on payment; at present it is only a contingent asset.

2. Contingent Liability

- (a) **Meaning:** A contingent liability is one which is not an actual liability but which may become on the happening some uncertain future event. Really, contingent liabilities have **two characteristics**:
 - i. Uncertainty as to whether the amount will be payable at all;
 - ii. Uncertainty about the amount involved.
- (b) **Disclosure:** It is sufficient for the amount of contingent liability to be stated on the face of the balance sheet by way of a note, unless there is a probability that a loss will materialize and its reasonable estimate can be made. In that event, it is no more a contingent liability and a specific provision should be made therefore.
- (c) **Examples:**
 - i. Arrears of dividends on cumulative preference shares;
 - ii. Bills of exchange discounted;
 - iii. Guarantees given by the company to companies under the same management; and
 - iv. Suit for damages against the company which it is defending.
 - v. Gratuities payable to staff on retirement or death.

An example, not involving loss, is the amount due on partly paid shares or the amount payable on a contract for construction of works, on payment, corresponding assets will come into existence.

(d) Distinction between Contingent Liability and Other Liabilities

<i>Basis of Distinction</i>	<i>Contingent Liability</i>	<i>Other Liabilities</i>
1. Meaning	It is an obligation which may or may not arise depending on the happening or non-happening of an uncertain future event.	These are financial obligations of an enterprise other than owners' equity
2. Disclosure	It is disclosed by way of foot note to the Balance Sheet.	These are disclosed on the liabilities side of the Balance Sheet.
3. Example	1. Bills discounted but not yet matured.	1. Creditors for goods 2. Outstanding expenses

9. GROUPING AND MARSHALLING OF ASSETS AND LIABILITIES:

1. **Meaning of Grouping:** The term '**Grouping**' means putting together items of a similar nature under a common heading. For example, under the heading 'Trade Creditors' the balances of the ledger accounts of all the suppliers from whom goods have been purchased on credit, will be shown.

2. **Meaning of Marshalling:** The term '**Marshalling**' refers to the order in which the various assets and liabilities are shown in the Balance Sheet. The assets and liabilities can be shown either in the order of liquidity or in the order of permanency.

(a) Order of Liquidity:

1. The **assets** are arranged **in the order of their liquidity**, i.e., the most liquid asset (e.g., cash-in-hand), is shown first. The least liquid asset (e.g., goodwill) is shown last. The least liquid asset does not mean an asset which cannot be encashed.
2. The **liabilities** are arranged **in the order of their urgency of payment**, i.e., the most urgent payment to be made (e.g., 'short-term creditors'), is shown first. The least urgent payment to be made (e.g., 'long-term creditors') is shown last.
3. Usually, the banking and financial companies, sole proprietorship and the partnership concerns prepare their balance sheets in the order of liquidity.
4. A general format of a Balance Sheet in order of liquidity is shown below:

Balance sheet of as at

<i>Liabilities</i>	<i>Rs</i>	<i>Assets</i>	<i>Rs</i>
<i>Current Liabilities:</i>		<i>Current Assets:</i>	
Bank Overdraft	XXX	Cash-in hand	XXX
Bills Payable	XXX	Cash at bank	XXX
Outstanding Expenses	XXX	Bills Receivable	XXX
Sundry Creditors	XXX	Sundry Debtors	XXX
Income received-in-advance	XXX	Prepaid Expenses	XXX
		Accrued Income	XXX
		Closing Stock	XXX
<i>Long-term Liabilities:</i>	XXX	<i>Investments</i>	XXX
Loan		<i>Fixed Assets:</i>	
<i>Capital:</i>		Furniture and Fixture	XXX
Opening balance XXX		Plant and Machinery	XXX
Add: Net Profit		Building	XXX
(Less: Net Loss) XXX		Land	XXX
XXX	XXX	Goodwill	XXX
Less: Drawing XXX			
	XXX		XXX

(b)Order of Permanence

This order is exactly reverse of the liquidity order.

5. The **assets** are arranged **in the order of their permanence** i.e., the least liquid asset (e.g., goodwill) is shown first and the most liquid asset (e.g., Cash-in-hand) is shown last.
6. The **least urgent payment** to be made (e.g., short-term creditors) is shown **last**.
7. The company as defined under the Companies Act, 1956 is required to prepare the balance sheet in order of permanence.
8. A general format of a Balance Sheet in the order of permanence is shown below:

Balance sheet of as at

<i>Liabilities</i>		<i>Rs</i>	<i>Assets</i>		<i>Rs</i>
Capital:			Fixed Assets:		
Opening Balance	XXX		Goodwill		XXX
Add: Net Profit	XXX		Land		XXX
(Less: Net Loss)	XXX		Building		XXX
Less: Drawings	XXX	XXX	Plant & Machinery		XXX
			Furniture & Fixtures		XXX
Ling-term Liabilities:			Investments:		XXX
Loan		XXX	Current Assets:		
Current Liabilities:			Closing Stock		XXX
Income received-in-advance		XXX	Accrued income		
Sundry Creditors		XXX	Prepaid expenses		XXX
Outstanding Expenses		XXX	Sundry Debtors		XXX
Bills Payable		XXX	Bills Receivable		XXX
Bank Overdraft		XXX	Cash at bank		XXX
			Cash in hand		XXX
					XXX
		XXX			XXX

ILLUSTRATION 1

From the following information, prepare the Profit & Loss Account for the year ending on March 31, 20X2;

	Rs		Rs
Gross Profit	62,000	Salaries and Wages	20,000
Discount received	1,000	Discount allowed	2,000
Interest on loan paid	2,500	Interest received	3,000
Commission received	2,000	Commission to Salesmen	1,500
Rent, Rates & Taxes paid	4,000	Rent received	1,000
Fire Insurance Premium	3,600	Carriage Outward	1,000
Freight outward	500	Repairs and Maintenance	600
Printing & Stationery	600	Traveling Expenses	1,600
Entertainment Expenses	1,200	Water and Electricity	1,200
Postage & Telegram	500	Advertising and Publicity	4,000
Sales Promotion Expenses	400	Telephone Expenses	1,000
Bad debts	1,000	Packing Expenses	500
Audit Fees	2,000	Bank Charges	400
Depreciation on Furniture:		Legal Charges	1,000
--Sales office	1,000	Miscellaneous Expenses	1,000
--Administrative office	2,000	Loss on sale of Fixed Assets	500
Miscellaneous Incomes	2,000	Loss by theft	5,000
Profit on sale of Fixed Assets	8,500	Dividend received on Shares	300
Loss by Fire	1,000	Income from Investments	200
Loss by Embezzlement			1,000

ILLUSTRATION 2

From the following information, prepare a Balance Sheet of Mr. X as at 31 March, 20X2 (a) In order of liquidity, and (b) In order of permanence.

	<i>Rs</i>		<i>Rs</i>
Plant and Machinery	1,00,000	Furniture and fixtures	20,000
Prepaid Expenses	1,000	Accrued Income	2,000
Income received in advance	2,000	Outstanding Expenses	1,000
Bills Payable	3,000	Bills Receivables	2,000
Sundry Debtors	1,00,000	Sundry Creditors	99,000
Bank Overdraft	10,000	Investments in Shares of X Ltd.	10,000
Long-term Loan from bank	1,00,000	Closing Stock	85,000
Capital	2,00,000	Building	1,00,000
Land	10,000	Goodwill	10,000
Drawings	10,000	Net Profit	60,000
Cash-in-hand	5,000	Cash at bank	19,000
Income Tax Paid	1000		

ILLUSTRATION 3

The following is the Trial Balance of Shri Ram as at 31st March 20X2:

<i>Particulars</i>	<i>Dr. (Rs)</i>	<i>Cr. (Rs)</i>
--------------------	-----------------	-----------------

Land and Building	1,42,500	--
Plant and Machinery	42,500	--
Fixture & Furniture	47,500	--
Motor Vehicles	47,500	--
(1.4.20X1) Stock	75,000	--
Purchases/Sales	5,25,000	6,30,000
Returns	10,000	5,000
Carriage Inward	1,000	--
Carriage Outward	2,000	--
Wages and Salaries	4,000	--
Salaries and Wages	20,000	--
Discount	2,000	500
Commission	1,500	2,000
Interest	2,500	3,000
Rent, Rates & Taxes	3,000	
Repairs	600	--
Insurance	3,600	--
Printing & Stationery	600	--
Water & Electricity	1,200	--
Postage & Telegrams	500	--
Traveling Expenses	1,600	--
Conveyance Charges	1,200	--
Entertainment Expenses	1,200	--
Staff Welfare Expenses	1,200	--

Sales Promotion Expenses	2,400	--
Bad Debts/Bad Debts Recovered	1,000	500
Depreciation	20,000	--
Miscellaneous Expenses/Incomes	1,000	1,500
Debtors/Creditors	2,05,000	50,000
Bills Receivables/Bills Payables	10,000	5,600
12% Investments (Purchased on 1.10.20X1)	50,000	--
12% Loan from bank (Long-term)(Taken on 1.11.20X1)	--	50,000
Cash in hand	5,000	--
Cash at bank	10,000	--
Drawings	9,000	--
Sales Tax Collected	--	4,000
Income Tax Paid	1,000	--
Capital Account	--	5,00,000
	12,52,100	12,52,100

Additional Information: Closing Stock as on 31.03.20X2 was Rs 42,000.

Required: Pass the necessary closing entries and adjusting entries and prepare the Trading and Profit & Loss Account for the year ending on 31st March, 20X2 and a Balance Sheet as on that date.

ILLUSTRATION 4

Taking the same information as given in Illustration 7, prepare the Income Statement and Balance sheet in **vertical form**.

ILLUSTRATION 5

A book keeper has submitted to you the following trial balance wherein the totals of the debit and credit balances are not equal:

<i>Particulars</i>	<i>Debit Balance</i>	<i>Credit Balance</i>
	<i>Rs</i>	<i>Rs</i>
Creditors.....	1,00,000	--
Bills Payable.....	--	5,600
Loan from Bank.....	50,000	--
Capital Account.....	4,54,000	--
Sales.....	--	6,30,000
Purchase Returns.....	5,000	--
Discount Earned.....	1,000	--
Bad Debt Recovered.....	3,500	--
Interest on Investments.....	3,000	--
Fixed Assets.....	3,00,000	--
Opening Stock.....	75,000	--
Debtors.....	--	2,05,000
Bills Receivables...	10,000	--
Investments.....	50,000	--
Cash in Hand.....	5,000	--
Cash at Bank.....	10,000	--
Drawings.....	--	9,000
Purchases.....	5,25,000	--

Sales Returns.....	--	10,000
Freight Inward.....	1,400	--
Freight Outward.....	--	2,000
Duty Paid on Purchases.....	--	1,600
Primary Packing Expenses.....	2,000	--
Rent Paid.....	--	3,000
Insurance Paid.....	3,600	--
Office & Administrative Expenses.....	13,200	
Discount Allowed	--	2,000

ILLUSTRATION 6

From the following trial balance and additional information, prepare Trading and Profit & Loss Account of Mr Charat Tulsian for the year ended 31st March, 20X2 and Balance Sheet as at that date:

Treatment of Items of Adjustments Appearing Outside the Trial Balance

<i>Item of Adjustment</i>	<i>Adjusting Entry</i>	<i>Treatment in Trading A/c</i>	<i>Treatment in Profit & Loss A/c</i>	<i>Treatment in Balance Sheet</i>
(a) Closing Stock	Closing Stock Dr. To Trading A/c	Shown on the credit side	X	Shown on the assets side as a current Asset
(b) Outstanding Expenses	Respective Expense A/c To Outstanding Expense Dr.	Added to the respective expense on the debit side	Added to the respective expense on the debit	Shown on the liabilities side as a Current Liability
(c) Prepaid Expenses (unexpired Expenses)	Prepaid Expenses A/c. To Respective Expense A/c	Deducted from the respective expense of the debit side	Deducted from the respective expense of the debit side	Shown on the assets side as a Current Asset
(d) Accrued Income (or Income earned but not received) or outstanding	Accrued Income A/c Dr. To Respective income A/c	X	Added to the respective Income on the credit side	Shown on the assets side as a Current Asset
(e) Unearned Income (or Income received in advance)	Respective Income A/c Dr. To Unearned income A/c	X	Deducted from the respective Income of the credit side	Shown on the liabilities side as a Current Liability
(f) Depreciation	Depreciation A/c Dr. To Respective Asset	X	Shown of the debit side as a separate item	Shown on the assets side by way of deduction from the value of concerned fixed asset.
(g) Additional bad Debts	Bad Debts A/c Dr. To Sundry Debtors A/c	X	Shown on the debit side by way of addition to Bad debts Or shown of the debit side of	Shown of the assets by way of deduction from the amount of sundry Debtors..

(h) Provision for Doubtful debts	P & L A/c To provision Dr. for Doubtful Debts A/c	X	Shown on the debit side as a separate item	Shown on the asset side by way of deduction from the amount of Sundry Debtors
(i) Provision for Discount on Debtors	P & L A/c To provision Dr. for Discount on Debtors A/c	X	Shown on the debit side as a separate item	Shown on the asset side by way of deduction from the amount of Sundry Debtors/Net of additional
(j) Reserve for Discount on Creditors	Reserve for Discount Dr. on Creditors A/c to P&L A/c	X	Shown on the credit side as a separate item	Shown on the liabilities side by way of deduction from the amount of Sundry Creditors
(k) Interest on Capital	Interest on Capital A/c Dr. To Capital A/c	X	Shown on the debit side as a separate item	Shown on the liabilities side by way of addition to the Capital
(l) Interest on Drawings	Capital A/c Dr. To Interest on Drawings	X	Shown on the credit side as a separate item	Shown on the liabilities side by way of Deduction from the Capital
(m) Manager's Commission on Profit	Manager's Commission To Outstanding Commission A/c	X	Shown on the debit side as a separate item	Shown on the liabilities side as current Liability
(n) Abnormal Loss of Stock	Loss of Stock A/c Dr. To Trading A/c	Total value of abnormal loss of stock is shown on the credit side as a separate item.	Total value of recovered loss of stock is shown on the debit side as a	The amount due from the insurance company is shown on the assets side as a current Asset.
(o) Goods Sent on Approval	(i) Sales A/c to Debtors A/c Dr.	Shown on the credit side by way of deduction from sales	X	Shown on the assets side by way of deduction from deposits
	(ii) Stock with customers A/c Dr. To trading A/c	Shown on the credit side by way of addition to closing Stock in-	X	Shown on the assets side by way of addition to closing stock in-hand

ILLUSTRATION 7: The following is the Trial Balance of Mr Wise as at 31st March, 20X2.

<i>Debit Balances</i>	<i>Rs</i>	<i>Credit Balances</i>	<i>Rs</i>
Plant & Machinery		Creditors	1,00,000
(Purchased on 1.7.20X1)	2,00,000	Bills Payables	5,600
Furniture & Fixtures		10% Loan Form Bank	
(Purchased on 1.7.20.X1)	1,00,000	(taken on 1.7.20X1)	50,000
Opening Stock	75,000	Capital Account	4,55,000
Debtors	2,05,000	Sales	6,30,000
Bills Receivables	10,000	Purchases Returns	5,000
12% Investments (purchased on 1.7.20X1)	50,000	Discount Earned	1,000
Cash in Hand	5,000	Bad Debts Recovered	2,500
Cash at Bank	10,000	Interest	3,000
Drawings	10,650		
Purchases	5,25,000		
Sales Returns	10,000		
Carriage Inwards	5,000		
Carriage Outwards	350		
Rent	3,000		
Insurance	3,600		
Office & Administration Expenses	13,200		
Discount Allowed	2,000		
Bad Debts	5,000		
Interest	2,500		
Selling & Distribution Expenses	15,800		
Income Tax paid	1,000		
	12,52,100		12,52,100

CHAPTER 1 : DEMAND

Desire + ability to pay + Willing to buy = Demand

Determinants of demand

- 4 Price of commodity ($P \uparrow \rightarrow D \downarrow$, $P \downarrow \rightarrow D \uparrow$)
- 4 Price of related commodities:
 - Substitutes ($P \uparrow \rightarrow D \uparrow$)
 - Complementaries ($P \uparrow \rightarrow D \downarrow$)
- 4 Income of consumers ($I \uparrow \rightarrow D \uparrow$, $I \downarrow \rightarrow D \downarrow$)
- 4 Tastes & Preferences of Consumers ($Fav \rightarrow D \uparrow$, $Unfav \rightarrow D \downarrow$)
- 4 Population ($Pop \uparrow \rightarrow D \uparrow$, $Pop \downarrow \rightarrow D \downarrow$)
- 4 Climate & Weather ($Fav \rightarrow D \uparrow$, $Unfav \rightarrow D \downarrow$)
- 4 Gov't Policies ($Fav \rightarrow D \uparrow$, $Unfav \rightarrow D \downarrow$)
- 4 Expectations about future prices

Types of Demand

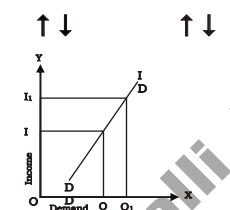
Price demand

Price $\uparrow \downarrow$ Demand $\uparrow \downarrow$

Income demand

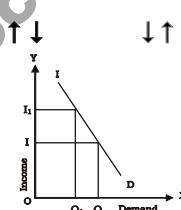
Superior goods

Income $\uparrow \downarrow$ Demand $\uparrow \downarrow$



Inferior goods

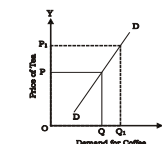
Income $\uparrow \downarrow$ Demand $\downarrow \uparrow$



Cross demand

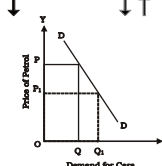
Substitutes

Price of Tea $\uparrow \downarrow$ Demand for coffee $\uparrow \downarrow$



Complementaries

Price of Petrol $\uparrow \downarrow$ Demand for car $\uparrow \downarrow$



Law of Demand

Assumptions

All the determinants of demand are assumed to be constant except price

Exceptions

- 4 Giffen's paradox (Generally inferior goods) Demand curve-back ward bending
- 4 Articles of distinction (Veblen goods)
- 4 Demonstration effect
- 4 Future expectations about prices
- 4 Irrational consumer

Importance

Useful to:

- 4 Farmers
- 4 Finance Minister
- 4 Consumer
- 4 Monopolist (In determination of Price)

Reasons for downward sloping demand curve

- 4 New Buyers
- 4 Old Buyers
- 4 Income effect
- 4 Substitution effect

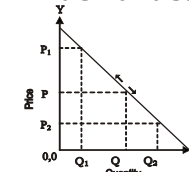
Changes in demand

Caused by Change in price

Extension & contraction

Movement along the same demand curve

Change in quantity demanded



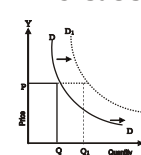
Caused by Change in other factors

Increase & Decrease

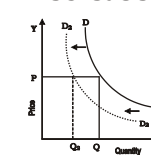
Shift in the demand curve

Change in demand

Increase



Decrease

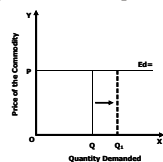


CHAPTER 2 : ELASTICITY OF DEMAND

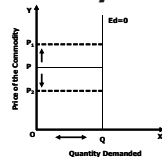
Price elasticity of demand

Degrees

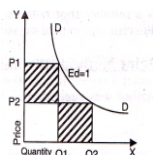
1) Perfectly elastic(∞)



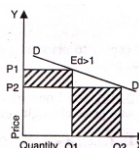
2) Perfectly inelastic (0)



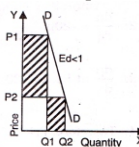
3) Unitary elastic (1)



4) Relatively elastic (>1)



5) Relatively In elastic (<1)

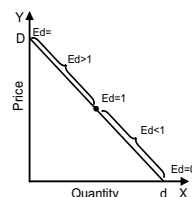


Methods

1) Point Method

$$E_p = \frac{dq}{dp} \times \frac{p}{q} \text{ Or}$$

$E_d = \frac{\text{lower segment}}{\text{Upper segment}}$



2) Percentage Method

$$E_d = \frac{\% \text{ Change In demand}}{\% \text{ Change in price}}$$

$$\frac{q}{p} \times \frac{p}{q} = \frac{q}{p} \times \frac{p}{q}$$

3) Arc Elasticity Method

$$E_d = \frac{q_2 - q_1}{p_2 - p_1} \times \frac{p_1 + p_2}{q_1 + q_2}$$

4) Total out lay Method

Price - T.Exp
 $\uparrow \downarrow$ $\downarrow \uparrow$ ($E_d > 1$)
 $\uparrow \downarrow$ $\uparrow \downarrow$ ($E_d < 1$)
 $\uparrow \downarrow$ Same ($E_d = 1$)

Factors

1) Availability of Substitutes

[If Available - Elastic
 If not Available - Inelastic]

2) Type of want

[Necessary - Inelastic
 Comforts, luxuries - Elastic]

3) Consumer habits

[Habitual consumers - Inelastic
 Others - Elastic]

4) No of purposes (uses)

[Can be used -elastic
 Can't be used -inelastic]

5) Price Range

[Very high /low -inelastic
 Middle range-elastic]

6) Postponement

[Yes- elastic
 No -inelastic]

7) Proportion of Expenditure

[Small -inelastic
 High -elastic]

Importance/uses

- 4 Useful to business firms
- 4 Determination of Price & output
- 4 Determination of prices
- 4 Useful to super markets
- 4 Useful to finance minister
- 4 Pricing factors of production
- 4 Explains the paradox of plain theory
- 4 Useful in foreign exchange rates
- 4 Nationalising an industry
- 4 Granting protection to industry

Income elasticity of demand

Formula

$$E_I = \frac{\% \text{ Change in demand}}{\% \text{ Change in income}}$$

$$= \frac{q}{y} \times \frac{y}{q}$$

Degrees

Negative (<0) - Inferior goods
 Positive (>0) - Superior goods
 0 to 1 - Necessaries
 >1 - comforts/ luxuries

Cross elasticity of demand

Degrees

Negative (<0) - Complementaries
 Positive (>0) - Substitutes
 Zero - Unrelated goods/ Independent goods

Formula

$$E_C = \frac{\% \text{ Change in demand of } x}{\% \text{ Change in price of } y}$$

$$= \frac{q_x}{p_y} \times \frac{p_y}{q_x}$$

CHAPTER 3: SUPPLY & ELASTICITY OF SUPPLY

SUPPLY

Determinants

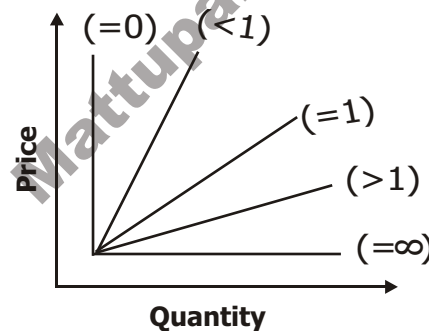
- 4 Prices of Products
- 4 Prices of related commodities
- 4 Prices of factor of production
- 4 State of technology
- 4 Government policy
- 4 Business policy
- 4 Time
- 4 Agreement among producers

Exceptions to law of supply

- 4 Auction sale
- 4 Fear of fall in prices in future
- 4 Rare commodities
- 4 Land
- 4 Supply of labour

Degrees of price elasticity of supply

- 4 Perfectly elastic supply ($= \infty$)
- 4 Perfectly inelastic supply ($= 0$)
- 4 Relatively inelastic supply (< 1)
- 4 Relatively elastic supply (> 1)
- 4 Unit elastic supply ($= 1$)



Elasticity of supply

Determinants

- 4 Nature of commodity
- 4 Time
- 4 Techniques of production
- 4 Estimates of future

Importance

- 4 Effect of price
- 4 Quasi rent
- 4 Better for

Measurements

- 4 Point elasticity
$$E_s = \frac{q}{p} \frac{p}{q}$$
- 4 Arc elasticity
$$E_s = \frac{q_2 - q_1}{p_2 - p_1} \frac{p_1 + p_2}{q_1 + q_2}$$

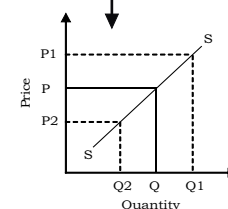
Changes in supply

Caused by change in price

Extension & contraction

Movement along the same supply curve

Change in quantity supplied



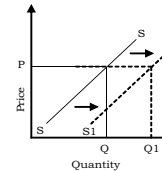
Caused by change in other factors

Increase & decrease

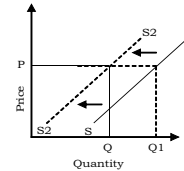
Shift in the supply curve

Change in supply

Increase



Decrease



CHAPTER 4: THEORY OF CONSUMER'S BEHAVIOUR

UTILITY

Cardinal (1,2,3...)
Marginal Utility analysis
 developed by Marshall

$$\begin{aligned} MU_n &= \frac{TU_n - TU_{n-1}}{Q_n - Q_{n-1}} \\ &= \frac{TU_n - TU_{n-1}}{Q} \end{aligned}$$

Assumptions:

- 4 Measurability of utility
- 4 Marginal utility of money is constant
- 4 Independent utility

Ordinal (I, II, III.....)
Indifference curve Analysis
 developed by Hicks & Allen

Assumptions

- 4 Rational consumer
- 4 Scale of preference
- 4 Diminishing marginal rate of substitution
- 4 Assumption of consistency
- 4 More units, more preference
- 4 Scale of preference is

Properties

Indifference curve:

- slopes downwards from left to right
- are always convex to origin
- can never intersect with each other
- do not meet the axes
- need not be parallel to each other
- higher indifference curve gives higher level of satisfaction than lower one

Superiority

- 4 Assumptions are near to reality
- 4 Non measurability of utility
- 4 Marginal utility of money is not constant
- 4 Explain cause for Giffen Goods
- 4 Two commodity model
- 4 Marginal rate of Substitution

Marginal Utility Analysis

Law of Diminishing Marginal Utility

Assumptions

- 4 Standard Units
- 4 Identical Units
- 4 No time interval
- 4 No change in tastes & habits
- 4 Some goods of special Nature
- 4 Availability of substitutes &

Importance

- 4 Price determination
- 4 Finance minister
- 4 Explains paradox of value
- 4 Basis for economic laws
- 4 Advantage to

Law of Equi-Marginal Utility

$$\frac{MU_a}{P_a} = \frac{MU_b}{P_b} = \dots = \frac{MU_n}{P_n} = MU \text{ of money}$$

Assumptions

- 4 Indivisibility of goods
- 4 Ignorance
- 4 Unlimited resources
- 4 Customs & fashions
- 4 Measurability of Utility
- 4 Constant utility of money

Importance

- 4 Consumption
- 4 Production
- 4 Exchange
- 4 Distribution
- 4 Government

Theory of consumer's surplus

Consumers surplus = Willing price - Actual price

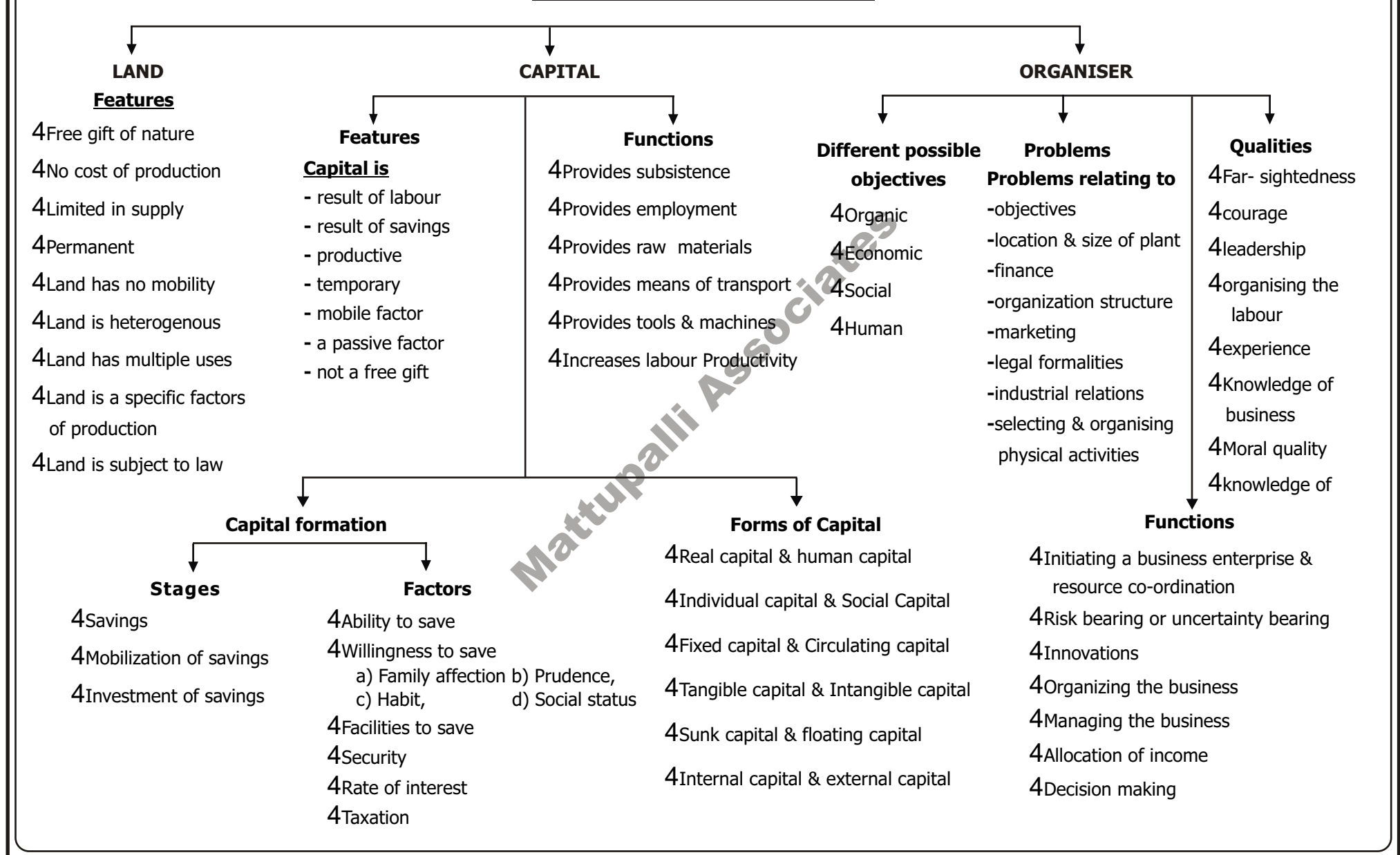
Criticisms

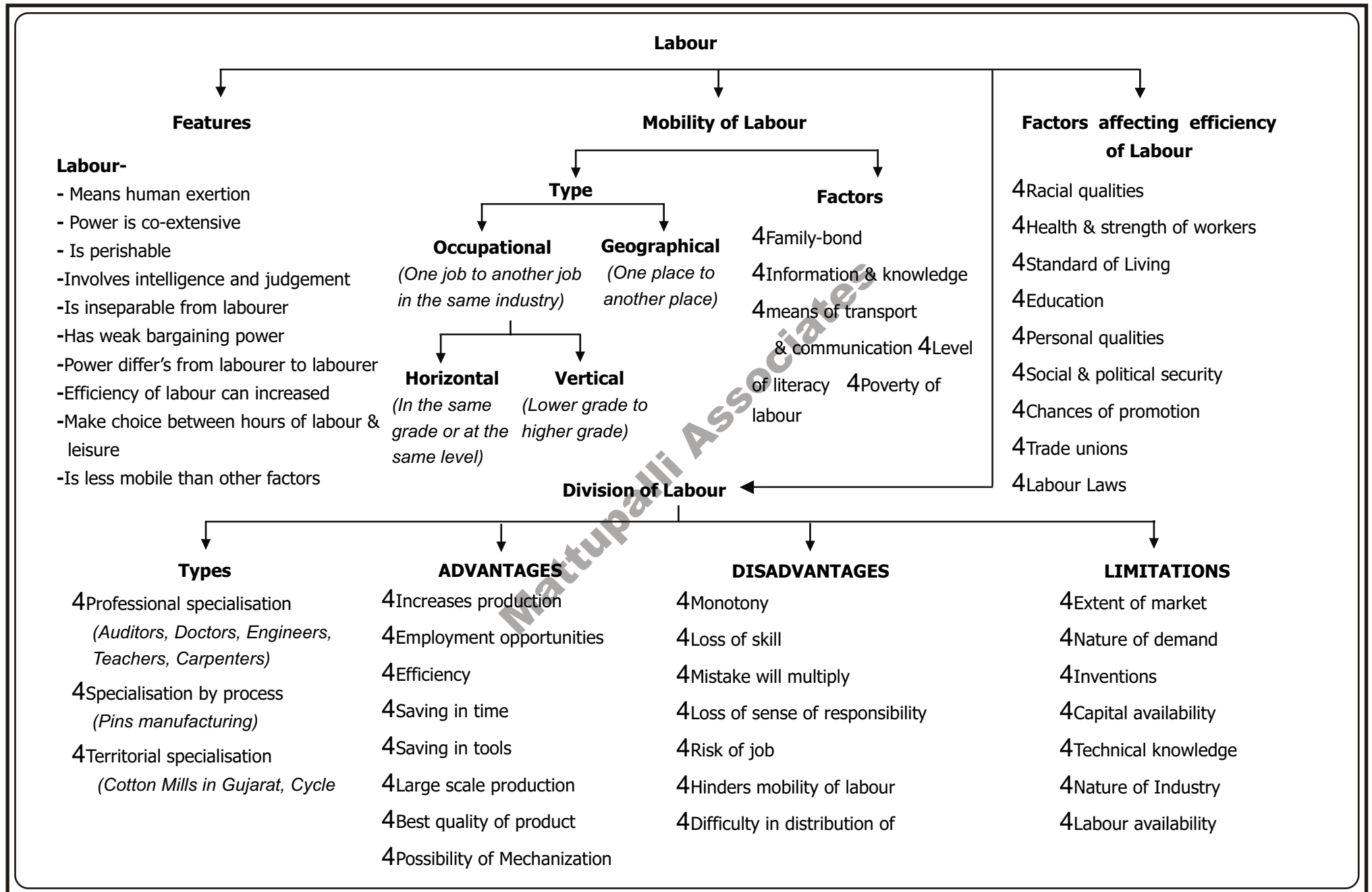
- 4 Imaginary
- 4 Measures mental satisfaction
- 4 Difficult to calculate willing price
- 4 Marginal utility of money is not constant
- 4 Apply only in inflation
- 4 Prestigious goods
- 4 Changes from person to

Importance

- 4 Price determination
- 4 Useful to finance minister
- 4 Price discrimination in discriminating monopoly
- 4 Understanding the Water-diamond paradox
- 4 Assessment of

CHAPTER 5: PRODUCTION





CHAPTER 6: COST ANALYSIS

Determinants of cost

- 4 Prices of factors of production
(If high- cost ↑, If low-cost ↓)
- 4 Technology
(Advanced-cost ↓, If not-cost ↑)
- 4 Size of plant
(Big-cost ↓, small-cost ↑)
- 4 Capacity Utilization or output level
(Output level ↑ -cost ↑, output level ↓ -cost ↓)
- 4 Period
(Short run-cost ↑, long run-cost ↓)
- 4 Stability of output
(If stable-cost ↓, If unstable-cost ↑)
- 4 Law of returns operating
(Diminishing returns-cost ↑, increasing returns-cost ↓)
- 4 Managerial efficiency

Components of cost

- 4 Prime cost
(Direct material + direct wages + direct expenses)
- 4 Production overheads
(Indirect material + indirect wages + indirect expenses)
- 4 Production cost
(Prime cost + production over heads)
- 4 Cost related to other functions
(Administrative over heads + selling over heads + distribution over heads)
- 4 Total cost

Relation between Average cost & Marginal Cost

- 4 Average cost and Marginal cost can be calculated from total cost
- 4 When Average cost falls Marginal cost also falls
- 4 When Average cost rises Marginal cost also raises
- 4 Marginal cost cuts Average cost at its optimum

Different types of costs

4 Implicit costs

(Earnings of factors of production belonging to organizer himself)

4 Explicit costs

(Remuneration paid to outside factors of

4 Accounting costs

(All payments made by the entrepreneur to the suppliers of various factors of production)

4 Economic costs

(Accounting cost {explicit}

4 Outlay costs

(Actual outlay of funds like wages, material, rent)

4 Opportunity costs

(Cost related to foregone

4 Direct costs

(Identified & traced to a particular product)

4 Indirect costs

(Can not be identified & traced to a particular

4 Shutdown costs

(Cost incurred after closing down of the business)

4 Abandonment costs

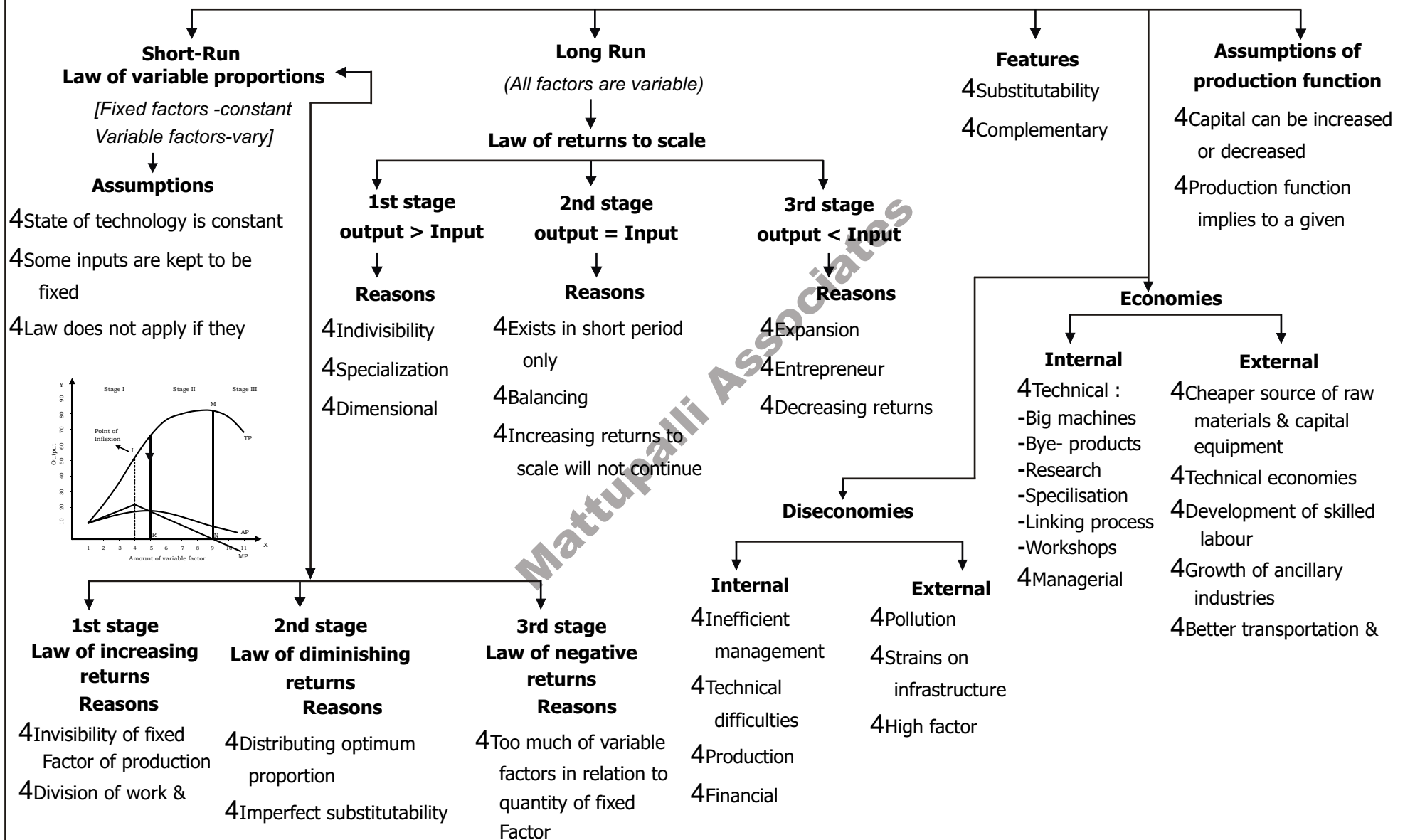
(Cost related to retirement of fixed asset from use)

4 Money costs

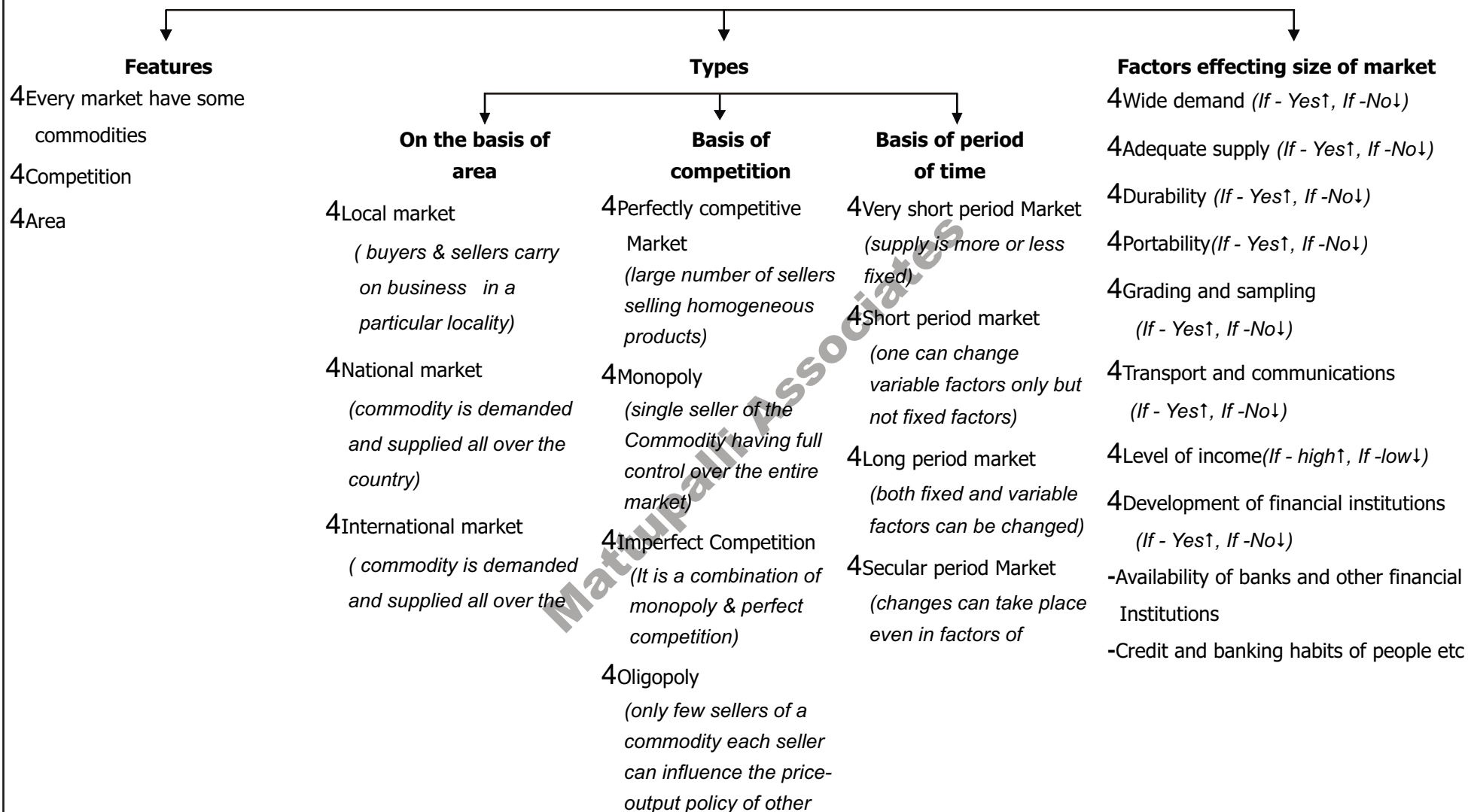
(Payment made to factors of production & other expenses)

4 Real costs

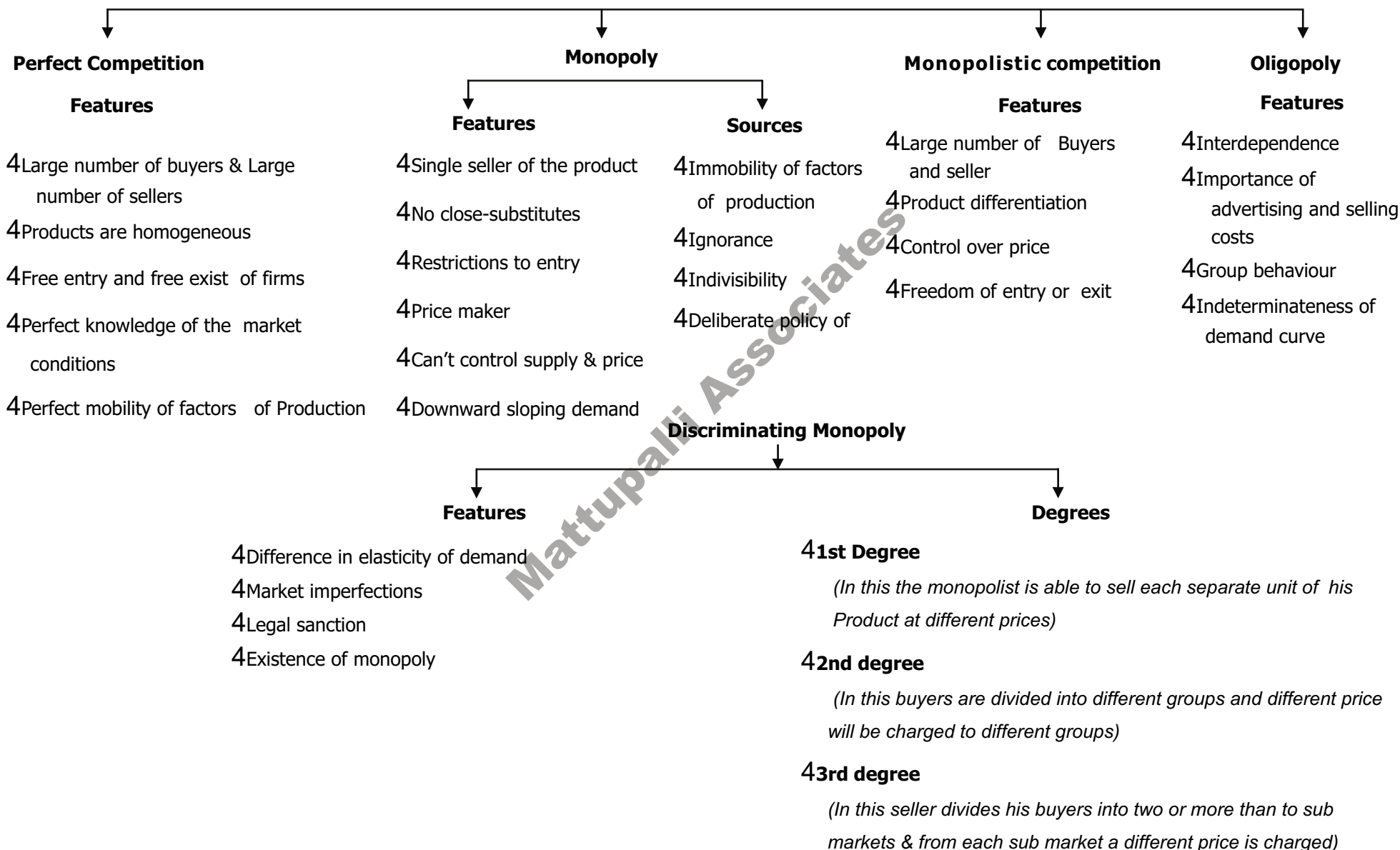
(Pains & sacrifices of labour or efforts &

CHAPTER 7: PRODUCTION ANALYSIS**PRODUCTION FUNCTION**

CHAPTER8: MARKETS & CHAPTER 9 : PRICE & OUTPUT DETERMINATION



CHAPTER 10: PRICE & OUTPUT DETERMINATION UNDER DIFFERENT MARKETS



MERCANTILE LAWS

PART – A

INDIAN CONTRACT ACT, 1872

15 MARKS

1. NATURE OF CONTRACT
2. OFFER AND ACCEPTANCE
3. CONSIDERATION
4. CAPACITY OF THE PARTIES
5. FREE CONSENT
6. LAWFUL CONSIDERATION AND OBJECT
7. VOID AGREEMENTS
8. PERFORMANCE OF CONTRACT
9. BREACH OF CONTRACT
10. CONTINGENT CONTRACT & QUASI CONTRACT

PART – B

THE SALE OF GOODS ACT, 1930

15 MARKS

1. FORMATION OF CONTRACT OF SALE
2. CONDITIONS AND WARRANTIES
3. TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS
4. UNPAID SELLER

PART – C

PARTNERSHIP ACT, 1932

10 MARKS

1. GENERAL NATURE OF PARTNERSHIP
2. RELATIONS OF PARTNERS
3. REGISTRATION AND DISSOLUTION OF FIRM

TOTAL**40 MARKS**

THE INDIAN CONTRACT ACT, 1872

CHAPTER-1 NATURE OF CONTRACT

1. DEFINITIONS	
A. CONTRACT Sec.2(h)	An agreement enforceable by law.
B. AGREEMENT Sec.2(e)	Every promise and every set of promises forming consideration for each other.
C. ENFORCEABILITY BY LAW	An agreement which creates legal obligation on the part of parties.
D. PROMISE Sec.2(b)	A proposal when accepted becomes a promise.
E. CONSIDERATION	Price paid by the one party for the promise of the other. Technical word meaning 'QUID PRO QUO' i.e. something in return

2. ESSENTIAL ELEMENTS OF A VALID CONTRACT

SECTION 10

- All **Agreements** are contracts
- if they are made by the **free consent**
- of the **parties competent to contract**
- for a **lawful consideration** and with a **lawful object** and
- are **not hereby expressly declared to be void**.

ESSENTIAL ELEMENTS OF A VALID CONTRACT	
1. AGREEMENT	In order to constitute a valid contract, there must be an agreement between the parties. To form an agreement, there should be proper offer by one and its proper acceptance by the other.
2. FREE CONSENT	Consent means agreed upon same thing in the same sense i.e. there should be consensus-ad-idem. A consent is said to be free when it is not caused by coercion, undue influence, fraud, misrepresentation or mistake. Example: - 'A' threatened to shoot 'B' if he (B) does not sell his house to him Rs. 20000 and 'B' agreed to it. Here the agreement is entered into under coercion and hence voidable at the option of 'B'.
3. COMPETENCY OF THE PARTIES	Parties must have the capacity to enter into a contract otherwise the contract is not valid.
Who is competent to contract	Who is incompetent to contract
• Major • Person of Sound mind • Person not disqualified by law from contracting	• Minor • Person of Unsound Mind • Person disqualified by law from contracting
4. LAWFUL CONSIDERATION	Consideration must not be unlawful, immoral or opposed to the public policy. Examples: Unlawful: -A agrees to sell narcotics to B for a sum of Rs. 100000. This agreement is not valid because the consideration is unlawful.

	Immoral: - An agreement for letting a house to a prostitute for carrying on her vocation there. Opposed to the public policy: - Trading with enemy, Agreement in restraint of marriage, trade, legal proceedings etc.
LAWFUL OBJECT	Object means the purpose or design. The object of the agreement must be lawful. Example:- 'A' and 'B' make an agreement for smuggling out some goods from India to another country. This agreement cannot be enforced in the court because the object is unlawful.
NOT EXPRESSLY DECLARED VOID	An agreement should not be one which is expressly declared void by the law. Example:- Agreement in restraint of trade, marriage or legal proceedings are expressly declared void by the law and hence not enforceable.
INTENTION TO CREATE LEGAL RELATIONSHIP	Parties must have an intention of creating the legal relationship. An agreement of a purely domestic or social nature is not a contract. Example 1:- 'A' invites his friend 'B' to his birthday party. 'B' accepts the offer. But he fails to turn up for the party. This agreement creates social and personal relationship between 'A' and 'B'. It cannot be enforced in the court. Thus A has no legal remedy against B. Example 2:- 'A' borrows sum of Rs. 500 from his friend 'B' for three months. 'B' gets legal right to sue upon 'A' if he fails to return money. It is because this agreement creates legal relationship, which can be enforced in the court.
BALFOUR Vs. BALFOUR (1919)	
In this case a husband just makes a promise to pay his wife monthly allowance of £30 for her maintenance. Later on they separated and husband failed to pay stipulated amount to his wife. She filed suit for that allowance. But it was held by the court that such arrangements are not contracts or do not result in a contract because parties did not intend to create legal relationship and finally the suit was dismissed.	
CERTAINTY OF MEANING	Agreement made by the parties must be certain or capable of being made certain. Example: 'A' is a dealer of kerosene oil and coconut oil. 'B' makes an agreement with him for buying 10 lts of oil. Meaning of this agreement is uncertain and therefore it cannot be enforced.
POSSIBILITY OF PERFORMANCE	An agreement to do an act impossible in itself is void. Example: - An agreement to discover treasure by magic is void.
LEGAL FORMALITIES	Such as in writing, registration etc must be completed otherwise the contract is not enforceable at law.

3. + TYPES OF CONTRACTS

A. ON THE BASIS OF ENFORCEABILITY	
1. VALID CONTRACT	A contract which contains all the essential elements.
2. VOID CONTRACT [SEC. 2(j)]	A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable.
3. VOID AGREEMENT [SEC. 2(g)]	An agreement which is not enforceable by law is said to be void. It is an agreement which cannot be enforced from the date when they were made. It is void ab initio .
4. VOIDABLE CONTRACT [SEC. 2(i)]	An agreement, which is enforceable by law at the option of one more of the parties, but not at the option of the other (s) is a voidable contract. For example: - Mr. A, at knife - point, asks B to sell his scooter for Rs. 50. Mr. B gives consent. The agreement is voidable at the option of B, whose consent is not free.
5. UNENFORCEABLE CONTRACT	An unenforceable contract is one which is good in substance but cannot be enforced by law due to some technical defects, such as under stamping, absence of writing, barred by limitation.
6. ILLEGAL CONTRACT	A contract which is forbidden by law. For example: - Agreement to commit crime.

B. CLASSIFICATION ON THE BASIS OF CREATION	
1. EXPRESS CONTRACT	A contract which is created either by word spoken or written. For example: - If 'A' of Agra offers to sell his car for Rs. 150000 to 'B' of Delhi by a letter and 'B' accepts the offer by writing a letter. Thus the contract between 'A' and 'B' is said to be an express contract.
2. IMPLIED CONTRACT	The contract which is created otherwise than by words spoken or written. i.e. these contracts are:-
A. Tacit Contract	A contract which is inferred from the conduct of the parties is said to be tacit contract. For example: - (i) When we enter into a bus without asking any question from bus conductor, we enter into implied contract. (ii) Obtaining cash form ATM
B. Quasi Contracts	These are the contracts, which are created neither by word spoken, nor written, nor by the conducts of the parties, but these are created by the law. For example: - If 'A' leaves his goods at 'B's' shop by mistake, then it is 'B's' duty to return the goods or to compensate the price. In fact, these contracts depends upon the principle that nobody will be allowed to become rich at the expense of the others. This principle is known as doctrine of unjust enrichment.
3. E-CONTRACT	An e-contract is one, which is entered into between two parties via internet.

C. CLASSIFICATION ON THE BASIS OF BASIS OF EXECUTION	
1. Executed Contract	An executed contract is a contract in which both the parties have performed their obligation. This is a contract which has been completed. For example:- If 'A' agrees to sell his car to 'B' for Rs. 100000. The contract is

	said to be executed if 'A' delivers car to 'B' and B pays the price to 'A'.
2. Executory Contract	An Executory contract is the contract which is to be performed in future.
3. Unilateral Contract	Where obligation is pending on the part of one of the parties.
4. Bilateral Contract	A Bilateral Contract is a contract in which obligation is pending on the part of both of the parties.

D. ENGLISH LAW CLASSIFICATION	
1. Simple Contracts	A simple contract is the contract that is not formal. These can be made orally or in writing and must be supported by consideration.
2. Formal Contracts	A formal contract is one which is entered into the prescribed form. These contracts may be sub-divided as follows:
a. Contract of Record	(i) Judgment of Court:- It is an obligation imposed by the court upon one or more persons in favour of the other/s. (ii) Recognizance:- It is a written acknowledgement of a debt due to state. It is met in connection with criminal proceedings.
b. Contract under Seal	It is a contract which derives its binding force from its form alone. It is also known as deed or specialty contract.

CHAPTER-2 OFFER & ACCEPTANCE

1.) PROPOSAL [Sec 2(a)]:-

- ✚ When one person signifies to another
- ✚ his willingness
- ✚ to do or to abstain from doing anything
- ✚ with a view to obtaining the assent of that
- ✚ either to such act or abstinence,
- ✚ he is said to make a proposal.

Example :- A tells B , “I want to marry”. This does not amount to offer but it is a mere expression of willingness.

Example:- A said to B, “I want to marry, Will you marry me.” This would amounts to offer because in this case, the intention of A is to obtaining the consent of B.

Example:- D said to E, “I want to sell my bike to you.” This is an offer “to do something”.

Example:- X said to Y, “I will not file a suit against you in the court of law, if you repay the overdue amount of Rs.100000.This is an offer for “not to do something”.

- **Offeror**: - Person who makes the offer.
- **Offeree**: - Person to whom offer is made.

LEGAL RULES REGARDING OFFER	
1. Offer must be capable of creating the legal relation	A social invitation, even if it is accepted, does not create legal relations because it is not so intended. (Balfour Vs. Balfour)

2. Offer must be certain, definite and not vague	The terms of the offer must be certain or capable of being made certain.	
Example 1	'A' has two Maruti cars, one is red and other blue. He offers to sell his car to 'B'. In this case, Which car he is offering to sell is not clear. Therefore the offer is not valid one.	
Example 2	'A', a dealer of coconut oil, offers to sell 10 lts of oil to 'B' for a certain price. This offer is valid one because it is capable of being made certain.	
Example 3	'A' offered to take a house on lease provided the house should be put into thorough repairs and should be sufficiently decorated. This offer is too vague and hence not valid.	
3. Offer may be express or implied	a. Express Offer	An offer which is made by words spoken or written. Example: - 'X' says to 'Y', " Will you purchase my white horse for Rs. 20000. Example: - 'X' writes to 'Y' a letter, " I want to sell my car for Rs. 40000 to you."
	b. Implied Offer	An offer which is made otherwise than by words spoken or written. Example:- A transport company runs buses on a particular route. This is an implied offer from the transport company to carry passengers on the route who are prepared to pay the specified fare. The acceptance of the offer is complete as soon as the passengers board the bus. A passenger who enters the bus also impliedly promises to pay the prescribed fare.
4. Offer must be distinguished from an invitation to offer	An offer should be distinguished from an invitation to offer. An offer is definite and capable of converting an intention into a contract. Whereas an invitation to an offer is only a circulation of an offer, it is an attempt to induce offers and precedes a definite offer.	
	Examples of Invitation to Offer 1. Window display of goods by a shopkeeper. 2. Quotations, Catalogue, Price list. 3. Advertisement in a newspaper for sale of an article. Example:- Goods are sold in a shop under 'self service' system. Customer select the goods in the shop and take them to the cashier for payment of price. Cashier refuses to accept the payment. Held that customer cannot bound the shopkeeper for delivery of goods. (Pharmaceutical Society of Great Britain v. Boots Cash Chemists Ltd.)	
5. Offer may be specific or general	Specific Offer	An offer made to a definite person is called Specific offer. A specific offer can be accepted only by the person to whom it is made.
	General Offer	An offer which is made to the public at large. Anyone having knowledge of the offer can accept this offer by complying with the terms of the offer. Example:- A company advertised in several newspapers that a reward of € 100 would be given to any person who contracted influenza after using the smoke balls of the company according to its printed directions. Carlill

	used the smoke balls according to the directions of the company but contracted influenza. Held that she could recover the amount as by using the smoke balls she had accepted the offer. (Carlill V. Carbolic Smoke Ball Co.1893)
6. Offer must be communicated to the person to whom it is made	An offer, to be complete, must be communicated to the person to whom it is made. Unless an offer is communicated to the offeree by the offeror or by his duly authorized agent, there can be no acceptance of it. An acceptance of an offer, in ignorance of the offer, is no acceptance and does not confer any right on the acceptor. Example:- S offered a reward to anyone who returned his lost dog. F bought the dog to S without having heard of the offer. Held, F was not entitled to the reward (Fitch v. Snedaker). Example:- S sent his servant L to trace his missing nephew. He then announced that anybody who traced his nephew would be entitled to a certain reward. L traced the boy in ignorance of this announcement. Subsequently when he came to know of the reward, he claimed it. Held, he was not entitled to the reward (Lalman Shukla v. Gauri Dutt)
7. Offer must be made with a view to obtaining consent of the offeree	A mere declaration of intention does not amount to offer. Example:- An auctioneer advertised in a newspaper that a sale of office furniture would be held. A broker came from a distant place to attend that auction, but all the furniture was withdrawn. The broker thereupon sued the auctioneer for his loss of time and expenses. Held, a declaration of intention to do a thing did not create a binding contract with those who acted upon it, so that the broker could not recover (Harris v. Nickerson).
8. An offer may be conditional	While making an offer the offeror may impose conditions for the acceptance of the offer. A conditional offer is a valid offer.
9. An offer should not contain a term the non compliance of which amounts to acceptance	Offeror cannot impose any such condition the non-fulfillment of which would lead to acceptance of that offer. Example:- A offers to sell out his bike to B stating that if B does not reply with in a week, he will assume that he has accepted the offer. This is not a valid offer, because failure on the part of B to reply would result in an acceptance.
10. Communication of Special terms	Example:- P deposited his bags in the cloakroom at the railway station. On the face of receipt, the words “See back” were printed. One of the conditions printed on the back was “ the liability of the railway company shall be limited to € 10 for any package”. P’s bag was lost. He claimed the actual value of bag amounting to € 24. Held that P cannot recover the amount more than € 10 since the railway company had taken all the reasonable steps to ensure that conditions printed on back printed were brought to the knowledge of P. (Parker v. S.E. Rail Co.)

2. TYPES OF OFFER

A. General offer	An offer made to the public at large. Anyone can accept this offer by doing the desired act .
B. Specific offer	An offer made to a definite person or a group of persons. Such offer can be accepted only by the specified person to whom it is made.
C. Cross offers	When two parties exchange identical offers in ignorance at the time of

	each other's offer, the offers are called cross offers. Two cross offers cannot become a binding contract in the absence of acceptance. Example:- A makes an offer for selling out his bike to B for Rs 20000. B, in ignorance of this offer makes a similar offer for buying A's bike for Rs.20000. These two offers are called cross offers and none of these would constitute an acceptance.
D. Counter offer	A qualified acceptance to the offer subject to modifications and variations in the terms of original offer. Counter offer amounts to rejection of the original offer. Example:- A offers B, " Will you purchase my car for Rs 100000. B replies, "I will purchase but I can pay only Rs 75000 for your car." This acceptance given by B is a counter offer.
E. Standing, open or continuing offer	An offer is allowed to remain open for acceptance over a period of time. Example:- Tender for supply of goods.

3.) LAPSE (Revocation) OF AN OFFER

- ✚ On expiry of stipulated or reasonable time.
- ✚ By not accepting in mode prescribed.
- ✚ By rejection by the offeree.
- ✚ By death or insanity of the offeror or offeree before acceptance.
- ✚ By revocation by the offeror at any time before acceptance.
- ✚ Revocation of standing offer at any time by giving notice to the offeree.
- ✚ Revocation by non fulfillment of condition precedent to acceptance.
- ✚ By subsequent illegality or destruction of subject matter.

4.) ACCEPTANCE:- Sec.2(b)

- When the person to whom proposal is made
- signifies his assent thereto,
- the proposal is said to be accepted.
- A proposal when accepted becomes a promise.

LEGAL RULES AS TO VALID ACCEPTANCE	
Acceptance must be absolute and unqualified	Offeree should be assented to all terms & conditions of the offer. A qualified acceptance amounts to counter offer.
Acceptance must be communicated	Mere mental acceptance is not acceptance. Acceptance cannot be made in ignorance of the offer. Mere silence is not acceptance.
Acceptance to Whom	Acceptance must be communicated to the offeror i.e. the person who made the offer.
Mode of Acceptance	Acceptance must be in the mode prescribed in the proposal. If no mode prescribed in the proposal, the acceptance must be according to some usual and reasonable mode.
Time for Acceptance	Acceptance must be given within specified time limits given in the offer. In case no time is specified in the offer, offer must be accepted within reasonable time and before the offer lapses.

	Example:- A person applied for shares in a company in June. He cannot be bound by the allotment made late in November since delay of 6 months in acceptance of application for shares was unreasonable. (Ramsgate Victoria Hotels v. Montefiore)
Acceptance by conduct	By performance of an act intended by the proposer.
Who can accept	
Specific offer	A Specific offer can be accepted only by the person to whom it is made.
General offer	A general offer can be accepted by anyone having knowledge of the offer by complying with the terms of the offer.

5.) AN ACCEPTANCE TO OFFER IS WHAT A LIGHTED MATCH TO A TRAIN OF GUNPOWDER

According to **Sir William Anson**, "An acceptance to offer is what a lighted match to a train of gunpowder".

✚ Offer is compared to a train of gunpowder.

✚ Acceptance is compared to a lighted match.

When a lighted match is applied to a train of gunpowder, an explosion takes place. In the same way, an acceptance is given to the offer, it would result into a contract and offer cannot be revoked thereafter.

A train may be removed before match is applied to gun powder. In the same way, an offer may be revoked before it is accepted by offeree.

6. COMMUNICATION OF OFFER & ACCEPTANCE (Section 4)	
(A) Communication of Offer	The communication of offer is complete when it comes to the knowledge of the person to whom it is made.
(B) Communication of Acceptance	The communication of acceptance is complete-
(a) As against the Proposer	When it is put into the course of transmission to him so as to be out of power of the acceptor to withdraw the same .
(b) As against the Acceptor	When it comes to the knowledge of the proposer.

7. REVOCATION OF OFFER & ACCEPTANCE (Section 4)	
The communication of revocation is complete-	
(a) As against the person who makes it	When it is put into the course of transmission to the person to whom it is made so as to be out of power of the person who makes it.
(b) As against the person to whom it is made	When it comes to his knowledge.

TIME FOR REVOCATION (Section 5)	
Revocation of Offer	An offer can be revoked at any time before the communication of acceptance is complete as against the proposer.
Revocation of Acceptance	An acceptance can be revoked at any time before the communication of acceptance is complete as against the offeree.

CHAPTER-3 CONSIDERATION

1.) CONSIDERATION: - “**QUID PRO QUO**” – i.e. something in return. Consideration is the price agreed to be paid by the promisee for the obligation of the promisor.

- ✚ When, at the desire of the promisor,
- ✚ the promisee or any other person
- ✚ has done or abstained from doing or
- ✚ does or abstains from doing or
- ✚ promise to do or to abstain from doing
- ✚ something,
- ✚ such act or abstinence or promise is called consideration for the promise. [Section 2(d)]

2. LEGAL REQUIREMENTS REGARDING CONSIDERATION

A. Consideration must move at the desire of the promisor	Consideration must move at the desire or request of the promisor. Any act done at the desire of a third party is not consideration. Example:- D constructed a market at the desire of the collector of the district. B, a shopkeeper of the market promised to pay commission to D on the sales effected by him. Later on B denies to pay the promised amount. D filed a suit in the court for the recovery of the amount. The court held that D cannot recover the amount from B because D has constructed the market at the desire of the collector , not at the desire of the promisor i.e. B. (Durga Prasad V. Baldeo)	
B. Consideration may move from the promisee or any other person	Consideration may move from the promisee or any other person who is not a party to the contract. Thus, there can be a stranger to a consideration. Example:- A, by a deed of gift transferred certain property to her daughter with the direction that daughter should pay an annuity to her sister . The daughter executed a writing in favour of her sister agreeing to pay the annuity. Later on, she refused to pay the amount to her sister taking a plea that no consideration is given to her in return from her sister. The court held that consideration need not necessarily move from the promisee. Hence, she is bound to pay the promised amount to her sister. (Chinnayya V. Rammayya)	
C. Executed and Executory consideration	If consideration under the contract has been given, it is said to be executed. If consideration under the contract is to be moved in future, it is called executory consideration.	
D. Consideration may be past, present or future	Past consideration	The words “ has done or abstained from doing ” indicates past consideration. Past consideration is no consideration in England.
	Present consideration	The words “ does or abstains from doing ” indicates present consideration. Consideration which moves simultaneously with the promise.

	Example:- Cash Sales.
Future consideration	The words “ promise to do or to abstain from doing ” indicates future consideration. Consideration which is to be performed in future. Example:- A get booked an air ticket from Delhi to Mumbai. The flight is to be take off on the next day. In this case the consideration from A is a Past consideration and consideration is pending on the part of Airlines which is to be performed in future.
E. Consideration should be real, not illusory	If consideration is an illusory one, then it is not valid.
F. Consideration need not be adequate	Though consideration is an essence of contract, adequacy of consideration is not regarded as an essence of contract. Courts do not regard the adequacy of consideration, it is at the part of promisor to consider that whether he is receiving adequate consideration or not.
G. The performance of an act what one is legally bound to perform is not consideration for the contract	
	Example:- Promise to pay money to a witness.
H. Consideration must not be unlawful, immoral or opposed to the public policy	

2.) A THIRD PARTY OR A STRANGER TO A CONTRACT CANNOT SUE

A stranger to a contract means a person who is not a party to the contract. There is a privity of contract between the parties. Therefore only a party to the contract can enforce its rights under the contract.

EXCEPTIONS:-

i. Trust	In case of trust, a beneficiary can sue upon the contract. Example:- H sued her father in law K to recover Rs 15000 being the arrears of allowance payable to her by K. K under an agreement made between K and H's father, in consideration of H's marriage to K's son D. Held that she can recover the amount because she is a beneficiary under the contract. (Khwaja Muhammad V. Hussaini Begum)
ii. Family Settlement	In case of family settlement, if the terms of settlement are reduced into writing, members who were not originally party to the contract can also sue upon it.
iii. Marriage Contracts	A female member can enforce a provision for marriage expenses made on partition of HUF between male members.
iv. Acknowledgement of Liability	Where a person admits his liability, thereafter, if he refused, he will be estopped from denying his liability. Example:- Where A receives money from B for paying it to C and A admits C the receipt of that amount. Later on if he refuses, he will be stopped from denying his liability to pay the amount.
v. Assignment	In case of assignment of a contract, Where the benefit under the contract has been assigned, the assignee (the person to whom benefits of contract are assigned) can enforce upon the contract.
vi. Covenant running with land	The person who purchases land with notice that the owner of land is bound by certain duties affecting land, the covenant affecting the land may be enforced against the successor of the seller.

3. NO CONSIDERATION, NO CONTRACT

The general rule of law is that an agreement without consideration is void.

EXCEPTIONS

(i) Agreement on account of Natural love and Affection



Example:- A husband by a registered document after referring to quarrels and disagreements between himself and his wife, promised to pay his wife a sum of money for her maintenance and separate residence, it was held that the promise was unenforceable. (**Rajlukhy Devi V. Bhootnath**)

(ii) Compensation for past voluntary services {Section 25 (2)}

- ✚ Services rendered voluntarily.
- ✚ Services rendered for the promisor.
- ✚ Promisor must be in existence at the time of rendering services.
- ✚ Promisor must have intended to compensate the promisee.

Example:- X finds Y's purse and gives it to him. Y promises to give X Rs 1000. This is a valid contract.

(iii) Promise to pay time barred debt {Section 25 (3)}

A promise to pay, wholly or in part a debt which is barred by law of limitation can be enforced if it is :-

- ✚ In writing and
- ✚ Signed by the person making it or his authorized agent.

(iv) Agency

- ✚ According to **Section 185** of the Indian Contract Act, no consideration is necessary to create an agency.

(v) Completed Gifts

- ✚ Gifts do not require any consideration. (**Explanation 1 to Section 25**)

(vi) Charity

- ✚ A promise to contribute to charity, though gratuitous, would be enforceable, if on the faith of the promised subscription, the promisee takes definite steps in furtherance of the object and undertakes a liability, to the extent of liability incurred, not exceeding the promised amount of subscription. (**Kedarnath V. Gorie Mohammad**)

(i) Bailment

- ✚ Consideration is not necessary to effect bailment. (**Section 148**)

CHAPTER-4 CAPACITY TO CONTRACT

1. WHO IS COMPETENT TO MAKE A CONTRACT

SECTION 11: – Every person is competent to contract who is of **age of majority** according to the law to which he is subject, who is of **sound mind** and is **not disqualified from contracting by any law** to which he is subject.

A. AGE OF MAJORITY

According to **Section 3 of Indian Majority Act, 1875** A minor is a person who has not completed **18 years** of age. Every person domiciled in India attains majority on the completion of 18 years of age.

Exceptions : - In the following cases, a person attains majority on completion of 21 years of age:-

1. Where the guardian of a minor is being appointed under Guardians and Wards Act, 1890.
2. Where the superintendence of minor's property is assumed by Court of Wards.

B. SOUND MIND PERSON (Section 12)

A person is said to be of sound mind for the purpose of making a contract if at the time when he makes it he is capable of understanding it and of forming a rational judgment so as to its effect upon his interests.

- ✚ A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind.
- ✚ A person who is usually of sound mind but occasionally of unsound mind, may not make a contract when he is of unsound mind.

UN SOUND MIND PERSONS

Durnkard	Idiot	Lunatic
•A contract by drunken person is altogether void. •Partial or ordinary drunkenness is not sufficient to avoid the contract.	•An idiot is a person who is permanently of unsound mind. •Such a person has no lucid intervals.	•A lunatic is a person who is mentally deranged due to some mental strain or other personal experience. However, he has some intervals of sound mind. •A patient in lunatic asylum, who is at intervals of sound mind, may contract during those intervals.

C. PERSONS DISQUALIFIED BY LAW

Alien enemy	An Alien enemy is a person who is a citizen of a foreign country which is at war with India.
Contracts during the war	An alien enemy cannot enter into contract during the period of war except a license from the central government.
Contracts entered before war	Contracts entered before war are either dissolved or merely suspended for the period of war and revived after the war is over.
Statutory Corporation	A statutory corporation cannot enter into contracts which are ultra virus its memorandum.
Municipal Bodies	Municipal bodies cannot enter into acts which are beyond their statutory powers.

Sovereign States, Ambassadors & Diplomatic Couriers	These persons enjoy certain special privileges. They cannot be sued in the Indian courts. However, they can enter into contracts and enforce those contracts in Indian Courts.
Convict	A convict cannot enter into contract during the period of imprisonment.
Insolvent	When the person is adjudged insolvent, his property stands vested in the official receiver or official assignee appointed by the court. He cannot enter into contracts in relation to property which is vested to the official assignee or receiver.
A contract with a party incompetent to contract is void ab initio.	

2. POSITION OF MINOR'S AGREEMENT

i. An agreement entered into by or with a minor is void ab initio	A minor is not competent to contract. A minor's contract being void, any money advanced to a minor cannot be recovered. { Mohiri Bibi V. Dharmodas Ghose (1903) }
ii. Minor can be beneficiary	Even if a minor is incapable of contracting, still no law prevents him from taking the benefit under a contract. A promissory note executed in favour of a minor is valid and can be enforced by the minor. A minor can be payee of a cheque or other negotiable instrument.
Minor as a partner	A Minor cannot become a partner in a firm but he can be admitted to the benefits of the partnership with the consent of all partners. (Section 30 of Indian Partnership Act, 1932)
Minor can always plead minority	If a minor by fraudulently representing his age enters into contract, still minor can take the shelter of minority. Example:- A, a minor by fraudulently representing himself to be a major, induce B to lend him Rs.2000. He refused to repay it and B sued him for the money. Held that the contract was void and A was not liable to repay the amount due.
KHAN GUL V. LAKHA SINGH	
Lahore High Court held that where the contract is set aside the <i>status quo ante</i> should be restored and the court may direct the minor, on equitable grounds, to restore the money or property to the other party. Thus, in such cases, if money could be traced, the court would, on equitable grounds, ask the minor for restitution.	
Sections 30 and 33 of the Specific Relief Act, 1963 provide that in case of a fraudulent misrepresentation of his age by the minor, inducing the other party to enter into a contract, the Court may award compensation to the other party.	
Ratification an attaining majority is not allowed	A minor cannot ratify the agreement on attaining the age of majority as the original agreement is void-ab-initio and therefore, validity cannot be given to it later on. Example: 'A', a minor makes a promissory note in favour of 'B'. On attaining majority, he makes out a fresh promissory note in lieu of old one. Neither the original, nor the fresh promissory note is valid.
Contract by minor's guardian	A contract may be entered into on behalf of a minor by his guardian or manager of his estate. In such a case the contract can be enforced by or against the minor provided that the contract (a) is within the scope of the authority of the guardian or manager, and

	party thereto or his agent, or to induce him to enter into the contract: ✦ the suggestion as to fact of that which is not true by one who does not believe it to be true. ✦ the active concealment of a fact by one having knowledge or belief of the fact. ✦ a promise made without any intention of performing it. ✦ any other act fitted to deceive. ✦ any such act or omission as to law specially declared to be fraudulent. ❖ A contract induced by fraud is voidable.
Q- Is mere silence amounts to fraud ?	
Ans: - No, Mere silence as to facts likely to affect the willingness of a person to enter into a contract is no fraud.	
Exceptions:-1.) Where it is duty of the person to speak.	
2.) Where silence itself equivalent to speech.	
(d) Misrepresentation	where a person asserts something which is not true though he believes it to be true, his assertion amounts to misrepresentation.

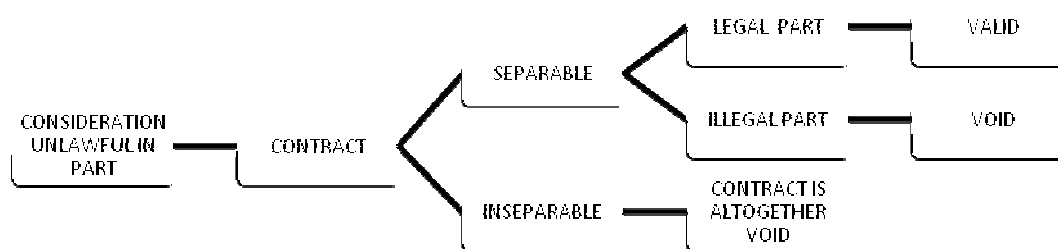
CHAPTER-6 LAWFUL CONSIDERATION & OBJECT

1. LAWFUL CONSIDERATION OR OBJECT [Section 23]	
Consideration or object is unlawful if it is: -	
A. Forbidden by law	Acts forbidden by law are those which are punishable under any statute as well as those prohibited by regulation or orders made in exercise of the authority conferred by the legislature. Example:- A promises to drop prosecution which he has instituted against B for robbery and B promises to restore the value of the things taken. The agreement is void, as its object is unlawful. Example:- A loan granted to the guardian of a minor to enable him to celebrate the minor's marriage in contravention of the Child Marriage Restraint Act is illegal and cannot be recovered back. Example:- A license to cut the grass is given to X by forest department under Forest Act. The license provides for imposition of penalty in the event of X choosing to assign his right. However if X assigns his right, the agreement would still be valid since there is no prohibition for such assignment as the consideration stipulating penalty is only to regulate the matter of administrative measure.
B. Defeat the provisions of any law	The term 'Law' includes any legislative enactment or rule of the Hindu and Muslim Laws or any other rule for the time being in force in India. Example:- Agreement in restraint of parental rights is in violation of Hindu Law.
C. Fraudulent	Where object or consideration is unlawful on ground of fraud. Example:- A, B and C enter into agreement for the division among them of gains acquired or to be acquired, by them for fraud. The agreement is void as its object is unlawful.
D. Injury to the person or property of another	The general term "injury" means criminal or wrongful harm. Where the object of an agreement is to cause injury to the person or property of another. Example:- An agreement to print a book in violation of another's copyright is void. Example:- A borrowed Rs. 1000 from B. A executed a bond promising to

	work for B without pay for 2 years and in case of default agreed to pay interest at a very exorbitant rate and the principal amount at once. Held, the contract was void (Ram Swaroop v. Bansi)
E. Immoral or opposed to the public policy	Example: - Letting house to a prostitute knowingly.
<u>Partial Illegality</u> :-(Section 24) If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void. Example:- A promises to survive the business on behalf of B, a licensed manufacturer of some permissible chemicals and some contraband items. B promises to pay A a salary of Rs. 100000 per month. The agreement is void, the object of A's promise and the consideration for B's promise being in part unlawful.	

CHAPTER-7 VOID AGREEMENTS

1. AGREEMENTS EXPRESSLY DECLARED VOID
Agreements by incompetent parties (Sec. 11)
Agreements with unlawful object or consideration (Sec. 23)
Agreement made under mutual mistake of fact (Sec. 20)
Agreements without consideration (Sec. 25)
Agreements in restraint of marriage, trade or legal proceedings etc.
Agreements to do impossible Acts (Sec. 56)
Example:- An agreement to discover treasure by magic is void.



- ❖ **Uncertain meaning** – An agreement the meaning of which is not certain is void but where the meaning thereof is capable of being made certain, the agreement is valid.(Sec. 29)

Example:- A agrees to sell 100 tons of oil @ Rs. 2000 per ton to B. The agreement is void on ground of uncertainty because in which type of oil they are dealing is not clear.

- ❖ **Wagering agreement** – It is an agreement involving payment of a sum of money upon the determination of an uncertain event. An agreement by way of wager is void.



No party have control over the event.
Collateral transactions are valid.

➔ **Speculative transactions are generally valid**

Elements:-

- Mutual intention of contracting parties to acquire or deliver the commodities.

- The undertaking or risk arising from movement in prices.

AGREEMENTS OPPOSED TO THE PUBLIC POLICY		
These are the agreements which are against the moral laws of the society and contravenes any established interest of society. Following agreements are opposed to the public policy:-		
(a) Trading with enemy	Any trade with person owing allegiance to a Government at war with India without the license of the Government of India is void, as the object is opposed to public policy.	
(b) Stifling prosecution	An agreement to stifle prosecution tends to be a preservation or an abuse of justice; therefore, such an agreement is void. The principle is that one should not make a trade of felony (crime). One should not convert a crime into a source of profit. ✚ Compromise of public offence is illegal. ✚ To drop uncompoundable offence without permission of court. Example:- A knew that B has committed a crime. He obtains a promise from B to pay him Rs. 20000 in consideration of not exposing B. This is a case of stifling prosecution & therefore illegal & void.	
(c) Champerty & maintenance	Maintenance	It is the promotion of litigation in which one had no interest. Example:- A promises to pay B a sum of Rs. 10000 if B filed a suit against C in the court. This agreement is in the nature of maintenance and hence void.
	Champerty	It is bargain whereby one party agrees to assist the other in recovering property, with a view to sharing the profits of litigation. Example:- An agreement to give assistance (monetary or otherwise) to another person to recover the property by legal action and to share the proceeds of litigation is a champertous agreement.
(d) Interference with the course of justice	An agreement whose object is to induce any judicial officer of the state to act partially or corruptly is void.	
(e) Marriage brokerage contracts	An agreement to negotiate marriage for reward, which is known as a marriage brokerage contract, is void, as it is opposed to public policy. For Example:- An agreement to pay money to a person hired to procure a wife is opposed to public policy and therefore void.	
(f) Interest (benefit) against obligation	Taking a benefit against the obligation. Example:- A, who is the manager of a firm, agrees to pass a contract to X if X pays to A Rs. 20000 privately; the agreement is void.	
(g) Sale of public office	✚ Bribe for appointment in a public office as it interferes with the appointment of a person best qualified for the service of public. ✚ An agreement to pay money to a public servant in order to induce him to retire from his office so that another person may secure the appointment is void. ✚ An agreement to procure a public recognition like Padma Vibhushan for reward is void.	

(h) Agreements for creation of monopolies void	Agreements having their object the establishment of monopolies are opposed to the public policy and hence void. It is also hit by MRTP Act. Example:- A local body granted a monopoly to A to sell vegetables in a particular locality. Held that the agreement was void.
(i) Agreement in restraint of marriage	Every agreement in restraint of marriage of any person, other than a minor, is void (Sec. 26). Example:- A promised to marry no one else except Miss B and in default pay her a sum of Rs.100000. A married some one else and B sued A for recovery of the sum. Held, the contract was in restraint of marriage, and as such void.
(j) Agreement in restraint of trade	An agreement by which any person is restraint from exercising a lawful profession, trade or business of any kind, is to that extent void.
Exceptions	(i) Sale of goodwill (Within specified local limits) ↓ (Reasonable)
	(ii) An agreement among the sellers of a particular commodity not to sell the commodity for less than a fixed price is not an agreement in restraint of trade. (iii) An agreement between partners not to carry on competing business during the continuance of partnership is valid. (Section 11 of Indian Partnership Act, 1932) (iv) Agreement with outgoing partner not to carry on competing business for a reasonable time will be valid.(Section 36 of Indian Partnership Act, 1932) (v) An agreement of service by which an employee binds himself, during the term of his agreement, not to complete with his employer is not in restraint of trade. Example:- B, a physician and surgeon, employs A as an assistant for a term of three years and A agrees not to practice as a surgeon and physician during these three years. The agreement is valid and A can be restrained by an injunction if he starts independent practice during this period. (vi) An agreement by a manufacturer to sell during a certain period his entire production to a wholesale merchant is not in restraint of trade.
(k) Agreement in restraint of legal proceedings	It is one by which any party thereto is restricted absolutely from enforcing his rights under a contract through a court or which abridges the usual period for starting legal proceedings. It is void. ➤ Exceptions – ◆ Settlement of dispute through arbitration. ◆ Question already arisen or which may arise in future refer to arbitration → such a contract must be in writing.

CHAPTER-8 PERFORMANCE OF CONTRACT

1. PERFORMANCE OF CONTRACTS [Section 37]

The parties to a contract must either perform, or offer to perform their respective promises unless such performance is dispensed with or excused under the provisions of the contract act or any other law.

Promises bind the representatives of the promisor in case of death of such promisor before performance, unless a contrary intention appears from the contract.

2. BY WHOM CONTRACT MAY BE PERFORMED

Promisor himself	If there is something in the contract to show that it was intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor. This means contracts which involves the exercise of personal skill & diligence or which are founded on personal confidence between the parties must be performed by the promisor himself.
Agent	Where personal consideration is not the foundation of the contract, the promisor or his representative may employ a competent person to perform it.
Representatives	A contract which involves the use of personal skill or is founded on personal consideration comes to an end on the death of the promisor. As regards any other contract, the legal representatives of the deceased promisor are bound to perform it unless a contrary intention appears from the contract. But their liability under a contract is limited to the value of the property they inherited from the deceased.
Third persons	Where the promisee accepts performance of the promise from a third person, he cannot afterwards enforce it against the promisor.
Joint promisors	When two or more persons have made a joint promise, then unless a contrary intention appears from the contract, all such persons must jointly fulfill the promise. If any of them dies, his legal representatives must, jointly with the surviving promisors, fulfill the promise. If all of them dies, the legal representatives of all of them must fulfill the promise jointly (Sec.42).

3. SUCCESSION & ASSIGNMENT

(a) Succession	(b) Assignment
When the benefits of a contract are succeeded to by process of law, then both burden and benefits attaching to the contract, may sometimes devolve on legal heir.	Benefits of a contract can only be assigned but not the liabilities there under.

4. EFFECT OF REFUSAL TO ACCEPT OFFER OF PERFORMANCE [Section 38]

When the promisor has made an offer of performance to the promisee, and the offer has not been accepted then the promisor is not responsible for non-performance, nor does he thereby lose his rights under the contract.

Conditions: -

-  It must be **unconditional**.
-  It must be made at **proper time and place**.
-  If the offer is to deliver **anything** to the promisee, promisee must have **reasonable opportunity to check the goods**.

- **An offer to one of the several promisees will have same legal consequences as an offer to all of them.**

4. EFFECT OF REFUSAL OF PARTY TO PERFORM PROMISE [Section 39]

When a party to a contract has **refused to perform** or has **disabled himself from performing his promise** in entirety, the promisor may put an end to the contract, unless he has signified by words or conduct, his acquiescence in its continuance.

❖ Rights to the aggrieved party

- ✚ To terminate the contract.
- ✚ To indicate, by words or by conduct, that he is interested in his continuance.
- ✚ Right to claim damages.

6. LIABILITY OF JOINT PROMISORS

- ✚ Promisee may compel any one or more of such joint promisors to perform the whole of the promise.
- ✚ If one of the joint promisors is made to perform the whole contract, he can call for a contribution from others.
- ✚ If any of the joint promisors make a default in making his contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

7. RIGHTS OF JOINT PROMISEES

- ✚ All of them jointly have right to claim performance.
- ✚ If any one of joint promisees dies, Survival promisee + Representatives of deceased promisee.
- ✚ If all of them dies. Representatives of deceased promises.

8. TIME & PLACE FOR PERFORMANCE OF THE PROMISE

- ✚ No time specified for performance of promise, promise must be performed within reasonable time.
- ✚ If promise is to be performed on a specified date but hour is not mentioned, the promisor may perform it any time during the usual hours of business, on such day .
- ✚ Delivery must be made at the usual place of business.
- ✚ When no place is fixed for performance of promise, it is the duty of the promisor to ask promisee to fix a reasonable place for the performance of promise.
- ✚ When the promisor has not undertaken to perform the promise without an application by the promisee and the promise is to be performed on a certain day, it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business.

9. PERFORMANCE OF RECIPROCAL PROMISES

- ✚ **Reciprocal Promises** When a contract consists of two promises, one being consideration for the other, such promises are called Reciprocal promises.
Example – A promises to deliver 500 quintals of rice and B promises to pay the price on delivery, the contract would consists of reciprocal promises.

Simultaneous performance of Reciprocal promises	Reciprocal promises may have to be performed simultaneously or one after another. Example – Where A promises to deliver 500 quintals of rice and B promises to pay the price on delivery, both the promises are to be performed simultaneously.
Performance of Reciprocal promises where order of performance is expressly fixed	When the order of performance of the reciprocal promises is expressly fixed by the contract, they must be performed in that order. Example – A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B can be called upon to perform the promise to pay for it.
Performance of Reciprocal promises when the order of performance is fixed by implication	The order of performance may sometimes be indicated not expressly, but by the nature of the transaction. Ex – A promises to make over stock for B and B promises to give security for the payment of price. A's promise to make over stock need not to be performed until the security is given by B.
Effect of one party preventing other from performing promise	- o Contract become voidable - o Another party is entitled to claim compensation on A/c of by suffered due to non-performance.
Reciprocal promise to do certain things that are legal → contract, and also some other things that are illegal → Void Agreement	

10. EFFECT OF FAILURE TO PERFORM AT A TIME FIXED IN A CONTRACT IN WHICH TIME IS ESSENTIAL

Where time is essential and the party fails to perform promise at or before specified time, the contract becomes voidable at the option of the promisee.
Where time is not essential, the contract cannot be avoided on the ground that time for performance has expired. The promise is only entitled to compensation from the promisor for any loss caused by delay.
But it must be remembered that even where the time is not essential it must be performed within a reasonable time otherwise it becomes voidable at the option of the promisee.
Where time is essential, promisor fails to perform within time & promisee accept the performance, he cannot claim compensation for non-performance at time agreed unless notice of intention to claim compensation is given.

11. APPROPRIATION OF PAYMENTS

Appropriation by Debtor	Appropriation of payment where debt to be discharged is indicated by debtor, payment, if accepted, must be applied accordingly. Latin maxim <i>Quicquid sovitur, sovitur secundum modum solventis.</i>
Appropriation by Creditor	Appropriation of payment where debt to be discharged is not indicated by debtor, creditor is entitled to appropriate it to the debt first in time.
Appropriation by Time	Where neither party appropriates, Payment shall be applied in discharge of the debts in order of time, where they are time barred or not. If debts are equal standing, the payment shall be applied in discharge of each proportionately.

12. CONTRACTS WHICH NEED NOT BE PERFORMED

1. Novation	When parties to a contract substitute a new contract for old . On novation, old contract is discharged and consequently it need not to be performed. There may be change in parties.
2. Rescission	When parties to a contract agree to rescind it, the contract need not be performed. In this case, only old contract is cancelled no new contract is formed .
3. Alteration	Where parties to a contract agrees to alter it, the original contract is rescinded, with the remit that it need not be performed.
	• No change in parties to the contract. • Change in terms & conditions of original agreement.
4. Waiver or Remit of performance by promisee	Promisee can dispense with performance without consideration and without a new contract or may extend the time of performance.

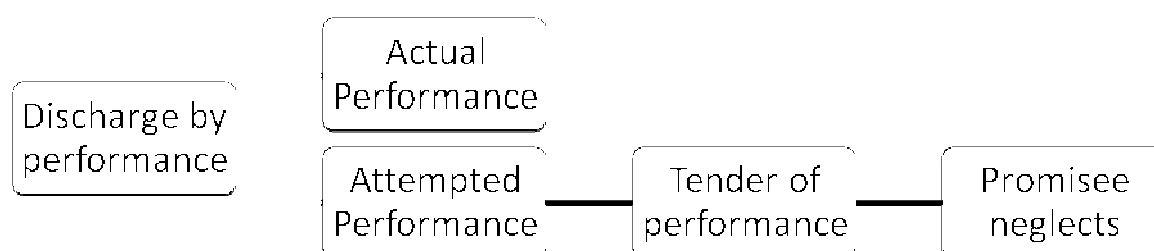
13. RESTORATION OF BENEFIT UNDER A VOIDABLE CONTRACT

If the person at whose option contract was voidable has rescind the contract, he shall **restore the benefit** (either return the goods the goods or pay for it) received there under from another party to such contract, to the person from whom it was received.

14. OBLIGATION OF PERSON WHO HAS RECEIVED ADVANTAGE UNDER VOID AGREEMENT OR ONE BECOMING VOID

When an agreement is discovered to be void or when a contract becomes void, any person who received any advantage under such agreement or contract must restore it, make compensation for it to the person from whom he received it. (**Either restore back the advantage received or pay compensation for it**)

15. DISCHARGE OF CONTRACT



Discharge by mutual agreement – Novation, Alteration, Rescission, Remission

Discharge by impossibility of performance.

Discharge of lapse of time e.g. Time barred debt under Indian Limitation Act, 1963

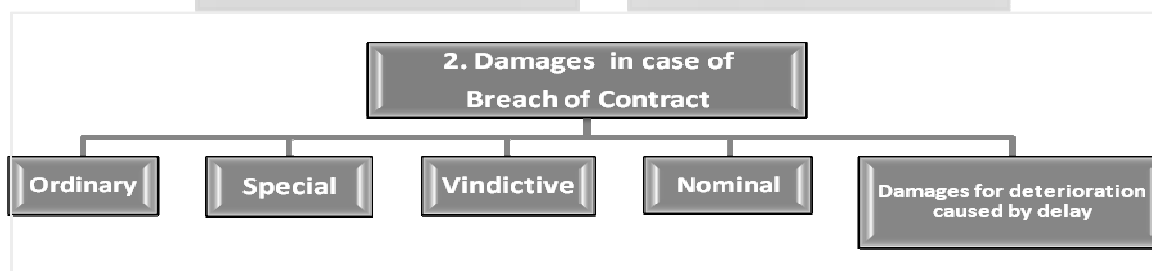
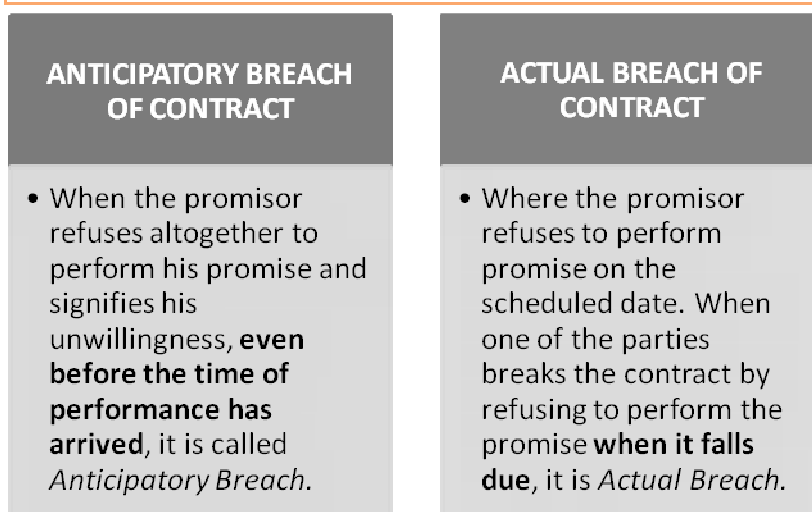
Discharge by operation of law such as by death of promisor, by insolvency, merger, material alteration etc.

Discharge by breach of contract

Actual Breach of Contract	Anticipatory Breach of Contract
Breach of contract at time of performance	Breach of contract before time of performance
Where promisee neglects or refuses to afford the promisor reasonable facilities for performance of promise.	

CHAPTER-9 BREACH OF CONTRACT

1. BREACH OF CONTRACT



i. Normal Damages Compensation for any loss or damage which arises naturally in the normal course of events. Ordinary damages are calculated by measuring the difference between the contract price and market price on the date of breach.

ii. Special Damages Where party to a contract receives a **notice of special circumstances** affecting the contract, he will also liable for special damages.

(iv) Nominal Damages These damages are awarded where the plaintiff has proved that there has been breach of contract but he has not in fact suffered any real damage. These damages are awarded just to establish right to decree for breach of contract. The amount may be a rupee or even 10 paise. Amount of damages depends upon loss of credit & reputation suffered on that A/c

(v) Damages for deterioration to goods caused by delay Damages can be recovered from the carrier even without notice. **“Deterioration”** not only implies physical damages but also loss of special opportunity for sale.

3. HOW TO CALCULATE THE DAMAGE

- | | |
|--------------------|--|
| ➤ Breach by buyer | ✚ Damage = Contract price - Market price at the date of breach |
| ➤ Breach by seller | ✚ Damage = Market price at the date of Breach - Contract price |

4. REMEDIES FOR BREACH OF CONTRACT	
(i) Rescission of Contract	 Discharge from his own obligations  Entitled to compensation for damages suffered
(ii) Suit upon Quantum Meruit	Quantum Meruit → “As much as is earned” Or “According to the quantity of work done” When the person has begun the work and before he could complete it, the other party terminates the contract or does something which make it impossible for the other party to complete the contract, he can claim for the work done under contract. He may also recover the value of work done when further performance of contract become impossible.
Suit for Quantum Meruit arise in three cases:–	
A. Work done and accepted under void contract.	
B. Act done or something delivered non-gratuitously, the person who enjoys the benefit must pay for it.	
C. Divisible Contract: - One part performed & refuses to perform other part. Party in default may sue other party who has enjoyed the benefit of past performance.	
(iii) Suit for specific performance	Where damages are not an adequate remedy in case of breach of contract, the court may in its discretion on a suit for specific performance direct party in breach, to carry out his promise according to the terms of contract.
(iv) Suit for Injunction	Where a party to a contract is negativating the terms of contract, the court may - be issuing an ‘ injunction order ’ restrain him from doing what he promised not to do.

CHAPTER-10 CONTINGENT & QUASI CONTRACT

1. CONTINGENT CONTRACT [Section 31]
Contingent contract is a contract to do or not to do something, if some event colletral to such contract, does or does not happen. E.g. – Contract of Insurance

2. ESSENTIAL ELEMENTS OF A CONTINGENT CONTRACT
The performance of a contingent contract is made dependent upon happening or non-happening of some event.
Event on which performance is made to depend, is an event colletral to the contract <i>i.e.</i> it does not form part of reciprocal promises which constitute the contract.
The contingent event should not be the mere will of the promisor. E.g. – A promise to pay Rs. 10,000, if he so chose, is not a contingent contract.

3. RULES RELATING TO ENFORCEMENT	
Contract contingent upon happening of an event (Section 32)	Where a contingent contract is made to do or not to do anything if uncertain future event happens, it cannot be enforced by law unless and until that event has happened. If event becomes impossible such contracts become void.
Contract contingent upon non-happening of an event (Section 33)	Where a contingent contract is made to do or not to do anything if any uncertain future event does not happen it can be enforced only the happening of that event becomes impossible and not before. If such event becomes happened, such contracts become void.
Contract contingent upon	Event shall have considered to become impossible when such person does anything which renders it impossible that he should act

future conduct of a living person (Section 34)	within any definite time or other than under further contingencies.
Contract contingent upon specified event happening within fixed time(Section 35)	It becomes void if at the expiry of fixed time, such event has not happened, or if before the time fixed, such event becomes impossible.
Contract contingent upon specified event not happening within fixed time(Section 35)	It may be enforced by law when the time fixed has expired and such event has not happened or before the time expired, if it becomes certain that such event will not happen.
Agreement contingent on impossible event (Section 36)	A contingent agreement to do or not to do anything, if an impossible event happens is void The impossibility of an event may or may not be known to the parties to the agreement at the time when they entered into it.

4. QUASI CONTRACTS

✚	Quasi contracts are based on principle of equity, justice and good conscience.
✚	In the case of Quasi contracts, the promisor voluntarily undertakes an obligation in favour of the promisee, or
✚	Obligation may be imposed by law upon a person for the benefit of another even in the absence of contract.

5. SALIENT FEATURES OF QUASI CONTRACTS

✚	It does not arise from any agreement of the parties concerned, but it is imposed by law , and
✚	It is a right which is available not against the entire world , but against a particular person/s only.

6. TYPES OF QUASI CONTRACTS

Claim for necessities	supplied to a person incapable of contracting, the supplier is entitled to claim their price from the property of such a person. <i>E.g.</i> – Minor, Person of unsound mind.
Right to recover money paid for another	A person who has paid a sum of money which another is obliged to pay, is entitled to be reimbursed by that other person provided that payment has been made by him to protect his own interest.
Obligation of a person enjoying the benefit of non-gratuitous act	(a) Where a person lawfully does anything for another person or delivers anything to him. (b) Not intending to do so gratuitously and (c) Such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the things so done or delivered.
Responsibility of Finder of goods	A person who finds goods belonging to another and takes them into his custody is subject to same responsibility as a bailee . * To take proper care * Not use it for personal purposes * Restore it to true owner, if owner is traced
Liability for money paid or thing	A person to whom money has been paid or anything delivered by mistake or under coercion must repay or return it.

**delivered by mistake
or under coercion**

7.	Wagering Agreement	Contingent Contract
1.	It is a promise to give money or money's worth upon the determination or ascertainment of an uncertain event.	It is a contract to do or not to do something if some event collateral to such contract does or does not happen.
2.	In a wagering agreement the uncertain event is the sole determining factor.	In a contingent contract, the event is only collateral.
3.	It is essentially of a contingent nature.	It may not be of wagering nature.
4.	Void	Valid
5.	Parties have no other interest in the subject matter of the agreement except the winning or losing of the amount of wager. It is a game of chance.	It is not so in this case both parties have interest in the subject matter of the contract.

INDIAN PARTNERSHIP ACT , 1932

CHAPTER-1 GENERAL NATURE OF PARTNERSHIP

1. PARTNERSHIP [Section 4]

Partnership is the relation between **persons** who have **agreed to share the profits of a business carried on by all or any one of them acting for all.**

PARTNER, FIRM & FIRM NAME :- Persons who have entered into partnership with one another are individually called **partners** and collectively a **firm** and the name under which their business is carried on is called **firm name**.

2. ESSENTIAL ELEMENTS OF PARTNERSHIP

1. Two or more persons	There should be at least two or more persons to form a partnership.
2. Business	There must be business. The term business includes every trade, occupation & profession. The business must be lawful. e.g. When two persons owned a building & jointly share the amount of rent. There is no partnership because there is no business.
3. Sharing of profits	Unless otherwise agreed, Sharing of profits implies sharing of losses as well. However, a person may become a partner in profits only.
4. Mutual agency	Business must be carried on by all partners or any one of the partners' who is acting for all. Every partner is the principal as well as agent of each other . he can bind the other partners for all the acts done by him and is bound by the acts of other partners as well.
5. Maximum number of partners	The Partnership Act does not mention any thing about the maximum number of persons who can be partners in a partnership firm, but Section 11 of the Companies Act, 1956 lays down the maximum limit of partners.

3. TRUE TEST OF PARTNERSHIP

✚ **Sharing of profits is not the true test of partnership.** Sharing of profits with the following persons does not make them partner:–

- ✚ A money lender or
- ✚ A servant (manager of a firm) or agent as his remuneration or
- ✚ Widow or child of a deceased partner or
- ✚ A previous owner of part of the business as the consideration for the sale of goodwill or share thereof.

Existence of **Mutual Agency** which is **cardinal principle of partnership law**, is the **true test of partnership**.

4. PARTNERSHIP V. JOINT STOCK COMPANY

COMPANY

A company is an **artificial person**, which is a **separate legal entity created by law** having a **perpetual succession & a common seal**.

Partnership vs. Joint Stock Company

S. No.	Basis	Partnership	Joint Stock Company
1.	Personality	No legal personality.	A company is a separate legal entity.
2.	Agency	Every partner is an agent of other partners as well as firm.	A member is not an agent of other members or company.
3.	Distribution of profits	Compulsory according to partnership deed.	No compulsion.
4.	Extent of liability	Unlimited.	Company limited by shares limited to the amount unpaid on shares held by member.
5.	Property	The property of the firm is the joint estate of all the partners.	The property of the company belongs to the company not to its members.
6.	Transfer of shares	A share in a partnership cannot be transferred without the consent of all partners.	Shares are transferable subject to provision contained in articles.
7.	Management	All partners.	Separation of management from ownership, management by Board of Directors.
8.	Maximum no. of membership	<u>Firm</u> Banking 10 Ordinary 20	<u>Company</u> Private Ltd. 50 Public Ltd. ∞
9.	Minimum no. of Membership	Firm 2	Private Co. - 2 Public Co. - 7
10.	Regulating Act	Indian Partnership Act, 1932	Companies Act, 1956
11.	Registration	Voluntarily	Compulsory
12.	Audit	No legal necessity	Legal requirement under Companies Act.

5. PARTNERSHIP Vs. CLUB

CLUB: A **club** is an association of persons formed with the object **not for earning profits** but **of promoting** some **beneficial purposes** such as improvement of health or providing recreation for the members etc.

5. Partnership vs. Club		
Basis	Partnership	Club
1. Objective	To earn profits.	To promote some beneficial purpose.
2. Agency	A partner is an agent of other partners as well as firm.	A member of a club is not an agent of other members or club.
3. Property	A partner is having an interest in property of the firm.	A member of a club has no interest in property of the club.

6. PARTNERSHIP Vs. HINDU UNDIVIDED FAMILY			
S. No.	Basis	Partnership	HUF
1.	Creation	By agreement	By status means by birth in the Hindu family.
2.	Death	Death of a partner ordinary leads to dissolution of partnership.	Death of a member does not affect family business.
3.	Management	Partners	Karta
4.	Liability	Unlimited	Karta → Unlimited Other family → Only to the extent of their share in family business
5.	Authority to bind the firm	Every partner can by his act bind the firm.	Karta has authority to contract for family business.
6.	Continuity	Firm is dissolved on death or insolvency of a partner.	HUF has continuity till it is divided.
7.	Governing law	Partnership Act, 1932	Hindu law
8.	Calling for A/cs	Partner can bring a suit against the firm for A/c's provided he also seals for dissolution of the firm.	On separation of HUF a member is not entitled to ask for A/c of the family business.
9.	Minor's capacity	Minor cannot become a partner though he can be admitted to the benefits of the partnership with the consent of all partners.	Minor becomes a member by incidence of birth.

7. PARTNERSHIP Vs. CO-OWNERSHIP		
S.No.& Basis	Partnership	Co-ownership
1. Creation	By contract	By agreement or Operation of law
2. Sharing of profits & losses	Yes	No, not necessary
3. Agency	Partners are agents of each other	A coowner is not an agent of other coowner.
4. Transfer of shares	A partner can transfer his share only with the consent of all other partners	A co-owner may transfer his interest or rights in property without the consent of other coowners.
5. Business	There must be a business.	It may exist without any business.

8. TYPES OF PARTNERS

- **Active Partner**
 - *Take active participation in conduct of partnership business.
 - *Public notice of the time of retirement.
- **Sleeping Partner** Dormant
 - * Do not take part in conduct of partnership business
 - * No public notice at the time of retirement.
- **Nominal Partner**

A person who lends his name to the firm, without having any real interest.
- **Partner by holding out** Partner by estoppels

Anyone who by words spoken or written or by conduct represents himself or knowingly permits himself to be represented, to be a partners in a firm, is liable as a partner in that firm to anyone who has on the faith of any such representation given credit to the firm.
- **Sub Partnership**

Partnership between partner and stranger
- **Partner in profits only**

A person may become a partner in profits only.

8. MINOR'S POSITION IN PARTNERSHIP

A minor cannot become partner of a firm because he is incompetent to contract but he can be admitted to the benefits of firm with the consent of all partners.

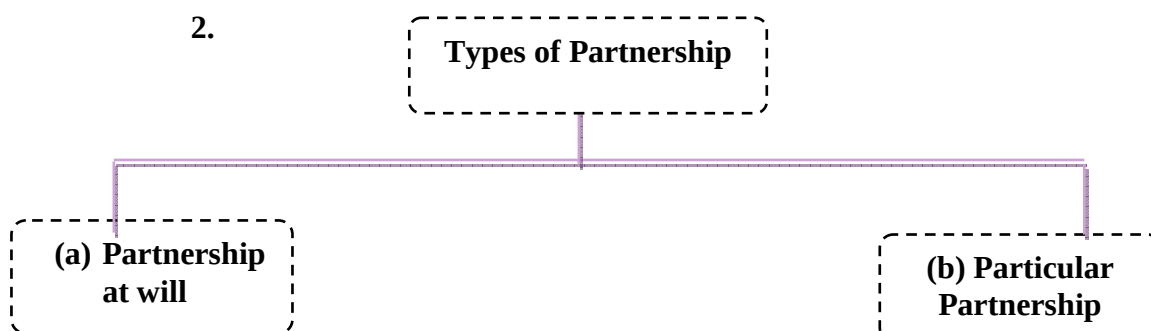
- + Minor has a right to agreed share of profits.
- + He has a right to have access to, inspect & copy **accounts** of the firm.
- + Right to sue partners for accounts or for payment of his share but only when severing his connection with the firm.
- + A public notice is required to be given within 6 months of, attaining majority or having knowledge of the fact that he is a partner in a firm, whichever is later, whether he elects to become a partner or not.
- + His share is not liable after the date of public notice.
- + If he elects to become a partner then no public notice is required to be given.
- + If he elects not to become a partner then public notice is required to be given.
- + If he fails to give public notice within 6 months, he shall be deemed to be partner of the firm on expiry of 6 months.
- + If he becomes a partner then he shall be liable towards the debts of the firm retrospectively. His share in property and profits of the firm shall remain same.

RELATIONS OF PARTNERS

1. RIGHTS OF PARTNERS
+ Right to take part in conduct of the business.
+ Right to be consulted
+ Right to have access to, inspect & copy books of the firm.
+ Right to share profits equally if there is no agreement otherwise.
+ Interest on capital → Not allowed . But if otherwise partnership agreement provides for the payment of interest on capital, it shall be payable only out of profits .
+ Interest on advances given by partner to firm will be paid at the rate agreed, if there is no

	agreement to this effect, interest is allowed @ 6% per annum .
✚	Right to be indemnified by the firm in respect of all expenses and liabilities incurred by him in the ordinary and proper conduct of business.
✚	Right to Remuneration – No remuneration allowed except there is an express agreement.
✚	Right to stop admission of a new partner.
✚	Right to retire with the consent of all other partners. Where partnership is at will, by giving notice to that effect to all other partners.
✚	Right not to be expelled from the firm by any majority of the partners.
✚	Right of outgoing partner to carry on competing business.
✚	Right of outgoing partner to share subsequent profits – the retiring partner or legal representatives of deceased partners has option to share of profits or to interest @ 6% p.a. on the amount of his share in property of the firm.
✚	Right to dissolve the firm – With the consent of all partners. Where partnership is at will, the firm may be dissolved by any partners giving notice in writing to all other partners of his intention to dissolve the firm.
✚	Right in emergency – A partner has right to bind the firm for acts done in emergency as are reasonably necessary for protecting the firm from loss. Provided he has acted in the same manner as a man of ordinary prudence would have acted in the like circumstances.

2.



(a) PARTNERSHIP AT WILL	(b) PARTICULAR PARTNERSHIP
Where no provision is made by contract between the partners for the duration of their partnership or for the determination of their partnership ,"Partnership is at will"	A person may become a partner with another person in particular adventure or undertaking. Such partnership is called "particular partnership"

3. DUTIES OF PARTNERS

✚	Duty to carry on the business of the firm to the greatest common advantage.			
✚	Duty to account for profits earned –			
	A.	From any transaction of the firm or	B.	From the use of firm's property or
	C.	Business connection of the firm or	D.	Firm's name.
✚	Duty not to carry on competing business to that of partnership firm.			
	A.	If carries on, must account for and pay the firm all profits made.	B.	Firm will not be liable for any loss arising under competing business.
✚	Duty to be just and faithful to each other.			
✚	Duty to render true accounts and full information of all things affecting the firm to any partner or his legal representatives.			

✚ Duty to indemnify the firm for any damage caused to it by reason of his fraud in conduct of firm's business.
✚ Duty to attend diligently his duties relating to conduct of firm's business.
✚ Duty not to claim remuneration:- Remuneration may be allowed to working partners provided there is specific agreement to that effect.
✚ Duty to contribute equally to the loss sustained by the firm, unless otherwise agreed.
✚ Duty to indemnify the firm for any loss caused to it by willful neglect in the conduct of business of the firm.

4. PARTNERSHIP PROPERTY OR PARTNERSHIP ASSETS OR JOINT STOCK OR COMMON STOCK OR JOINT ESTATE

All properties, rights and interests which partners may have brought into the common stock as their contribution to the common business.	All property, rights and interests acquired or purchased by or for the firm or for the purposes and in the course of business of the firm and	Goodwill of the business
---	---	---------------------------------

5. IMPLIED AUTHORITY OF A PARTNER

✚ **Authority** means capacity of the partner to bind the firm, this capacity may be:

Express authority	⇒ By express agreement between the
Implied authority	⇒ Authority presumed

IMPLIED AUTHORITY

An act of a partner done in a usual way for the business of the firm binds the firm provided the act is done in the name or any manner expressing or implying an intention to bind the firm such an authority of a partner to bind the firm is called implied authority.

❑ ACTS BEYOND IMPLIED AUTHORITY (Section 19)
(a) Submission of dispute relating to firm's business for arbitration as it is not the ordinary business of partnership firm to enter into submission for arbitration.
(b) Compromise or relinquish any claim or portion of a claim by the firm against an outsider.
(c) Withdraw a suit or proceedings filed on behalf of the firm.
(d) Admit any liability in a suit or proceeding against the firm.
(e) Acquire immovable property on behalf of firm.
(f) Transfer immovable property belonging to the firm.
(g) Opening a bank account on behalf of the firm in his own name.

(h) **Enter into partnership** on behalf of the firm.

6. LIABILITY TO THIRD PARTIES

- ✚ Contractual liability
- ✚ Liability for tort or wrongful act
- ✚ Liability for misapplication of money received by a partner from a third party

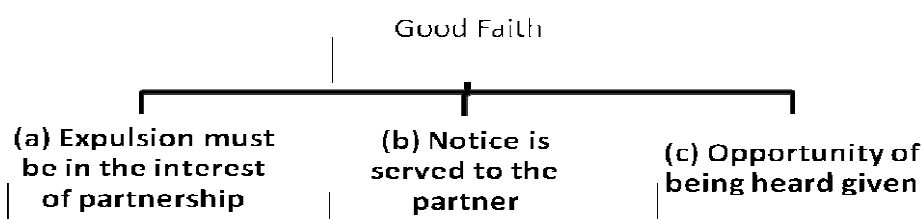
In all these cases, all the partners as well as firm are liable to third parties.

7. EXPULSION OF A PARTNER

A partner may not be expelled from a firm by a majority of partners.

Exception – A partner may be expelled when:

1. **Power of expulsion existed** in a **contract** between the partners.
2. Power has been exercised by **majority of the partners** and
3. Power has been exercised in –



➤ If a partner is otherwise expelled, such expulsion is null and void.

REGISTRATION AND DISSOLUTION OF A FIRM

1. REGISTRATION OF A FIRM

❖ Mode of effecting Registration

- ✚ By post
- ✚ By hand delivery

- ❖ To the registrar of the area in which any place of business of a firm is situated or proposed to be situated.
- ❖ A statement in **prescribed form** along with **prescribed fee** stating –
 - ✚ Name of the firm
 - ✚ Principal place of business
 - ✚ Names of other places of business
 - ✚ Date of joining of each partner
 - ✚ Name in full and permanent addresses of partners &
 - ✚ Duration of the firm
- ❖ Signed by all the partners or their agents specially authorized for this purpose.
- ❖ **Registration when complete** – When registrar is satisfied that all the provisions related to registration have been duly complied with, he shall record an entry of the statement in a register called the register of firms and shall file the statement. Then he shall issue a certificate of registration.

- ❖ However, registration is deemed to be complete as soon as an application in prescribed form with prescribed fees and necessary details concerning the particular of partnership is delivered to the registrar.

Q. IS REGISTRATION OF FIRMS' COMPULSORY?		
Ans. No, Registration of firms is not compulsory. But as a consequence of non-registration, following disabilities are to be faced by partnership firms –		
DISABILITIES		
1.	No suit against third party	The firm or any other person on its behalf cannot bring an action against a third party for breach of contract entered into by him.
2.	No set off of more than Rs.100	If an action is brought against the firm by a third party, then neither the firm nor partner can claim any set off for a value more than Rs. 100 in a suit.
3.	No action against firm	A partner of an unregistered firm cannot bring legal action against the firm or any other partner.
But such a person may sue for –		
☐ Dissolution of firm or ☐ For accounts and realization of his share in the firm's property where the firm is dissolved.		

Note – Non-registration of a firm does not affect the right of third parties against the firm or its partners.

2. DISSOLUTION OF FIRM Dissolution of firm means discontinuation of the Jural relation existing between all the partners of the firm.

Cases where dissolution of firm takes place –

1. By agreement between all the partners.
 2. By insolvency of all the partners.
 3. When business of the firm becoming unlawful.
 4. By notice of dissolution by a partner where partnership is a will.
- Subject to the agreement between the partners, on happening of following contingencies –
- ✚ Efflux of time
 - ✚ Completion of venture
 - ✚ Death of a partner
 - ✚ Insolvency of a partner
5. By intervention of court –
- ✚ Partner becoming of unsound mind
 - ✚ Permanent incapacity of a partner
 - ✚ Misconduct of a partner affecting the business
 - ✚ Willful or persistent breaches of agreement by a partner
 - ✚ Transfer or sale of whole interest by a partner
 - ✚ Improbability of business being carried on save at a loss
 - ✚ On other equitable ground for dissolution as court may satisfies

3. CONSEQUENCES OF DISSOLUTION	
(a) Continuing liability until public notice	In spite of dissolution of the firm, partners continue to be liable for any act done by any of them, which would have been an act of the firm if done before the dissolution, until public notice is given of the dissolution.
(b) Rights to enforce winding up	On dissolution of partnership, any partner or his representative shall have right, against other partners – ✚ To have property of the firm applied in payment of the debts of the firm and ✚ To have the surplus distributed among the partners or their

		representatives according to their respective rights.
(c) Authority of partners after dissolution		The authority of a partner to bind the firm & other mutual rights and obligations continue – ✚ Which are necessary to wind up the firm. ✚ To complete the unfinished transactions pending at the date of dissolution.
(d) Settlement of Partnership A/c's	i. Losses including deficiencies of capital are to be paid – (i) Out of profits, then (ii) Out of capital, then (iii) By partners individually in their profit sharing ratio i. Assets of the firm + Contributions by partners on A/c of deficiencies of capital must be applied in following order:– (i) To pay debts of outsiders then (ii) To pay partner's loan then (iii) To pay partner's capital then (iv) Balance will be shared in profit sharing ratio	
4. Personal profits earned after dissolution		and till the firm is wound up, partners must A/c for, the profits from carrying on business of the firm, to the other partners.
5. Return of premium on partnership's premature dissolution (Section 51)		In case of dissolution of partnership earlier than the period fixed for it, the partner paying premium is entitled to return of the premium as such part thereof as may be reasonable, regard being had to the terms of agreement & to the length of time during which he was a partner, except when partnership is dissolved:– ✚ Due to death of one of the partners or ✚ Mainly due to misconduct of the partner paying the premium or ✚ Pursuant to an agreement containing no provisions for the return of the premium or any part thereof

MODE OF GIVING PUBLIC NOTICE (SECTION 72)

In every case where public notice of any manner in respect of partnership firm is required to be given under this act, it must be given

- ✚ By **notification in the official Gazette**, and
- ✚ In at least **one vernacular (local language) newspaper** circulating in the district where the firm to which it relates has its place or principal place of business.

In case of **registered firms**, in addition to above notification, a notice is also required to be **served on the Registrar of firms**.

THE SALE OF GOODS ACT, 1930

CHAPTER-1 FORMATION OF CONTRACT OF SALE

DEFINITIONS

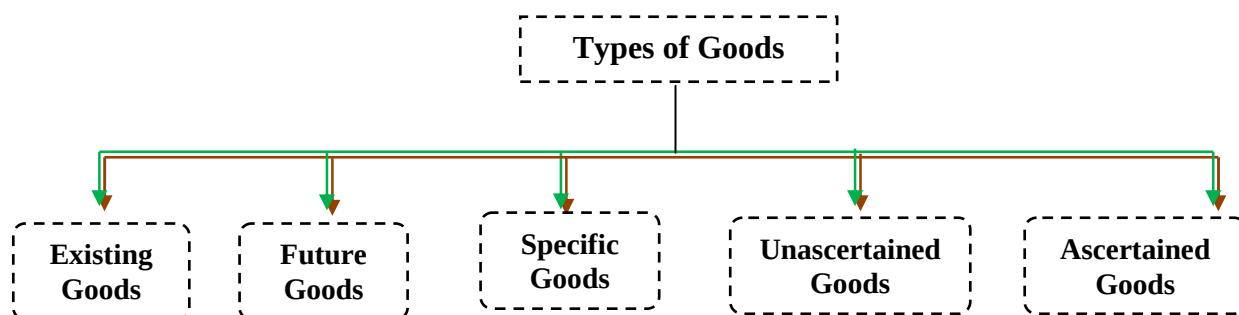
- ✚ **Buyer [Sec 2 (1)] :-** Buyer means a person who **buys** or **agrees to buy** goods.
- ✚ **Seller [Sec 2 (13)] :-** Seller means a person who **sells** or **agrees to sell** goods.

✚ **Goods [Sec 2 (7)] :-** Goods means every kind of **movable property** other than actionable claims & money and **includes** :

- Stock and shares
- Growing crops
- Grass &
- Things attached to or forming part of land,

which are agreed to be severed before sale or under the contract of sale.

[**Actionable claims** are claims which can be enforced only by an action or suit e.g. Debt.]



Existing Goods	Goods which are in existence at the time of contract of sale <i>i.e.</i> those owned & possessed by the seller.
Future goods	Means goods to be manufactured or produced or acquired by seller after making the contract of sale. In case of future goods, there is an agreement to sell.
Specific Goods	Means goods identified & agreed upon at the time of a contract of sale has been made.
“Unascertained” or “Generic” goods	Means goods defined only by description and not identified and agreed upon.
Ascertained goods	Means goods identified in accordance with the agreement after the contract of sale has been made

✚ **Goods in Deliverable State:-** Goods are said to be in a deliverable state when they are in such a condition that the buyer is bound to take delivery of them under the contract.

E.g. – A contracts to sell timber and makes bundles thereof, Goods will be in a deliverable state, after A has put the goods in such a condition.

✚ **Delivery [Sec. 2 (2)]:** - Delivery means voluntary **transfer of possession** by one person to another.

Kinds of Delivery

a. Actual Delivery	It is actual when the goods are physically delivered to the buyer.
b. Constructive delivery	When it is effected without any change in the custody or actual procession of thing. E.g. Delivery by attornment (acknowledgement). E.g. Where a warehouseman holding the goods of A, agrees to hold them on behalf of B, at A’s request.
c. Symbolic Delivery	When there is a delivery of thing in token of a transfer of something else E.g. Delivery of goods in transit by handing over the documents to title (ownership) to goods, B/L, Dock warrant, Delivery of key of a Warehouse.

 Document of title to goods :- Includes:

- ➡ Bill of lading
- ➡ Dock warrant
- ➡ Warehouse keeper's certificate
- ➡ Wharfingers' certificate
- ➡ Railway receipt
- ➡ Multimodal transport document
- ➡ Warrant or order for delivery of goods or any other document used in the ordinary cause of business as a proof of possession or control of goods.

 Mercantile Agent [Sec 2 (9)]: - It means an agent having in the customary course of business as such agent an authority either

- ➡ To sell goods or
- ➡ To consign goods for the purpose of sale or
- ➡ To buy goods or
- ➡ To raise money on the security of the goods..

 Property [Sec 2 (ii)]

It means **General property** (Right of ownership in goods) and **not** merely **special property**.

 Insolvent [Sec 2 (8)]

A person is said to be insolvent when he **ceased to pay** his debts in the ordinary course of business **or cannot pay** his debts as they become due whether he has committed an act of insolvency or not.

 Contract of sale [Sec.4 (1)]

A contract of sale is a **contract** whereby the **seller transfers** (sale) **or agrees to transfer** (agreement to sell) **property** (ownership) in **goods** to the **buyer** for a **price**.

❖ **Essentials:**

- At least two parties
- Subject matter of contract must be Goods
- Price in money only (not in kind) should be paid or promised.
- Transfer of ownership in goods
- A contract of sale must be absolute or conditional.
- Other essentials of a valid contract.

2. SALE Vs. AGREEMENT TO SELL

S. NO.	BASIS	SALE	AGREEMENT TO SALE
1.	Property in goods	Transfer	Not transfer
2.	Risk	Transfer	Not transfer
3.	Type	Executed contract	Executory contract
4.	Sue for Price	Yes	No, only damages unless price was payable at stated date.
5.	Loss of destruction Breach by Seller	Buyer Buyer's Right (i) To recover the goods (ii) Suit for damages.	Seller Buyer's right to claim damages only.

3. SALE Vs. HIRE PURCHASE

S. NO	BASIS	SALE	HIRE PURCHASE
1.	Transfer of property	Immediate	On the payment of last instalment
2.	Position	Buyer → Owner	Hirer → Bailee till he pays last instalment
3.	Right of termination	Buyer cannot terminate the contract and is bound to pay the price.	Hirer may terminate the contract by returning the goods to its owner without any liability to pay remaining instalment.
4.	Buyer's Insolvency	Risk of loss → Seller	Seller has no risk, right to take back goods
5.	Passing of title by buyer	Buyer can pass good title to bonafide purchaser	Hirer cannot pass any title even to a bonafide purchaser
6.	Tax	Tax is levied at the time of contract.	Tax is not leviable unless it eventually ripens into sale

4. Sale v. Bailment

BAILMENT : A bailment is the delivery of goods for some specific purpose under a contract on the condition that the same goods to be returned to the bailer or are to be disposed off according to directions of the bailer.

SALE Vs. BAILMENT

S.NO	BASIS	SALE	BAILMENT
1.	Transfer of ownership	Yes	No Only transfer of possession
2.	Return of goods	Return of goods in contract of sale not possible.	Bailee must return the goods to the bailor on accomplishment of the purpose for which the bailment was made.
3.	Consideration	Consideration price money only	Consideration may be gratuitous or non gratuitous.

5. SALE Vs. CONTRACT FOR WORK AND LABOUR

S. NO	SALE	CONTRACT FOR WORK & LABOUR
1. Transfer of ownership	Yes	No Only doing some work of labour. ➤ E.g. Gold supplied to goldsmith for preparing an ornament ➤ An artist ask to paint a picture.

6. Modes of forming contract of sale –

There may be:-

- 🚩 Immediate delivery of goods or
- 🚩 Immediate payment of price but delivery at the some future date or
- 🚩 Immediate delivery of goods and immediate payment of price or
- 🚩 Delivery or payment or both are to be made in instalments or
- 🚩 Delivery or payment or both are to be made at some future date.

7. Destruction of subject matter of contract (Sec. 7 & 8) :-

- (a) Goods not existing at the time of contract.
 - ✚ Goods destroyed without knowledge of the seller, **contract is void-ab-initio**.
- (b) If there was agreement to sell & Goods perishing after contract is made.
 - ✚ Without any fault of buyer or seller, agreement becomes void.

8. Ascertainment of price (Sec. 9 and 10)

Price is the monetary consideration for sale of goods [Sec 2 (10)]

- ✚ Price may be:
 - Fixed by the contract or
 - Agreed to be fixed in a manner provided by the contract. *E.g.* by a valuer or
 - Determined by the course of dealings between the parties.
 - Where price cannot be fixed in any of above ways, buyer is bound to pay a reasonable price to the seller.

9. Stipulation as to time (Section 11)

As regard time for payment of price, unless a different intention appears from the contract, stipulation as regard this is not deemed to be essence of the contract of sale.

But delivery of goods must be made without delay. Stipulations as to time of delivery are usually the essence of contract.

CHAPTER-2 CONDITIONS & WARRANTIES

1. Condition – A condition is a stipulation **essential to the main purpose of contract**, the breach of which gives the **right to repudiate the contract & to claim damages**.

2. Warranty – A warranty is a stipulation **collateral to the main purpose of contract** the breach of which gives rise to a **claim for damages** but **not to a right to reject the goods** and treat the contract as repudiated.

3. DISTINCTION BETWEEN CONDITION AND WARRANTY

CONDITION	WARRANTY
1. Essential to the main purpose of contract.	1. Collateral to the main purpose of contract.
2. Aggrieved party can repudiate the contract or claim damages or both in case of breach of condition.	2. Aggrieved party can claim only damages in case of breach of warranty.
3. A breach of condition may be treated as breach of warranty.	3. A breach of warranty cannot be treated as breach of condition.

4. WHEN A CONDITION MAY BE TREATED AS WARRANTY

- (i) When buyer altogether waives the performance of the condition.
- (ii) Where buyer elects to treat the breach of condition as one of warranty. He may only claim damages instead of repudiating the contract.
- (iii) Contract is non-severable, the buyer has accepted either the whole goods or any part thereof.
- (iv) Where fulfillment of any condition or warranty is excused by law by reason of impossibility or otherwise.

5. EXPRESS & IMPLIED CONDITIONS & WARRANTIES

- ✚ **Express Conditions** – are those which are agreed between the parties at the time of contract and are expressly provided in the contract.
- ✚ **Implied Conditions** – are those which are presumed by law to be present in the contract. An implied condition may be negated or waived by an express agreement.

❖ Implied Conditions :-

Condition as to title	
- In case of sale, seller has right to sell the goods & - In case of agreement to sell, he will have right to sell the goods at the time when property is to pass. - If the seller's title turns out to be defective, buyer must return the goods to the true owner and recover the price from the seller.	
Sale by description	In this case, there is implied condition that goods correspond with the description.
Sale by sample	- Bulk shall correspond with the sample in quality. - The buyer shall have a reasonable opportunity of comparing the bulk with the sample and - The goods should be free from any defect rendering them unmerchantable, which would not be apparent on reasonable examination of the sample.
Condition by sample as well as description	Bulk must correspond with sample & description
Condition as to quality or fitness	- No implied condition as to quality or fitness of the goods sold for any particular purpose. - Condition as to reasonable fitness of goods for a particular purpose is implied if the buyer had made known to the seller the purpose of his purchase and relied upon the skill & judgment of the seller to select the best goods and seller has ordinarily dealing in those goods.
Condition as to wholesomeness	In case of eatables & provisions, in addition to merchantable quality, goods shall be wholesome.

❖ IMPLIED WARRANTIES	
1. Warranty as to undisturbed possession	Buyer shall have & enjoy quiet possession of goods.
2. Warranty as to non-existence of encumbrances	Goods shall be free from any charge in favour of a third party not declared or known to the buyer before or at the time contract is entered into.
3. Disclosure of dangerous nature of goods	Goods are dangerous & buyer is ignorant of danger, seller must warn the buyer of the probable danger.
4. Warranty as to quality or fitness by usage of trade	An implied warranty as to quality or fitness for a particular purpose may be annexed by the usage of trade.

6. CAVEAT EMPTOR

Means Let the buyer beware

- It is the responsibility of the buyer to make proper selection of goods. If the goods turn out to be defective he cannot hold the seller liable. The seller is in no way responsible for bad selection of the buyer. The seller is not bound to disclose the defects in the goods which he is selling.

EXCEPTIONS

1. Where buyer makes known to the seller the particular purpose for which the goods are required, so as to show that he relies on seller's skill & judgement.	
2. Goods purchased under patent name or brand name	No implied condition that the goods shall fit for any particular purpose.

3. Sale by description	Goods shall correspond with the description. Goods shall be of merchantable quality, if purchased from dealer. the rule shall not apply. But if buyer has examined the goods & the defects were such which ought to have been revealed by ordinary examination, the rule shall apply.
4. Sale by sample	if bulk does not correspond with sample.
5. Goods by sample as well as description	Goods shall correspond with both description as well as sample.
6. When quality or fitness assumed by usage of trade	for a particular purpose & seller deviates from that.
7. Fraud or misrepresentation by the seller.	

CHAPTER-3

TRANSFER OF OWNERSHIP AND DELIVERY OF GOODS

1. PASSING OF PROPERTY (PASSING OF OWNERSHIP)	
❖ Rules:	
(i)	No transfer of property to the buyer, unless & until goods are ascertained.
(ii)	Where there is a contract of sale of specific or ascertained goods, property passes to the buyer at the time when parties intend to pass it.
(iii)	Where there is an unconditional contract for the sale of specific goods in a deliverable state, property in goods passes to the buyer when the contract is made. (Sec. 20). The property shall not pass when the goods are made in deliverable state but shall pass only when the buyer has notice of it. (Sec. 21)
(iv)	Where the goods are in deliverable state, but the seller is bound to weigh, measure, test or to do same act or thing for the purpose of ascertaining price, the property does not pass until such act or thing is done. When the seller has done its part the property passes even if the buyer has to do something for his own satisfaction. (Sec. 22)
(v)	Unascertained goods Property passes when ✚ There is ascertainment of goods & ✚ There unconditional appropriation to the contract.
Appropriation of goods	It involves selection of goods with the intention of using them in performance of contract and with the mutual consent of seller & the buyer.
(vi)	Goods sent on approval or 'sale' or 'pattern' Property passes – ✚ When buyer signifies his approval or acceptances to the seller. ✚ When he does any act adopting the transaction & ✚ If he does not signifies his approval or acceptance to the seller but retained the goods beyond a reasonable time. (Sec. 24)
(vii)	Sale for cash only or return Property pass only when the cash is paid for.
(viii)	Conditional appropriation When the seller reserves the right of disposal until certain conditions are fulfilled, the property therein will not pass to the buyer till the condition imposed, if any, by the seller has been fulfilled.

2. PASSING OF RISK [Sec. 26]

“Risk follows ownership”. The general rule is “*Risk passes with property*”.

Exceptions –

- ✚ If there is delay of delivery due to fault of seller or buyer, the goods shall at the risk of the party in default, as regards loss which might not have arisen but for the default.
- ✚ The duties and liabilities of the seller and buyer as bailee of goods for the other party remain unaffected even when the risk has passed generally.

3. TRANSFER OF TITLE [Sec. 27 to 30]

The general rule regarding transfer of title is that the seller cannot transfer to the buyer of goods a better title than he himself has. If the seller is not the owner of the goods, then the buyer also will not become the owner i.e., the title of buyer shall be the same as that of the seller. Latin maxim “**Nemo dat quod non habet**”. which means no one can give what he has not got.

Exceptions – Sale by non-owner → valid

Sale by Mercantile Agent

- ✚ For documents of title to goods
- ✚ Agent in possession of goods with consent of owner
- ✚ Sale made acting in ordinary course of business as mercantile agent &
- ✚ Buyer acted in good faith & at the time of contract of sale, no notice of fact that seller has no authority to sell.

Sale by one of the joint promisors

Buyer - Good title (Purchase in good faith + No knowledge of fact that seller has no authority to sell).

Sale by person in possession under voidable contract provided contract has not been rescinded until the time of sale.

Sale by one who already sold the goods but continues to be in possession thereof. (Person obtains delivery in good faith + No notice of previous sale)

Sale by buyer obtaining possession before property in goods has vested in him.

Effect of estoppel Where the owner is estopped by the conduct from denying the seller's authority to sell, the transferee will get a good title on against the true owner.

Sale by an unpaid seller

Sale by official receiver or liquidator of a company.

Sale by finder of goods under certain circumstances.

4. RULES REGARDING DELIVERY OF GOODS

(i) Buyer to apply for delivery	The seller is not bound to deliver the goods until the buyer has applied for delivery, unless otherwise agreed
---------------------------------	--

(ii) Place of Delivery –	✚ If there is no contract to the contrary, goods must be delivered at the place where they were at the time of sale. ✚ In case of agreement to sell, goods agreed to be sold are required to be delivered at the spot where they were at the time when agreement was entered into. ✚ If goods were not in existence when agreement to sell was entered into, then delivery will be made at the place where they would be manufactured or produced.
---------------------------------	--

(iii) Time of Delivery	If not fixed by the parties, the seller must send them within reasonable time.
------------------------	--

(iv) Goods with third	In this case, there will be no delivery unless and until such
-----------------------	---

party	third person acknowledges to the buyer that he hold goods on his behalf.
	In case, there is a transfer of document of title to goods, it will be treated as symbolic delivery. Even if the goods are in custody of a third person, no acknowledgement is required.
(iii) Time for tender of Delivery	Demand or tender of delivery should be made at a reasonable hour otherwise such demand is ineffectual. What is reasonable hour is a question of fact.
(iv) Expenses for Delivery	Expenses related to putting the goods into a deliverable state must be borne by the seller, unless there is a contract to the contrary.
(v) Delivery of wrong quantity	✚ In case of delivery of lessor quantity of goods, the buyer may either accept the same and pay for it or reject it. ✚ In case of excess delivery, the buyer may accept or reject the delivery, if he accepts the whole of goods, he shall pay for them at the contract rate. ✚ In case goods mixed with goods of a different description and delivery in made, the buyer may accept the relevant goods and reject the rest or reject the whole. ✚ Note: Mixing of goods with inferior goods does not amount to a mixing of goods of different description.
(vi) Part Delivery	Part Delivery would have the same effect for the purpose of passing of property in such goods as delivery of the whole. But delivery of part of goods will not be treated as delivery of the whole.
(vii) Installment deliveries	Unless otherwise agreed, the buyer is not bound to accept delivery in installments. ✚ The parties to the contract thereon may determine the rights and liabilities in case of delivery by installments and payments.
(x) Delivery of carrier	Subject to the terms of contract, the delivery of the goods to the carrier for transmission to the buyer, is prima facie deemed to be delivery to the buyer.
(xi) Goods deteriorate during transit	Where goods are delivered at a distant place, the liability for deterioration necessarily incidental to the course of transit will fall on the buyer, though the seller agrees to deliver at his own risk.
(xii) Buyer's right to examine the good	If goods are not previously examined by the buyer, the seller is bound, on request, to afford the buyer a reasonable opportunity of examining the goods.

5. Acceptance of delivery of Goods

- ❖ Acceptance is deemed to take place when the buyer:
 - ✚ Intimates to the seller that he had accepted the goods; or
 - ✚ Does any act to the goods which is inconsistent with ownership of the seller; or
 - ✚ Retain the goods after the lapse of a reasonable time, without intimating to the seller that he has rejected them.

CHAPTER-4 UNPAID SELLER

Unpaid Seller – The seller of goods is deemed to be an unpaid seller when –

- ✚ The whole of the price has not been paid or tendered and the seller has an immediate right of action for the price. A bill of exchange or other negotiable instrument was given as payment, but the same has been dishonoured, unless this payment was an absolute, and not a conditional payment.

1. RIGHTS OF UNPAID SELLER AGAINST THE GOODS

(i) Right of Lien (Section 47)

- ✚ Goods are in possession of seller
- ✚ Lien until the payment or tender of the price of such goods.
- ✚ **Cases where right of lien can be exercised:**
 - (a) Goods sold without any stipulation of credit or
 - (b) Goods sold on credit but term of credit has expired or
 - (c) Buyer becomes insolvent

✚ Cases under which seller loses his right of lien

- ➡ Where he delivers the goods to a **carrier** or other **bailee** for the purpose of **transmission** to the **buyer** without reserving the right of disposal of goods.
- ➡ Where the **buyer** or his agent lawfully **obtains possession** of the goods.
- ➡ Where seller the **waived** the right of lien.
- ➡ **By Estoppel i.e.**, where the seller so conducts himself that he leads third parties to believe that the lien does not exist.

(ii) **Right of stoppage in transit** – This right can be exercised only if all the following conditions are fulfilled:

- ✚ **Seller** must be **unpaid**.
- ✚ Seller must have **parted with** the **possession** of the goods.
- ✚ **Goods** are **in transit**.
- ✚ **Buyer** has become **insolvent**.

(iii) **Right of re-sale** – The right to re-sell the goods can be exercised by the unpaid seller under the following conditions:

- ➡ Goods are of perishable nature, no need to inform to the buyer of intention of resale.
- ➡ In case of other goods, when notice of intention of resale is given by unpaid seller to the buyer & buyer does not within reasonable time pay or tender the price.

(B) RIGHT OF UNPAID SELLER AGAINST THE BUYER

(i) Suit for price (Section 55)

- (a) Property has passed to the buyer (ownership).
Buyer wrongfully neglects or refuses to pay price of goods.
- (b) Property has not passed to the buyer.
Price is payable on a particular date irrespective of delivery.
Buyer wrongfully neglects or refuses to pay price of goods.

(ii) Suit for damages for non-acceptance (Section 56)

When buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance.

(iii) **Suit for damages for Breach (Section 60)** – Where the contract is repudiated by the buyer before the date of delivery, the seller may treat the contract as rescinded and sue for damages for the breach.

(iv) **Suit for interest** – Where there is –

- Specific agreement between seller and buyer as to interest on price of goods from the date.
- On which payment becomes due, the seller may recover the interest from the buyer.

2. **RIGHT OF LIEN Vs. RIGHT OF STOPPAGE IN TRANSIT**

S.No.	RIGHT OF LIEN	RIGHT OF STOPPAGE IN TRANSIT
1.	It is a right to retain possession.	It is a right to regain possession
2.	Seller should be in possession of the goods.	 Seller should have parted with the possession.  Possession should be with a carrier &  Buyer has not acquired the possession.
3.	The right of lien can be exercised even when the buyer is not insolvent.	It can be exercised only if buyer is insolvent.
4.	The right of stoppage in transit starts where right of lien ends.	Its starting point is the end of right of lien.

4. EFFECT OF SUB-SALE OR PLEDGE BY THE BUYER ON UNPAID SELLER'S RIGHT

- The unpaid seller's right of lien or stoppage in transit is not effected by any further sale or other disposition of goods by the buyer.

Exceptions –

-  When seller has given his assent to such sale, mortgage or other disposition of goods made by the buyer.
-  When a document of title of goods has been transferred to the buyer and the buyer transfers the documents to a person who has bought the goods in good faith & for value.

5. RIGHT OF BUYER AGAINST THE SELLER IN CASE OF BREACH OF CONTRACT (Section 57 to 59)

(i)	Suit for non-delivery [Section 57] –	Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.
(ii)	Suit for specific performance [Section 58]	Where property has passed to the buyer, the buyer can also exercise the right to sue for specific performance.
(iii)	Suit for damages for Breach of warranty [Section 59]	Buyer is entitled to claim damages from the seller.
(iv)	Suit for recovery of price [Section 61]	The buyer has right to recover the money paid to the seller where the consideration for payment of it has failed.

6. AUCTION SALE

✚ It is a mode of selling property by inviting bids publicly and the property is sold to the highest bidder.

✚ An auctioneer is an agent governed by law of agency.

PROVISIONS RELATED TO AUCTION SALE
Where goods are put for sale in lot, each lot is prima facie deemed to be subject matter of a separate contract of sale.
The sale is complete when auctioneer announces its completion: ✚ By fall of hammer or ✚ Any other customary manner.
Any bidder may retract from his bid until announcement is made.
<u>Right to bid</u> may be <u>reserved expressly</u> by or behalf of the seller and where such a right is expressly reserved, but not otherwise, the <u>seller</u> or any one person on his behalf <u>may bid</u> at the auction.
If seller's right to bid has not been expressly reserved, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale
Reserve Price – The sale may be notified to be subject to a reserve or upset price.
Pretended bidding – If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.