d. Profits, closing stock and all the balance sheet items ------- Events
e. As per accounting equation approach, Accounts are classified as – Assets, Liabilities, Capital, Expense and Income.
f. Increase in Assets or expenses are debited and Decrease in assets or expense are credited.
g. Increase in Capital or income or liability is Credited and Vice versa.
h. As per traditional approach, Accounts are divided as ----- Personal A/c, Nominal A/c and Real A/c.
i. Real A/c--- Debit what comes in and credit what goes out.
j. Nominal A/c---- Debit expenses or losses and credit income or gains.
k. Personal A/c --- Debit the receiver and Credit the giver.
l. Journal is called as Book of first entry or Book of original entry or Primary book.
m. Journal contains 5 columns and all columns of journal are not filled at the time of journalising.
n. Normally personal and real accounts are balanced and nominal accounts are not balanced and are closed by transferring to trading and profit and loss A/c.

Nature of account

S.No	Name of account	Nature of account	Balance
1	Bank	R. Personal a/c	Debit (A)
2	Cash at bank	Real a/c	Debit (A)
3	Provision for Bad and doubtful debts	Nominal a/c	Credit
4	Provision for discount on debtors	Nominal a/c	Credit
5	Provision for discount on Creditors	Nominal a/c	Debit
6	Salary	Nominal	Debit (E)
7	Accrued/Outstanding salaries	R. Personal a/c	Credit (Liability)
8	Prepaid salaries	R. Personal a/c	Debit (A)
9	Commission received in advance	R. Personal a/c	Credit (Liability)
10	Closing stock	Real A/c	Debit (A)
11	Trading A/c, Profit and loss a/c	Nominal A/c	-
12	General reserve	Nominal A/c	Credit
13	Deferred revenue expenditure	Nominal A/c	Debit
14	Loose tools	Real A/c	Debit
15	Consignment A/c	Nominal a/c	-
16	Goods sent on consignment a/c	Real A/c	Reduced from purchases
17	Depreciation a/c	Nominal a/c	Debit (Loss)
18	Bills receivable a/c	Personal a/c	Debit(A)
19	Bills payable a/c	Personal a/c	Credit (Liability)
20	Joint venture a/c	Nominal a/c	-
21	Co-venturer's a/c	Personal a/c	-
22	Joint bank a/c	R. Personal a/c	Debit
23	Joint venture with coveturer a/c	R. Personal a/c	-
24	Share application/allotment/call a/c	Personal a/c	Credit
25	Share capital a/c	Personal a/c	Credit
26	Forfeited shares a/c	Nominal a/c	Credit
27	Calls in arrears a/c	Personal a/c	Debit
28	Calls in advance a/c	Personal a/c	Credit
29	Security premium a/c	Nominal a/c	Credit
30	Discount on issue of shares	Nominal a/c	Debit
31	Debentures a/c	Personal a/c	Credit
32	Capital redemption reserve a/c	Nominal a/c	Credit
33	Premium payable on redemption of pref.share a/c	Personal a/c	Debit
34	Revaluation a/c	Nominal a/c	-

6. Ledger:

a. Ledger is called as book of final entry or principle book.
b. The process of transferring the entries from journal to ledger is called as Posting. Ledger contains all set of accounts i.e. personal, real, Nominal a/c.
c. L.F. no in journal is filled at the time of posting only.
d. Ledger account has two sides and contains 4 similar columns on each side of account. (Total 8 columns)
e. Entries are recorded in chronological order (Date-wise) in journal and in analytical order in ledger.

f. The technique of finding the net balance after considering the totals of debits and credits is called as Balancing of an account.

S.No	Balance	Opening Balance	Closing Balance
1	Debit Items	On Debit side of account as "To Balance b/d"	On Credit side of the account as 'By Balance c/d"
2	Credit Items	On Credit side of an account as "By Balance b/d"	On Debit side of an account as "To Balance c/d"

7. *Subsidiary books:*

a. Subsidiary books are the part of journal and are also called as Primary books.
b. Cash book is both journal and ledger.
c. Types of cash book- Simple Cash book, Double columnar Cash book and Three column cash book.
d. In cash book, cash discount is recorded and not the trade discount. Discount column of cash book is merely totalled and not balanced. Discount column of cash book is a memorandum columns and not an account.
e. Contra entries are recorded in Three columnar cash book.
f. The balance in petty cash book represents an asset. Incase of Imprest system, Main cashier reimburses the amount spend by Petty cashier at the end of the period.

S.No	Subsidiary Book	Transactions to be recorded	Posting		Source
			Periodical total	Individual	
1	**Purchase Book**	All Credit Purchase of Goods	Debit side of Purchases a/c	Credit side of Creditors a/c	Inward Invoice
2	**Sales Day Book**	All Credit Sale of Goods	Credit side of Sales a/c	Debit side of Debtors a/c	Outward Invoice
3	**Sales returns Book**	All Credit sales returns	Debit side of Sales returns a/c	Credit side of Debtors a/c	Credit Note
4	**Purchase returns Book**	All Credit Purchase returns	Credit side of Purchase returns a/c	Debit side of Creditors a/c	Debit Note
5	**Bills receivable Book**	all Bills drawn by the business on the debtors	Debit side of Bills receivable a/c	Credit side of Debtors a/c	Bill Drawn
6	**Bills Payable book**	All Bills accepted by Business or All promissory notes prepared by Business	Credit side of Bills payable a/c	Debit side of Creditors a/c	Bill accepted

g. Opening entries, closing entries, transfer entries, Dishonour of bill, rectification entries, Adjustment entries, Bad debts and Bad debts recovered are recorded in JOURNAL PROPER.
h. Miscellaneous transactions:
- ✓ Trade discount allowed/ received ---- Not recorded anywhere
- ✓ Cash discount allowed/received ------ In two/ Three columnar cash book
- ✓ A Dishonour of Bill receivable ----------- In Journal Proper
- ✓ A Dishonour of Discounted Bill receivable --------- In Cash Book
- ✓ An Endorsement of Bill receivable to creditor ------ In journal Proper
- ✓ An Endorsement of cheque to a creditor ------ In cash book
- ✓ Return of goods sold for cash and cash paid immediately -------------- In cash book but not in Sales returns book.
- ✓ Return of goods sold for cash and cash was not paid immediately ---- In Journal proper but not in Sales returns book.

8. *Trial Balance:*

a. Preparation of TB is third phase in accounting process.
b. Trial balance is not a conclusive proof of accuracy of books of accounts.
c. Trail balance is a statement and prepared as on particular date.
d. Trail balance contains all accounts i.e. personal, real and nominal a/c.
e. Methods of preparing TB----- Totals method, Balance method, Totals and Balance method.
f. Nil balance items are not showed in Trail balance under Balance method.
g. The difference between debits and credit balances of TB is transferred to Suspense a/c.
h. Suspense a/c is either personal or real or nominal. It may have Debit balance or credit balance.
i. Suspense a/c is shown in liability side of balance sheet f it has credit balance.
j. The object of opening suspense a/c is to avoid the delay in preparation of Final accounts.

9. *Rectification of errors:*

<table>
<tr><td>Stages</td><td colspan="2">One Sided error</td><td colspan="4">Two sided error</td></tr>
<tr><td colspan="7">Stage 1</td></tr>
<tr><td rowspan="2">Before preperation of Trial Balance</td><td colspan="2">Rectified through Rectification statement</td><td colspan="4">Rectification entry was recorded</td></tr>
<tr><td colspan="2">No rectification entry is recorded</td><td>Write the Wrong entry</td><td>Reverse the wrong entry</td><td>Write the correct entry</td><td>Rectification entry</td></tr>
<tr><td colspan="7">Stage 2</td></tr>
<tr><td rowspan="2">After preperation of TB but before preperation of Final accounts</td><td colspan="5">Suspense account was created</td><td></td></tr>
<tr><td colspan="2">Rectified Through Suspense account</td><td colspan="4">Same as 1st stage</td></tr>
<tr><td>Stage 3</td><td colspan="6">Suspense account is shown in Balance sheet as asset or liability</td></tr>
<tr><td rowspan="2">After preperation of Final accounts (error identified in next period)</td><td>Error related to Nominal account (Prior period items)</td><td>Through P&L adjustment account and suspense account</td><td colspan="4" rowspan="2">Same as Second stage. If rectification entry contains any nominal accounts, then on behalf of nominal account we use Profit and Loss adjustment account.</td></tr>
<tr><td>Error related to Balance sheet item</td><td>Through Suspense account and respective balance sheet item</td></tr>
</table>

10. *Bank Reconciliation Statement:*

- ***a.*** Bank passbook is the copy of the customers copy in the books of Bank.
- ***b.*** BRS is the statement showing the causes for the difference between the balance as per bank column of cash book and balance as per Pass book.
- ***c.*** BRS is prepared by the customer of bank on particular date.
- ***d.*** It is not part of Books of accounts. It is prepared periodically.
- ***e.*** Favourable balance = Debit balance as per Cash book = Credit Balance as per Pass book
- ***f.*** Overdraft balance = Credit balance as per cash book = Debit balance as per pass book
- ***g.*** Favourable balance is shown under Assets side and OD balance is shown under Liability side of balance sheet.
- ***h.*** Causes for the differences are ------ Timing difference and Errors in cash book or pass book.

<table>
<tr><td rowspan="3">Causes for differences</td><td rowspan="2">Timing difference</td><td>Transactions appearing in cash book but not in pass book</td><td>Uncollected cheques and Un presented cheques</td></tr>
<tr><td>Transactions appearing in Pass book but not in Cash book</td><td>Bank charges, Interest allowed by bank, Expenses directly paid or income directly received by banker</td></tr>
<tr><td>Errors</td><td>Errors in cash book</td><td>Errors in pass book</td></tr>
<tr><td>Items to be adjusted in Amended cash book and not appears in BRS</td><td colspan="3">Errors in cash book, Transactions appearing in pass book but not in cash book like bank charges, interest allowed by banker etc.,</td></tr>
<tr><td>Items not to be adjusted in adjusted cash book but appears in BRS</td><td colspan="3">Uncollected cheques, Unpresented cheques and Errors in pass book</td></tr>
<tr><td colspan="4">In Balance sheet Bank balance as per Adjusted cash book appears and not as per the pass book</td></tr>
<tr><td colspan="4">In the absence of Adjusted cash book, Balance as per bank column of cash book appears in Balance sheet</td></tr>
</table>

11. *Inventories:*

- a. Inventory includes Raw material, WIP, Finished goods and consumables also. But it does not include machinery spares if their use is irregular in business.
- b. **Purpose:** (a) True profits; (b) Financial Position; (c) Liquidity and (d) Compliance with AS-2

c. **Nature:** Inventory is part of current assets and also working capital; Inventory excludes plantation products.
d. Inventory valuation effects tax liability but not effect cash flows.
e. Cost of Goods sold = Opening stock+ Purchases+ Direct expenses- Closing stock
f. Cost of goods available for sale = Opening stock+ Purchases
g. If COGS, Cost of goods available for sale is given, then closing stock= Cost of goods available for sale- COGS
h. Adjusted Purchases= Opening stock+ Purchases- Closing Stock
i. Net sales = Gross sales- Sales returns
j. Net Purchases = Purchases- purchase returns- goods issued as charity, donation, free samples etc.,
k. Inventory should be valued at Cost or Net realisable value whichever is lower.
l. Cost means Historical cost and includes Cost of purchase, Conversion cost and other cost incurred for bringing the goods to godown.
m. In case of stores ledger, The total of Receipts columns represents Cost of goods available for sale, the total of Issue column represents Cost of Goods sold and Balance column represents Closing stock.

i. "Cost" **excludes** - Storage Costs, Interest costs, Abnormal Losses, Administration OH, Selling & Distribution OH
j. **Net Realisable Value:** Estimated Selling Price (Less) Estimated Costs of disposal / making the sales
k. In case of inventory not ordinarily interchangeable, Specific identification method is useful. Actual cost specifically identified for each good and is useful for high value assets, Customised products etc.,
l. In balance sheet stock as per books appears, but not as per physical stock verification.

m. FIFO Vs LIFO Method:

Particulars	FIFO Method	LIFO Method
Assumption	Goods coming in first will go out first	Goods coming in later will go out first.
Closing Stock	Closing Stock consists of latest purchases	Closing Stock consists of earlier purchases
Valuation	Closing Stock will be valued at the Current market prices.	Closing Stock will be valued at the prices of initial purchases
Inflation - Prices Increase / rising prices	Value of Closing Stock will be higher Cost of Goods Sold will be lower	Value of Closing Stock will be lower Cost of Goods Sold will be higher
Deflation - Prices decrease /falling prices	Value of Closing Stock will be lower Cost of Goods Sold will be higher	Value of Closing Stock will be higher Cost of Goods Sold will be lower
Matching of costs	Current Costs are NOT matched with the current revenues	Current Costs are MATCHED with the current revenues
Recognition	Approved by AS-2	NOT approved by AS-2

n. Simple Average Cost Vs Weighted Average Cost:

Particulars	Simple Average Cost	Weighted Average Cost
Formula	**Cost p.u. =** Sum of all purchase prices / No. of purchases	**Cost p.u. =** Sum of all purchase values/ Sum of purchase quantities
Recognition	**NOT** approved by AS-2	Approved by AS-2

o. Retail Selling Price Method/ Adjusted Selling Price Method:

Applicability: (a) Retail Traders (b) Inventories are small and not significant (c) Similar Gross Profit Margins	
Calculation: Basic Formula: Cost of Goods Sold + Gross Profit = Selling Price	

p. Steps involved in Retail Selling Price Method:

a) In the sum, Selling Price will be given.
b) GP Ratio will be given - GP Ratio may be given as GP Ratio **ON SALES** or GP Ratio may **ON COST**
c) <u>**If GP Ratio is given on Sales:**</u>
Step 1 - (GP Ratio/100) x Selling Price = G.P Amount
Step 2 - Cost of Goods Sold = Selling Price - G.P Amount
Step 3 - Cost of Goods Sold (from Step 2) =
Opening Stock (given)+Purchases (given)+Direct Expenses (given) - Closing Stock (to be found)
d) <u>**If GP Ratio is given on Cost:**</u>
Step 1 - Since GP Ratio is on cost, but we do not know cost, assume Cost be "X".
Step 2 - Formula - Cost of goods sold-I- GP = Sales = > X + (G.P.Ratio/100) x (X) = Sales
Step 3 - From Step 2, Cost of goods sold shall be obtained and based on that, Closing Stock will be found.

Inventory Systems

Particulars	Perpetual	Periodic
Meaning	Continuous updating of stock records - Receipts & issues are immediately recorded	Ascertaining closing stock by taking actual physical count at a particular date. It is also called as Physical inventory system.
Stock value	Stock value can be known at any point of time	Stock value will be known only at end of fixed period
Nature	Stock Ledger maintained - FIFO, LIFO etc	Physical Verification of closing stock is made

Note: Inventory control system is possible only under perpetual inventory system.

Reconciliation of Stock as per Physical Verification and Stock as per Stock Ledger

(assumed that Physical verification made on a date after the Balance Sheet date - after 31st March)

	Particulars	Rs.	Rs.
	Cost of Stock as per Physical Verification (given in the question)		
Less:	Purchases during the period		
Add:	COST of Sales during the period - If sales is given, then find out the cost of such sales using the GP Ratio - follow the steps under "Retail Selling Price Method"		
Add:	Purchase Returns during the period		
Less:	Cost of Sales Returns during the period - If GP Ratio is given, find out the cost - Steps are similar to that under Retail Selling Price Method		
Add:	Cost of Consignment Stock with Consignee (not available physically with consignor)		
Less:	Cost of Stock received on consignment (available with him, but does not belong to him)		
Add:	Cost of goods sent on approval - for which APPROVAL NOT RECEIVED - Sales value of goods sent on approval will be given. % of goods approved will also be given. With this, find out % of goods not approved. Find out the cost of such unapproved goods using G.P.Ratio- Same as retail selling price		
Add / Less:	Any error in the Stock Sheet		
	Cost of Closing Stock as per Books		

q. **Note:** If physical verification is made on a date before the balance sheet date, then all the above adjustments are to be reversed (**EXCEPT** Stock sent on Consignment, Stock Received on Consignment, Sale or Return transactions).

12. Depreciation

1. **Meaning:** Arises due to (a) Natural wear and tear (b) Use (c) Consumption (d) Efflux (passage) of time (e) Obsolescence through technology and market changes - due to external causes beyond the asset itself)
2. **Applicability:** Depreciation is calculated on Fixed Assets and NOT on Current assets.
3. **Coverage:** Depreciation - Tangible Fixed Assets; Amortisation - Intangible Fixed Assets like patents.
4. **Nature:** It is an expense and a charge against profits; Mandatory to provide depreciation irrespective of profits or losses.
5. **Period of depreciation:** Depreciation is computed from the date it is ready for use.
6. **Purpose:** Systematic Allocation of the cost of the fixed asset over its useful life.
7. **Exception:** Land is not subject to depreciation because it has an indefinite Life.
8. **Rate of depreciation:** Schedule XIV of the Companies Act, 1956 deals with rates of depreciation.

Methods of Accounting;

(a) Asset Credit Method - Fixed Asset is directly credited for depreciation.

(b) Provisioning Method - Provision for Depreciation is credited. Provision for depreciation is a liability and is shown as deduction from the respective fixed asset in the Balance Sheet.

(c) Provision for depreciation is shown either on liability side of Balance sheet or as a reduction from Assets.

Terms in relation to depreciation

Historical Cost/Original Cost - Amount actually spent for purchasing the asset + other necessary expenses

Estimated Net Residual Value = Expected Sale Value (-) Expenses for making the sale / disposal / repairs. Otherwise called as Scrap Value

Depreciable Amount = Historical Cost - Estimated Net Residual Value (or) Scrap Value

Written Down Value/Book Value = Historical Cost-Depreciation

Useful Life - No. of years benefits will be received or no. of production units / hours that can be used

Methods for depreciation

Method	Important Features
Straight Line or Fixed Instalment (E.g. Buildings)	• Benefits from the asset are uniform - Depreciation amount is uniform every year • Amount of Depreciation = (Historical Cost - Scrap Value) / Useful life • Rate of Depreciation = Amount of Depreciation/Historical Cost • Balance at the end of useful life is ZERO (if scrap value is Nil) or Scrap Value • If rate is given, amount of depreciation = Historical Cost x Rate of depreciation • **Demerit:** Ignores the variations in the asset use
Written Down Value or Reducing Balance (Eg. Machinery)	• Benefits from the asset decrease - Depreciation also decreases • Amount of depreciation -1 Year = Historical Cost x Rate of Depreciation • Amount of depreciation - Next years = WDV x Rate of Depreciation • Balance at the end of useful life shall NEVER be ZERO.

Method	Important Features
Sum of digits of years	• Depreciation amt.= Depreciable Amt. x No. of balance years (incl. Current year) ÷ Sum of the years in the useful life of the asset • Depreciation amount will decrease every year. Variation from WDV Method
Machine Hour	• Depreciation amt. = Depreciable Amt. x No. of Machine Hours used in Current year ÷ Total No. of Machine Hours the machine can be used • Depreciation amount may increase or decrease (based on use of machine hours)
Production Units	• Depreciation amt.= Depreciable Amt. x No. of Units produced in Current year ÷ Total No. of Units that can be produced by the machine • Depreciation amount may increase or decrease (based on No. of units produced)
Depletion	• Useful for **wasting assets** Eg. Coal Mines, Oil Wells, Quarries etc. • Depreciation amt.= Depreciable Amt. x No. of Units extracted in Current year ÷ Total No. of Units that can be extracted from the asset • Depreciation amount may increase or decrease (based on No. of units extracted)
Annuity (For e.g. Long Term Leases)	• Notional Interest is calculated under Annuity Method - Interest Debited to Asset A/c • Interest calculated on the Opening WDV of the asset ; • Amount of Depreciation = Historical Cost x Annuity Value (given in question) • Amount of Depreciation shall be uniform throughout the life of the asset.
Sinking Fund	• **Purpose:** To provide funds at the end of the useful life of fixed asset for its replacement • **Amount of Depreciation:** Historical Cost x Sinking Fund Value • **Features:** Amount equal to depreciation is invested outside in Specified investments; • **Accounts involved:** Sinking Fund A/c and Sinking Fund Investment A/c (SFI A/c) • **Sinking Fund A/c:** Depreciation, Profits on sale of SFI transferred to Sinking Fund A/c • **Balance in Sinking Fund A/c** transferred to P&L A/c or General Reserve

Factors of Depreciation and Change in them

Factor	Change in factor
Book Value	Changes will be given prospective effect; New Amount of depreciation **= [(Existing Book Value ± Increase / Decrease) - Residual Value] / Remaining useful life**
Useful Life	Changes will be given prospective effect; New Amount of Depreciation **= [Existing Book Value- Residual Value] / Remaining years in the Revised useful life**

Residual Value	Changes will be given prospective effect; New Amount of Depreciation **= [Existing Book Value- Revised Residual Value] / Remaining useful life**
Depreciation Method	Changes will be given retrospective effect; Amount of past depreciation to be provided due to change - Step I: Determine the Book Value under the Old Method till date of change Step II: Determine the Book value under the New Method till date of change Step III: Find out [Step I - Step II]; If Difference is (+) = Profit, Credit P&L A/c; if Difference is (-) = Loss, Debit P&L A/c Change in Method of Depreciation can be made for: Compliance with Law / Statute / AS (b) For better presentation of financial Statements

Revaluation of Fixed Assets

1. **Upward Revaluation:** If the Fixed Asset is revalued and the value is increased, then the profit on such revaluation shall be credited to REVALUATION RESERVE A/c.
2. **Downward Revaluation:** If the Fixed Asset is revalued and the value is decreased, then the loss on such revaluation shall be debited to PROFIT AND LOSS A/C.

Note:

- ✓ AS-2 recommends SLM and WDV methods of depreciation. IT authority recommends only WDV method.
- ✓ In case of idle asset, under production unit's method, Depreciation provided is Zero.
- ✓ When compared to SLM vs. WDV, Higher depreciation is provided under SLM and lower depreciation is provided under WDV.

13. CONSIGNMENT

1. **Meaning:** "Consignment" means "To Send". Goods are sent from one person Consignor - (Principal) to another person Consignee - (Agent) on behalf of and at the risk of Consignor;
2. **Nature:** Profits / Losses belong to Consignor; Commission is given to Consignee;
3. **Pro-forma Invoice:** Invoice sent by Consignor to Consignee along with goods;
4. **Account Sales:** Statement sent by Consignee to Consignor;
5. Ownership of consigned goods - lies with the consignor
6. **Accounts maintained:**

Books of Consignor		
Consignment A/c	Nominal A/c	To determine profits
Goods Sent on Consignment A/c	Real A/c	To record the goods sent
Consignee A/c	Personal A/c	Amt paid or reed, from him
Consignment Stock	Real A/c	Cl. Stock belongs to Consignor
Consignment Debtors	Personal	To record Cr. Sales, if Del Credere Commission not paid
Stock Reserve	Nominal A/c	Reverse unrealized profits in Cl. Stock (in case of loading)
Abnormal Losses	Nominal A/c	To record losses of goods due to accident etc.
Consignor A/c	Personal A/c	Amt paid or reed, from him
Commission A/c	Nominal A/c	To record the commission income from consignor
Bad Debts A/c	Nominal A/c	To record Bad Debts, if del Credere Commission is given

Determination of Profits for the Consignor (Books of consignor)

Prepare Consignment Account – Exactly/ SIMILAR To TRADING A/c

Particulars	**Rs.**	**Particulars**	**Rs.**
To Opening Stock A/c			
To Goods Sent on Consignment A/c - (Cost price or Loading Price)		By Goods sent on Consignment A/c - (Profit or Loading in Goods sent)	
To Bank - Expenses paid by Consignor			
To Consignee - Expenses paid by Consignee		By Consignee A/c - Cash Sales	

To Consignment Debtors A/c - Disc. Allowed		By Consignment Debtors A/c - Credit Sales	
To Consignment Debtors A/c - Bad Debts (if del Credere Commission is not given)		By Abnomal losses A/c	
To Consignee A/c – Commission			
To Stock Reserve A/c - (Unrealised profits on Closing Stock)		By Closing Stock A/c - (at Cost Price or Loaded Price)	
To Profit on Consignment A/c (Bal. fig.)		**By Loss on Consignment A/c (Bal. fig.)**	
Total		**Total**	

Notes:

1. Consignment account will come in the books of the Consignor only and not in Consignee Books.
2. Profits or losses on Consignment A/c shall be transferred to Profit and Loss Account.

Types of Commission(Unless otherwise stated every commission is calculated on total sales only)

1. **Normal Commission -** Calculated as a % on Total Sales Value
2. **Over Riding Commission -** Calculated as a % on Excess Sales Value over and above the sale value calculated at a prescribed rate. It is given to promote additional sales by the consignee
3. **Del-Credere Commission -** Risk of bad debts borne by consignee. It is calculated on TOTAL SALES.
4. **Notes -** Journal Entry for Credit Sales in the Books of Consignor:

If del credere commission is not given	If del Credere Commission is given
Consignment Debtors A/c Dr To Consignment A/c	Consignee A/c Dr To Consignment A/c

If Del-credere commission is given, then bad debts are responsible for consignee. Bad debts are recorded in consignee books and is adjusted against Commission received.

Notes:

1. **Normal Loss -** Loss which cannot be ignored / avoided; **Abnormal loss -** Avoidable losses, accidents etc.
2. Godown Rent, Godown Insurance, Interest paid, Selling Expenses, Advertisement, Transport to Customer' place are to be **EXCLUDED** in valuation-of Closing Stock.
3. For valuing Closing Stock, All **proportionate** expenses incurred by Consignor included
4. Closing stock valuation is effected by Normal loss.

Valuation of Abnormal Loss

1. **Inclusions:** All the costs incurred till the point of abnormal loss. i.e. If Loss happened during transport from Consignor to Consignee's place, Consider all the expenses of consignor till the accident - i.e. Purchase price, Loading Charges, Freight and Transit Insurance.
2. **Abnormal loss incurred either during the transit or at the consignee's place.**
3. If loss incurred at consignee place, then Cost price + Proportionate expenses incurred by consignor + Proportionate non selling expenses incurred by consignee is considered for Valuation of abnormal loss.
4. **Net loss to be transferred to P&L a/c**=Gross Abnormal losses - Insurance Compensation

Summary for Valuation

Particulars	Valuation of Closing Stock	Valuation of Abnormal Loss
Expenses of Consignor	Always include	Always include
Selling Expenses of Consignee	Always exclude	Always exclude
Non-Selling Expenses of Consignee	Always include	• If Loss incurred during transit – not Include • If loss incurred at consignee place - include

14. JOINT VENTURE

1. **Meaning:** Partnership for specific period or specific purpose - Temporary Partnership
2. **Nature:**
   a) **Going Concern Assumption is not followed**
   b) Accounting is based on Liquidation / Realisable basis
   c) Parties in a Joint Venture are called as "Co-venturers"
3. **Capital vs Revenue:** Distinction between capital and revenue expenditures NOT made. Hence, Profits shall be determined considering both capital and revenue expenditure.

4. **Method of Accounting:**
   a. **Separate Books Maintained for JV -** The following accounts are maintained **SEPARATELY:**
      - **Joint Bank Account -** Personal Account - To record all bank transactions
      - **Joint Venture Account** - Nominal Account - To determine the profits
      - **Co-Venturer's Account** - Personal Account - Similar to Capital Accounts

   b. **Separate Books NOT Maintained for JV** - But Each co-venturer records ALL transactions:
   The following accounts are opened in the books of **each co-venturer:**
      - **Joint Venture Account -** Nominal Account - To determine the profits
      - **Co-Venturer's Account -** Personal Account - Records transactions in which other co-venturer is involved

   c. **Separate Books NOT Maintained for JV** - Each co-venturer records HIS OWN transactions:
   The following accounts are opened in the books of each co-venturer:
      - **Memorandum Joint Venture Account** - Nominal Account - To determine the profits - Not **part of Accounts books.**
      - **Joint Venture with other venturer Account -** Personal Account - Records transactions in which he is involved. Transactions involving the other venturer will be ignored. It represents amount Due to Other coventurer or amount due from other coventurer.

5. Other Points:
   a. In case of abnormal loss no entry was recorded. Insurance claim realised is considered as income and credited to Joint venture a/c
   b. If the Goods costing Rs.20,000 was lost and nothing was recovered ------ No entry was recorded
   c. If the Goods costing Rs.20,000 was lost and Rs.15,000 was recovered from insurance company ------- only Rs.15,000 is credited Joint venture a/c.
   d. If the Goods costing Rs.20,000 was taken over by Co-venturer for Rs.18,000. Then Stock taken over by co-venturer credited to Joint venture a/c is Rs.18,000.

15. BILLS OF EXCHANGE

Features of Promissory Note / Bill of Exchange

Particulars	**Promissory Note**	**Bill of Exchange**
Nature	Unconditional Undertaking to pay	Unconditional Order to pay
Parties	Maker and Payee	Drawer, Drawee and Payee
Authorisation	It is signed by the maker	It is signed by the drawer
Example	Rupee Note	Bills drawn during normal business
Liability	Primary Liability is on the Maker	Primary liability on the drawee Secondary liability on the drawer

Note: If A sold goods to B. then
- ✓ A draws a bill on B in case of Bill of exchange
- ✓ B draws a promissory note on A.

Calculation of Due Dates

H elated Terms	Sight - Means Acceptance Grace days – 3
Specified days **after sight**	Count specified days from the date immediately after the date of acceptance and also include 3 grace days.
Specified Months **after sight**	Add 3 Months directly to the **date of acceptance** and include 3 grace days
Specified days / Months **after date**	The Starting date shall be **date of drawing**
When Due date is **public holiday** and known before	The Due date shall be the **immediate preceding Business** (Working) day
When Due date is public holiday & declared **suddenly**	The Due date shall be the **immediate succeeding Business** (Working) day

Special Situations

Retirement	When bills are paid before the due date. Calculate **Rebate** (called discount / Interest) = Amount paid x Int. Rate x No. of days or Months between date of payment & maturity date ÷ 365 or 12

Renewal	When bills are not paid on due date and are renewed for further period. Calculate **Interest=** Amount Unpaid x Int. Rate x No. of days or Months between date of renewal & fresh due date ÷ 365 or 12
Discounting '	The bills are discounted with the banker by the drawer and Money is received from the bank Discount will be deducted by the bank **Discount =** = Amount of Bill x Int. Rate x No. of days or Months between date of discounting & due date 365 or 12 If the drawee does not pay, then the bank can recover the money from the drawer.
Dishonour	• **Rejection** of the bill of exchange by the Bank • On Rejection, Noting Charges will be paid to the Notary Public by the Drawer. • If the drawee is insolvent, then final dividend / recovery shall be made as "Specified paise for every rupee" i.e. 60 paise for every rupee => If total bill amount is Rs. 10,000 + **Noting Charges** Rs.500 = Total Dues is Rs.10,500 => Amount recovered = 10,500 x 0.60 = 6,300 • Dishonour of bill recorded is in Bills receivable Book.
Endorsement	• When the bills receivable is transferred in favour of any other person by the drawer • Transferor-Endorser; Transferee-Endorsee

Accommodation Bills

a) **Meaning:** Bills drawn by one trader on another, when they are in need of funds.
b) **Feature:** There is no sale / purchase by one party on the other.
c) Discounting: The drawer of the above bill will discount the bill with the bank and share the proceeds.
d) **Discount Charges** are **shared** by both the parties in the ratio in which they share the amount of bill.

Note:

i. If the number of promissory notes are prepared, those are recorded in Bills payable book
ii. If the number of Bills prepared by the company, then those are recorded in Bills receivable book
iii. Rebate on bill is expense to Drawer and income to Drawee.
iv. Noting charges are first borned by the holder of bill.
v. In case of accommodation of bills, Discount charges are divided in the ratio in which net proceeds are shared by both parties.

16. SALE ON APPROVAL BASIS

1. **Meaning:** Goods are sent but Sale happens only if approval is given by the receiver.
2. **Modes of Approval:** (a) Direct Approval (b) Doing something which implies (indicates) approval and (c) when approval is not given within specified time / reasonable time, the goods are deemed as approved.
3. **Method of Accounting -** 3 Methods based on the volume of transactions
   a) **I Method - Transactions are very less / rare - Ordinary sale Method is followed -** When goods are sent, it is treated as sale and reversal is made for those goods not yet approved by customer.
   b) **II Method - Transactions are frequent, but not numerous -** Sale or Return Journal is prepared - It is 16-columnar table containing details of goods sent, goods approved, goods returned and closing stock. Entry is passed only if the goods are approved and for closing stock?
   c) **III Method - Transactions are frequent and numerous -** Two Books Maintained -

$$\left.\begin{array}{l}\text{Sale or Return Journal} - \text{Same as Method II}\\ \text{Sale or Return Ledger} - \text{Same as Method I}\end{array}\right\}\text{Momorandum Records. They do not form part of the Accounts Books}$$

4. **Final Stock lying with the customers** belong to the sender and hence **recorded at cost** in the books of sender as "Stock on Approval basis".
5. **In Stock Reconciliation Statement,** the cost of such goods shall be added to physical stock to arrive at the book stock.

FINANCIAL STATEMENTS OF SOLE PROPRIETORSHIP CONCERNS

1. Financial Statements - Consists of (a) Income Statement; (b) Balance Sheet and (c) Cash Flow Statement
2. **Manufacturing Account - Prepared only by Manufacturing entities - Period Statement**
   a) **Purpose:** Used to find out the Cost of Goods Manufactured; Always contain Debit balance;
   b) NRV / Scrap Value of by products / damaged raw materials will be credited to Manufacturing A/c
   c) Balance in Manufacturing A/c transferred to the Trading Account
   d) Contains on the debit side -
      - Factory and Production related expenses.
      - Opening WIP is added and Closing WIP is deducted.
   e) Manufacturing account is always closed by transferring to Trading a/c.
3. **Trading Account - prepared by Manufacturing and Trading entities - Period Statement**

a) It is used to determine Gross Profits of the business.
b) It contains all expenses relating to Trading Operations i.e. buying and selling
c) It is to be credited by Abnormal loss, if any and Closing Stock (if not adjusted in purchases)
d) If the Manufacturing Account is prepared, then all the production expenses like wages, electricity shall be transferred to Manufacturing A/c.

4. Profit and Loss Account - prepared by Manufacturing and Trading entities - Period Statement

a) It is used to determine the Net Profits of the business.
b) **Debit Side items -** Indirect Expenses, Administration OH (not related to production), Selling and Distribution OH, Losses and Provisions
c) **Credit Side items -** Gross Profit, Interest received, Dividend received, revenue profits on sale of fixed asset, insurance claim received for loss of stock etc.

5. Balance Sheet - Positional Statement -

a) Balance Sheet explains the Financial Position of the Enterprise as on a particular date.
b) It consists of assets and liabilities of the business
c) 2 Approaches for preparation - Permanence Approach:
- On Liabilities Side, Long Term Liabilities are shown first and then Current Liabilities are shown.
- On Assets Side, Fixed Assets are shown first and then Current Assets are shown.

d) Liquidity –
- On Liabilities Side, Current liabilities are shown first and then Long Term Liabilities are shon.
- On Assets Side, Current Assets are shown first and then Fixed Assets are shown.

Balance Sheet as at 31st March, (under Permanence Approach)

Liabilities	Ms.	Rs.	Assets .	Rs.	Rs.
Capital		XXX	Fixed Assets		XXX
Reserves and Surplus Profit and Loss Account General Reserve Capital Reserve	XXX XXX XXX	XXX	Historical Cost Less: Provision for depreciation		XXX XXX
Secured Loans		XXX	Long Term Investments		XXX
Unsecured Loans		XXX	Short Term Investments		XXX
Current liabilities & Provisions,			Current Assets		XXX
Bank O/D Sundry Creditors Bills Payable Provisions for repairs O/s Expenses Incomes Received in advance	XXX XXX XXX XXX XXX XXX	XXX	Closing Stock Bills Receivable Sundry Debtors Less: Provision for bad debts Less: Provision for discount on debtors Cash at Bank Cash in Hand	XXX (xx) (xx)	XXX XXX XXX XXX XXX
Total		**xxxx**	**Total**		**xxxx**

6. Provision for Bad Debts:

a) Computation of Closing Provision - [Debtors - FRESH Bad Debts (Note)] X % of provision Note: New bad debts (unaccounted) should only be deducted; Bad Debts written off should not be deducted
b) Computation of amount to be transferred to Profit and Loss Account:
= Closing Provision + Total Bad Debts (Fresh + Old) - Opening Provision

7. Provision for Discount on Debtors

a) Computation of Closing Provision -
= [Debtors - FRESH Bad Debts (Note) - Closing Provision for bad debts] X % of provision **Note:** New bad debts (unaccounted) should only be deducted; bad debts written off should not be deducted
b) Computation of amount to be transferred to Profit and Loss Account:
= Closing Provision + Total discount allowed - Opening Provision

8. Provision for Discount on Creditors

b) Computation of Closing Provision = [Creditors] X % of provision
c) Computation of amount to be transferred to Profit and Loss Account:

= Closing Provision + Total discount received - Opening Provision

9. **Computation of Manager's Commission:**
   a) Before Charging such commission-Net profits x Rate of Commission ÷ 100
   b) After Charging such commission - Net profits x Rate of Commission ÷ (100+ Rate of commission)

Note:

i. If adjusted purchases or COGS is given in Trial balance, then Closing stock is shown in TB, but not Opening stock
ii. If adjusted purchases is not given inside the TB, then opening stock and purchases are shown, but not closing stock
iii. Wages and salaries are shown in Trading a/c. Salaries and wages are shown in Profit and loss a/c.
iv. If closing stock, Outstanding exp, Prepaid exp, Accrued Income, income received in advance is given in TB, these appear only in Balance sheet and not in income statement.
v. Income tax paid by proprietor appears in TB, then debited to capital/ drawings a/c.
vi. Provision for Discount on Debtors is always calculated after deduction of Provision for bad and doubtful debts.
vii. If the opening and adjusting entries are not passed both trial balance and balance sheet will be tallied.
viii. Grouping means putting the similar nature of items under a common head.
ix. Marshalling means order in which the various assets and liabilities are arranged in balance sheet.
x. Bad debts, Discount allowed, Discount received a/c appears in TB,
   a. If no respective provision exist ------- appear in income statement
   b. If the respective provision exists----- appear in the respective provision a/c
xi. Provision for discount on creditors is of debit balance item.
xii. Raw Material Consumed = Opening Raw material + purchases – Closing Raw Material
xiii. Prime Cost = Direct material+ Direct wages+ Direct Expenses
xiv. Cost of goods manufactured = Raw material consumed+ opening WIP- closing WIP + manufacturing wages
xv. Cost of goods manufactured sold = Cost of goods manufactured+ Opening finished goods- closing finished goods

ACCOUNTING FOR PARTNERSHIP FIRMS

1. **Meaning:** Agreement between persons, who have agreed to share the profits or losses of the business carried on by all or any of them acting for all.
2. **Relevant Law:** The Partnership Act, 1932
3. **Partnership Deed:** A registered agreement between the partners explaining the terms and conditions of their partnership including those relating to sharing of profits, Remuneration, Interest on Capital, Interest on drawings etc.
4. **Absence of above terms:** In the **absence of agreement** among the partners,

Interest on Partners' Capital , Interest on Partners' drawings, Partners' Remuneration	Shall Not be charged / allowed
Profits / Losses Sharing Ratio	Equal
Interest on Partners' Loan	6% p.a. (maximum)

Types of Capital

a) **Fixed Capital -** The capital account balance does not changes. All transactions affecting Capital A/c relating to Interest on capital / drawings, remuneration, commission etc. are not recorded Capital Account but are recorded in a separate A/c called "Current A/c".
   ✓ Capital account always shows Credit Balance and Current account shows either Dr or Cr balance
   ✓ Interest on capital is calculated on Capital account balance only.

b) **Fluctuating Capital -** All the above transactions are directly recorded in the Capital Account and hence capital account balance will change from one year to another.

Special Points:

1. **Interest on Capital**
   ✓ Interest on capital is provided only if it is provided by agreement and firm has profits.
   ✓ In case of losses no interest on capital is provided
   ✓ In case of insufficient profits, Profits will be distributed in Capital ratio in the form of interest on capital
   ✓ In case date of introduction of capital is not given, then 6 months is considered.
2. **Calculation of Interest on Drawings:** Total Drawings x Interest Rate x Multiplication Factor
   a. If the fixed amount is drawn at regular intervals of time, then

Time of drawings	Multiplication Factor	Time of drawings	Multiplication factor
Beginning of every month	6.5/12	Beginning of each quarter	7.5/ 12

Middle of every month	6/12	Middle of each quarter	6/12
End of every month	5.5/12	End of each quarter	4.5/12

Note: a) Where the date of drawings not given, multiplication factor will be 6 / 12

b) Variable amount is drawn at various dates: then we will use the Product method.

3. **Interest on Loans and Advance:** This is charge against profit and transferred to profit and loss a/c. In the absence of agreement interest is 6%p.a. simple interest.
4. **Remuneration to partner:**
   - ✓ It is considered as Appropriation out of profits and includes salary or commission paid to Partner.
   - ✓ If Profit before charging commission is given, Commission is 10% of Profit after charging commission, then
     Commission = Profit before charging commission X Rate/(100-rate)
   - ✓ If Profit after charging commission is given, Commission is 10% of Profit before charging commission, then
     Commission = Profit after charging commission X Rate/(100+rate)
5. Rent paid to the partner is a charge, not an appropriation.

Guaranteeing Profits for a particular partner

1. Any of the partners may be guaranteed a minimum share of profits by all or some of the remaining partners.
2. In case his share of Profits < Guaranteed profits, the deficit should be paid by the remaining partners or the agreed partners in their profits sharing ratio or any other agreed ratio.
3. If the all the remaining partners gives guarantee to the incoming partner in their profit sharing ratio, then that guarantee is called as Firm Guarantee.
4. Journal entry is:
   Guranteeing partner's capital a/c Dr
   To Guaranteed partner's capital a/c

Goodwill

1. **Nature :** Goodwill is an intangible asset
2. **Only purchased Goodwill is shown in the financial statements. Excess of Net assets over Purchase consideration is considered as Purchased goodwill.**
3. **Two types:** (a) Purchased Goodwill (Actually bought) (b) Self Generated Goodwill (created by own efforts)
4. **Methods for valuation of goodwill:**
   a. **Average Profits Method:** Average Actual Profits x No. of years of purchase
      Note: Average Actual Profits = Profits for no. of years given No. of years
   b. **Super Profits Method:**
      - **Goodwill =** Super Profits x No. of years of purchase
      - **Super Profits:** [Average Profits (similar to (a)) - Normal Profits]
      - Normal Profits = Actual Capital Employed x Normal Rate of Return (NRR)
      - Actual Capital Employed = [**Tangible** Fixed Assets + Current Assets - Current Liabilities]
5. **Discounting or Annuity Method:** Super Profits x Annuity Factor at given interest rate
6. **Capitalisation Method:**
   - **Goodwill =** Normal Capital Employed - Actual Capital Employed [given in (b) above]
   - **Normal Capital Employed** = Average Actual Profits [similar to (a) above] / NRR

Comparative study of Reconstitution of firm under various cases

S.No	Basis of comparison	Change in Profit sharing ratio	Admission	Retirement	Death
1	How can it be?	When partners so decide	With the consent of all the partners or in accordance with express agreement	With the consent of all the partners or in accordance with express agreement or In case of partnership at will, written notice to all the partners	
2	Ratios to be calculated	Sacrificing ratio/ Gaining ratio	SR = Old ratio - New ratio	GR = New ratio - Old ratio	GR = New ratio - Old ratio

3	**How to calculate the share of goodwill?**	Firm's goodwill X Share of gaining partner	Firm's goodwill X Share of Incoming partner	Firm's goodwill X Share of retiring partner	Firm's goodwill X Share of deceased partner
4	**Who has to compensate to whom?**	Gaining partner should compensate to sacrificing partner	Incoming partner should compensate to sacrificing partner	Existing partners should compensate to outgoing partner	Existing partners should compensate to outgoing partner
5	**Entry for goodwill**	Gaining partners capital a/c Dr TO Sacrificing partner's capital a/c	Incoming partners capital a/c Dr TO Sacrificing partner's capital a/c	Gaining partners capital a/c Dr TO Retiring partner's capital a/c	Gaining partners capital a/c Dr TO Deceased partner's capital a/c
6	**Profit/ Loss on revaluation**	All partner's in their profit sharing ratio	Old partners in Old ratio	All partners in old ratio	All partners in old ratio
7	**Entry for ravaluation profit (old ratio)**	Revaluation A/c Dr To All partner's capital a/c	Revaluation A/c Dr To Old partner's capital a/c	Revaluation A/c Dr To All partner's capital a/c	Revaluation A/c Dr To All partner's capital a/c
8	**Entry for ravaluation loss (old ratio)**	Reverse the above entry	Reverse the above entry	Reverse the above entry	Reverse the above entry
9	**Accumulated losses and reserves**	All partner's in their profit sharing ratio	Old partners in Old ratio	All partners in old ratio	All partners in old ratio

Calculation of new profit sharing Ratio and Sacrifice Ratio (for admission)

1. **Situation I: Old partners' old share is given; New Partner's share is also given -**
   a) Assume the total share is 1. Deduct the new partner's share.
   b) Balance Value shall be divided among the old partners in their Old Profit Ratio.
2. **Situation II: Old Partners' old share is given; New Partner's share is also given; Further, the sacrifice from each of the old partners is also given:**
   Deduct the amount of sacrifice given, from Old Partners' Old Share. The balance will be their new share
3. **Situation III: Old Partners' old share is given; AND New Partner's share is NOT given; But value of share SURRENDERED by the old partners in favour of the new partner is given:**
   a) Compute the sacrifice by each old partner using the formula = Surrendered Share x Old Profit share
   b) New Partners' Share = Sum of Sacrifice given by all the old partners
   c) Old Partners' New profit share = Old Share - Sacrifice [as per (a)]
4. **Situation IV: Old Partners' old share is given; New Partner's share is also given; The Old partners have to share the remaining profit share in an agreed ratio (given in the question):**
   a) Find the balance share available after deducting the New Partner's share.
   b) New Profit share for old partners = Divide above balance in the ratio as agreed between old partners

New profits sharing Ratio and gaining Ratio (for retirement / Death)

1. **Situation I: All partners' share is given i.e. 3:2:1; Profit share after retirement is not given-**
   a) Remove the profit share of the Outgoing Partner from the ratio.
   b) The remaining ratio shall be the new profit sharing ratio for the existing partners i.e. 3:2
2. **Situation II: All partners' share is given; Ratio in which the Outgoing Partners' share to be divided among the existing partners' also given:**
   a) Divide the outgoing partner's share in the agreed ratio.
   b) Existing Partners' New Ratio: Old Profit Share + value as per (a) above

Determination of Capital of the Partners (after Admission)

Date	Particulars	X	Y	Z	Date	Particulars	X	Y	Z
	To Accumulated losses	xxxx	xxxx			By Balance B/d	Xxxx	xxxx	
	To Goodwill (New Ratio)	xxxx	xxxx	xxxx		By Goodwill (old ratio)	Xxxx	xxxx	
	To Revaluation – Losses	xxxx	xxxx			By Reserves & Surplus	Xxxx	xxxx	
	To Bank A/c -Payment made on retirement					By Revaluation – Profits	Xxxx	xxxx	

	To Balance c/d	**xxxx**	**xxxx**	**xxxx**		By Bank - Capital by New Partner			Xxxx
	Total	**xxxx**	**xxxx**	**xxxx**		**Total**	**Xxxx**	**xxxx**	**Xxxx**

Non-Payment of money due to the executors of the dead partner:

a) **Option I -** Interest at 6% p.a. on the balance due to the dead partner

b) **Option II -** Proportionate share in the profits earned by the business for the remaining part of the year:

Profits x Amount due to the outgoing partner x No. of days / months outstanding ÷ 12 or 365

(Capitals of existing partner + Amount due to outgoing partner)

Joint Life Policy Account (JLP)

Point of discussion	**Particulars**
Meaning	Life Insurance Policy taken on all the partners together.
Accounting -1 Method	• JLP premium is treated as expenditure and written off in P&L A/c • At the time of maturity, entire JLP proceed shared among all the partners in the Profit Sharing Ratio (PSR).
Accounting - II Method	• JLP Premium is treated as asset to the extent of surrender value. • Excess of premium over surrender value is considered as loss and transferred to P&L a/c • Surrender Value means "value realized from policy if it is surrendered now" • In case of retirement, surrender value realised and transferred to JLP a/c and nothing was transferred to Partner's capital a/c • In case of Death, Policy amount realised, transferred to JLP a/c. The difference between policy amount and surrender value is considered as profit and transferred to partners capital a/c in PSR
Accounting - III Method	• JLP Premium treated as asset FULLY. • JLP Reserve is created for the entire premium paid by debiting to the P&L Account • The difference between JLP premium and Surrender Value is transferred from the JLP reserve A/c to the JLP A/c.

Note:

1. In case of Individual policies are taken by the firm,
    a. Death of partner ----- Policy amount of the Deceased partner and surrender value for the remaining partners will realised and total amount is shared among all partner in PSR.
    b. Retirement of partner ----- Surrender value for all policies will realised and total amount is shared among all partner in PSR.
2. If the Death of partner is made in between the accounting period, then profits up to the date of death is transferred to the deceased partner through Profit and loss suspense a/c.
3. Profit and loss suspense account is closed by transfer to profit and loss a/c at the end of the period or by transfer to partner's capital a/c in their PSR.
4. JLP premium a/c is of nominal nature, JLP a/c is of real a/c or asset, JLP reserve a/c is of personal a/c.
5. Credit Balance in Revaluation A/c - Profits; Debit Balance in Revaluation A/c - Losses
6. Revaluation A/c is in the nature of Nominal Account.
7. If the revaluation account is prepared, then all assets and liabilities are shown at the revalued figures only.
8. Where the assets / liabilities are shown only at original values, then Memorandum Revaluation A/c is opened
9. The first part of Memorandum revaluation a/c is shared among the Old partner's capital a/c in their old PSR and Second part transferred to the All partner's capital a/c in New PSR. (Admission)
10. The first part of Memorandum revaluation a/c is shared among the All partner's capital a/c in their old PSR and Second part transferred to the Existing partner's capital a/c in New PSR. (In case of retirement or Death)
11. **If the first part of Memorandum revaluation a/c shows profits, then second part shows loss.**

Company Accounts

1. Company is an association of persons and registered under provisions of companies act 2013 or under any previous law..
2. Features of company is :--- Artificial person, separation of management from ownership, Common seal, Limited Liability, Perpetual succession, Separate legal entity etc.,
3. Kinds of companies:

Type of company	**Nature**

Government company	Not less than 51% of **PAID UP CAPITAL** was held by CG or SG or combination of SG and CG
Statutory company	Registered under special act under central of state legislation
Foreign company	Registered outside india and having a place of business in India
Holding company and Subsidiary company	X holds not less than 51% of nominal value of Y ltd or controls the composition of its board of directors. Then X ltd is called as Holding company and Y ltd is called as Subsidiary company
One person company	Which has only one person as a member
Small company	Company other than public company, - Paid-up capital of which does not exceed Rs. 50 lacks or such higher amounts as may be prescribed which shall not be more than Rs. 5 crores or - Turnover of which as per its last profit and loss account does not exceed Rs.2 crores or such higher amounts as may be prescribed which shall not be more than Rs. 20 crores

Note: Audit of Statutory company and Govt. company was done but C &AG. The subsidiary of Govt. Company is also called as Govt. company

Particulars	**Private company**	**Public company**
Minimum paid up capital	Rs.1,00,000	Rs.5,00,000
Minimum no. of persons	2	7
Maximum no. of persons	200	Unlimited
Minimum no. of Directors	2	3
Restrictions in AOA	✓ Transferability of shares ✓ On maximum no. of members ✓ Not invite the capital or public deposits from public ✓ Not issue the prospectus	No such restrictions

Note: Public companies are either listed or unlisted companies. But private company is always Unlisted company.

4. Sec.128 --- Maintenance of Books of accounts --- Sales book, purchase book, Register of Fixed assets and liabilities, Cost records in case of manufacturing entities.
5. Sec.129 and Schedule III deals with preparation of financial statements.
   a. Part I --- Balance sheet as at (Vertical format only)
   b. Part II ---- Statement of profit and loss for the period ended
6. The total capital of company is called as Share capital and is divided into number of equal parts with fixed amount. Each part is called as Share and Fixed amount is called as Par value or Nominal value or Face value.
7. Shares are divided into two types ----- Equity shares and preference shares
   a. Preference shares are those shares which carries preferential rights as to payment of dividend and repayment of capital.
      i. They do not have any voting rights and carry fixed rate of dividend
      ii. Unless otherwise specified, preference shares are assumed to be (a) Cumulative (b) Redeemable, (c) Non-Participating and (d) Non-Convertible
   b. Equity shares means shares other than preference share capital and carried voting rights.
8. Types of share capital:
9. Minimum application money is 5%of Nominal value as per Companies act and 25% of issue price as per SEBI.
10. Public company can't make the allotment until the minimum subscription was received. Minimum subscription as per SEBI is 90% of issue. Allotment was done only with the approval of BOD.
11. If minimum subscription not received ---- Refund total amount within 15 days(Non underwriter issue) or 7 days (Underwriter issue) from closure of issue
12. **Issue of shares at par:** It means issue price and nominal value both are equal.
13. Issue of shares at premium ---- means Issue price > Nominal value. The excess of issue price over nominal value is Security premium (capital profit), shown under Reserves and surplus.
14. Purposes of utilization of Security premium (Sec.52)
    Fully paid Bonus shares, For Buy back of Equity shares, Writing of the Discount on issue of shares, Providing Premium of redemption of preference shares or debentures
15. Issue of shares at Discount ------ means Issue price < nominal value. The excess of Nominal value over issue price is Discount on issue of shares and considered as capital loss and shown under Other Non- current / Current assets and written off by charging to Security premium or P&L a/c over the period.
16. As per companies act,2013 Issue of shares at discount is not allowed except in Sweat equity shares.

17. In case of over subscription, BOD either reject the excess application and allot the remaining or Adjust the applied shares with the issued shares i.e. Pro-rata basis.
18. Calculation of Pro-rata allotment
    No. of shares applied by an applicant =
    [(Total No. of Shares Applied ÷ Total No. of Shares Allotted) x No. of Shares allotted to an applicant]
    No. of shares allotted to an applicant =
    [(Total No. of Shares Allotted ÷ Total No. of Shares Applied) x No. of Shares applied by an applicant]
19. Interest on Calls in arrears as per Table F is 10%p.a and on calls in advance is 12%p.a.
20. Interest on calls in arrears is calculated from members on the unpaid amount from the last date fixed to the date of actual payment.
21. Minimum time gap between two calls is One month.
22. While passing the an entry for Share forfeiture-----
    a. Share capital a/c is debited with Called up capital
    b. Share forfeiture account is Credited with Paid up amount
    c. Calls in arrears a/c is Credited with Unpaid up amount. In the absence of Calls in arrears a/c, respective Allotment or call a/c is credited.
    d. Security Premium a/c is Debited only if the SP is not received in cash.
23. Re-issue of shares is not an allotment and is considered as Sale and must be done through Auction only.
24. In case of re-issue
    a. Max loss allowed is Balance remaining in the share forfeiture a/c
    b. Share capital a/c is credited with Paid up capital and excess of re-issue price over the nominal value is credited with Security premium a/c
    c. If the shares are reissued at loss, then loss is debited to Share forfeiture a/c
    d. If the shares are originally issued at discount, the Discount or loss on re-issue is first debited to Discount on issue of shares and excess loss debited to Share forfeiture a/c.
    e. The balance remains in share forfeiture a/c relating to reissued shares is transferred to Capital Reserve.
    f. Share Forfeiture a/c is always shown as an addition to Share capital in Balance sheet.
    g. If the re-issued amount and forfeited amount taken together is more than the face value of reissued price then it is not necessary to transfer such amount to Security premium account.
25. The amount to be transferred to Capital Reserve shall be computed as follows:

Balance in Share forfeiture account for reissued shares		XX
Less: Difference between reissue price and called up value		(xx)
Net amount to be transferred to Capital Reserves per share (a)		XX
No. of shares reissued	(b)	XXX
Total Amount transferred to Capital Reserve	**[(a) x (b)]**	**Xxxx**

Redemption of Preference shares:

1. **Irredeemable:** It is not possible to issue preference shares which are irredeemable.
2. **Maximum period** for redemption of preference shares is 20 years
3. Only fully paid shares can be redeemed by company as per Sec.55
4. Redemption of preference shares cannot be constituted as reduction of Authorized capital.

Sources for redemption of preference shares:

Option I: Fresh Issue of shares (Equity shares or Preference shares)	Determination of no. of shares to be issued: **If new shares are issued at discount / face value:** Amount required for redemption / Issue price of new shares **If new shares are issued at premium:** Amount required for redemption / Face Value of new shares

Option II: Divisible Profits	**Divisible Profits:** Profits available for distribution as dividend **Inclusions:** P&L A/c (Cr.), General Reserve, Dividend Equalization reserve **Exclusions:** Capital Reserve, Capital Redemption Reserve, Revaluation Reserve, Securities Premium **Capital Redemption Reserve:** If shares are redeemed out of divisible profits, then the amount equal to the **face value of shares redeemed** out of such profits shall be transferred from such divisible profits to **"Capital Redemption Reserve A/c".**
Option III: Combination of both	a) Determine the Divisible Profits available b) Determine the amount of fresh shares to be issued = [Face Value of shares redeemed - Divisible Profits] c) No. of Fresh shares to be issued = Step (b) ÷ Issue Price (par/discount) OR Face value (premium)

Note:

✓ Premium on Redemption of Preference Shares is financed from Profit and loss a/c or from Securities Premium

✓ Proceeds of Debentures are not utilized for Redemption of preference shares.

✓ Only the balance remains in Share Premium a/c and CRR a/c is available for Issue of Fully paid bonus shares.

Issue of Debentures

1. **Meaning:**
   a) Debentures refer to the instruments evidencing the indebtedness of the company towards its holders.
   b) Normally redeemed at the end of the specified period of time / over a period of time.
2. **Types of Debentures:**
   a) First Mortgage and Second Mortgage debentures
   b) Bearer and Registered Debentures
   c) Redeemable and Irredeemable Debentures
   d) Secured (Mortgaged) and Unsecured Debentures **(Naked Debentures)**
   e) Convertible and Non-Convertible Debentures
3. **Treatment of loss / discount on issue of debentures : Written off over the period of debentures**
   a) Debentures redeemed at the end of the specified period - Loss equally written off over the period
   b) Debentures redeemed at the end of fixed intervals - Written off in the ratio of the O/s amount
   c) Debentures are irredeemable - Written off over a longer period of time.
   Note: Loss on issue of debentures = Premium on redemption + Discount on issue of debentures
4. **Interest on Debentures: Computed on the face value / nominal value of the debentures and is a charge against profit.**
5. **Issue of Debentures as a collateral security - Accounting Methods:**
   a. I Method:- DO NOT Account in the Books, but issue shall be shown under the respective liability.
   b. II Method:— Debentures shown both on the assets and on the liabilities of the Balance Sheet. Further, a note that "such debentures are issued as collateral security" shall be written in the Balance Sheet.
6. Issue of Debentures against the purchase of assets/services, In this case
   No. of debentures to be issued= Purchase consideration/ Issue price (including SP)
7. When debentures or shares are issued to promoters, then Goodwill a/c is Debited.
8. Interest Accrued and Due is shown along with Debentures under secured loans.
9. Interest Accrued and but not due is shown under the head Current Liability.
10. If the debentures are issued as a collateral security, interest is paid on bank loan only but not on debentures.

<u>CAPITAL AND REVENUE EXPENDITURE</u>

1. Classification of expenditure into capital and revenue is in accordance with Going Concern Concept.
2. Expenditure for which the benefit was extended for more than one accounting period is called as Capital expenditure.
3. Expenditure is classified as Capital only if it
   a. Increases the efficiency or earning capacity of asset
   b. Incurred for purchase of asset and incurred before put to use
   c. Incurred for reduction of operating expenses in future.
4. Expenditure for which the benefit was received with in one accounting period is called as Revenue expenditure.
5. Capital expenditure is shown in Balance sheet and revenue expenditure is debited to P&L a/c.
6. Examples:

Capital expenditure	**Revenue Expenditure**

Overhaul expenses of second hand machinery purchased	Overhaul expenses
Amount spent for replacement of warn out part of machinery, increases efficiency of machinery	Amount spent for replacement of warn out part of machinery
White wash exp of building purchased	White washing exp
Interest on term loan taken for purchase of asset upto date of put to use	Interest on term loan taken for purchase of asset after date of put to use
Amount spent for reduction of working expenses	Amount spent on structural alteration as per Law
Temporary huts created at construction site to house the material	Dismantling and Demolition charges
Legal fees paid to purchase the asset	Legal fees paid to retain the title of property
	Inauguration expenses incurred for opening new branch
	Compensation paid to workers
	Shifting of inventory form one godown to another

7. Differed revenue expenditure: It is a revenue expenditure, but the benefits extended for more than one accounting period.
   Eg:- General manager attended meeting in abroad for developing market and meeting was successful, Advertisement expenses, Discount on issue of shares
8. Examples for capital receipt: - Insurance claim on plant and machinery, Subsidy received from Govt. for Fixed asset, Security premium, Scrap value of fixed asset.
9. Revenue receipts: - Amount received from Debtors, General subsidy/grant received, Bad debts recovered.

CONTINGENT ASSET AND CONTINGENT LIABILITY

1. Contingency is usually arises from unplanned or unexpected events that arises
   a. Possibility of inflow of economic benefits to enterprise ------ Contingent asset
   b. Possibility of outflow of economic benefits to enterprise ------ contingent Liability
2. Example for contingent Liability:- Bills discounted with banker not yet matured, Workmen compensation fund under dispute, Arrears of preference divided, Municipal taxes under dispute etc.
3. Contingent asset is neither recognised nor disclosed in financial statements.
4. Contingent Asset is shown in Appropriate authorities report (BOD report) if it is probable but not reliably estimated.
5. Contingent asset is not shown in financial statements as per conservatism principle.
6. Contingent liability is ignored if it is remote
7. Contingent liability is shown by way of notes if it is probable and not estimated certainly.
8. If contingent liability is probable and estimated certainly, then create a provision/liabilty in financial statement
9. If contingent asset is probable and estimated certainly, then it is recognised as asset or income in financial statements.
10. Contingent liability is shown in financial statements as per Full disclosure concept.
11. Contingent liability is not included in total of balance sheet.
12. Provision is a present obligation of uncertain amount which can be measured reliably by using substantial degree of estimation.

MERCANTILE LAWS

INDIAN CONTRACT ACT

BASICS

1st September, 1872 [Applicable except Jammu Kashmir]

1. Agreement means every promise and every set of promises, forming consideration for each other. – 2(e)
2. An Agreement enforceable by law is Contract.
3. Proposal when accepted becomes a promise. – 2(b)
4. Promises which form the consideration or part of the consideration for each other are called Reciprocal Promises.
5. **Types of Contracts –**
   a) **Valid:** All essentials of a Contract are present and enforceable by law. Sec(10)
   b) **Void:** Contract that ceases to be enforceable by law. Collateral Agreements not void.
   c) **Voidable:** Enforceable at the option of one or more parties but not at the options of others.
   d) **Illegal:** Contracts forbidden by law. Collateral Agreements are void.
   e) **Unenforceable:** Good but suffers some technical defect.
   f) **Express:** Contracts by words either spoken or written.
   g) **Implied:** other than by words either spoken (or) written.
   h) **Quasi**: Contract that was never intended by parties, Tacit Contracts = inferred from conduct of parties
   Examples: Drawing cash from ATM fall of hammer in auction.
   i) **Executed:** Contracts that are wholly performed or executed.
   j) **Executory:** Contracts that are partially performed or wholly unperformed.
   k) **Unilateral:** One-sided - only one party has to perform his obligation.
   l) **Bilateral:** Obligation outstanding on part of both the parties.
   m) **English law:** Contract of record - judgment of the court. Payrole Contract under seal - written, signed, sealed and delivered by parties.
6. **Essentials of a Valid Contract:** (a) Agreement between two parties, (b) Consensus-ad-idem - meeting of minds - agreeing to the same thing in the same sense and the same time, (c) Intention to create legal relationship. No domestic and social nature, (d) Consent of parties must be free and genuine, (e) Parties should be competent to contract, (f) Lawful consideration, (g) Lawful and legal object, (h) Not expressly declared void, (i) Meaning of agreement must be certain or capable of being made certain, Q) Capable of performance, and (k) Legal formalities, wherever required.

OFFER – 2 (a)

1. **Proposal/ Offer:** Signifying to another willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence.
2. Modes of making offer: (a) By doing an act: (i) Words - oral or written, or (ii) Conduct of parties, (b) By abstaining from doing an act.
3. **Rules**
   (a) Creation of legal relationship.
   (b) Certain, definite and not vague. It should not contain a term the non compliance of which would amount acceptance.
   (c) If agreement contains a basis for ascertaining a valid term, agreement is not void on its being vague.
   (d) Offer can be express or implied, specific or general.
   (e) Communication of offer is a must.
   (f) Offer should be made to obtain the consent of the offeree.
   (g) Offer may be conditional or non-conditional. Different from invitation to offer.
4. **Specific Offer:** Made to specific person or group of persons. It can be accepted only by the person to whom the offer is made.
5. **General Offer:** Made to the public at large. Not necessary for offeree to be known to the offeror. A stranger by complying with conditions of offer is deemed to have accepted the offer.
6. **Invitation to offer:** Proposal of certain terms on which the person is willing to negotiate and invites the other party to make an offer on those terms.
7. Invitation to offer = Expression of initial intention. Offer = Expression of final willingness.
8. Tender = Offer, Notice of tender = Invitation to Offer.
9. Definite/Specific Tenders offer to supply a definite quantity of goods.
10. Standing Tender = Offer to supply goods periodically. (which remains opens for a long period of time.)

11. **Revocation of Tender:** Tender can be withdrawn before its acceptance. Clause in a tender cannot restrict this right. When not revocable? - Tenderer on some consideration has promised not to withdraw or there is a statutory prohibition.
12. **Cross Offer:** Two persons making identical offers to each other, in ignorance of each other's offer. One cannot be offer and other cannot be acceptance. No concluded contract.
13. **Counter Offer -** Original offer is cancelled. Acceptance may be given to the counter offer. (Offer with modifications)
14. **Lapse of offer -** (a) Revocation of offer, (b) Rejection of offer, (c)Acceptance not made within a stipulated time or reasonable time, (d) Non fulfillment of conditions by the acceptor, (e) Death or insanity of offeror or offeree before acceptance, (f) Acceptance not in prescribed mode, (g) Cross and counter offers, and (h) Change in law or circumstances, (i) Illegality/destruction of subject matter.

ACCEPTANCE

ACCEPTANCE

Expressed Acceptance   Implied Acceptance

1. **Meaning of Acceptance:** Consent to the offer. When the person to whom proposal is made signifies his assent thereto, the proposal is said to be accepted.
2. **Rules:** (a) Acceptance should emanate from an offer, (b) It can be made only by the offeree, (c) Should be made before the lapse of the offer, (d) Performance of conditions of offer = acceptance, (e) Acceptance should be for the exact terms of the offer. Any variation becomes counter offer, (f) Acceptance should be communicated, (g) Silence ≠ Acceptance. Exception - Offeree by his previous conduct has indicated that silence amounts to his acceptance, (h) Acceptance shall be as per prescribed mode, and (i) Acceptance to be made within the specified time.
3. **William Anson's saying:** Acceptance is to a proposal what a lighted match-stick is to a train of gun-powder.
4. Special terms and conditions must be communicated in some reasonable manner. There should be reasonable notice of such conditions on the face of the document, else acceptor is not bound.
5. **Contracts over the phone:** Duty of the acceptor to ensure/confirm that his message is duly received by the offeror.
6. **Agreements to agree for future:** Terms are not definite and concluded. No concluded contract. Law does not allow making an agreement to agree in the future.

Communication of offer and acceptance

Communcation of offer	Complete when it comes to the knowledge of the person to whom it is made.
Communication of acceptance	As against the Offeror - when it is put into course of transmission by the acceptor. As against the acceptor - When it comes to the knowledge of the proposer.

Time for revocation	Offer - before communication of its acceptance is complete, as against the proposer. Acceptance - before communication of its acceptance is complete, as against the acceptor.
When communication of revocation complete?	Person revoking (offeror/ acceptor) - when it is put into course of transmission. Person receiving the letter of revocation (either offeror/ acceptor) - When he receives such letter of revocation.

CONSIDERATION – 2(d)

1. **Meaning & Definition**: Consideration = something in return. 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 promises to do or abstain from doing, something. Such act / abstinence/ promise = consideration. No consideration = No contract. Technical word – conses us – ad – idem.
2. **Rules**
   a) Consideration must move at the desire of the Promisor.
   b) It can be done by the promisee himself or by any other person.
   c) Consideration may move from a stranger.
   d) Consideration may be past, present or future. English law does not recognize past consideration.

e) Consideration must be real and not illusory. Not valid if - physically impossible, legally not permissible, uncertain, fulfillment of pre existing obligation.
f) It must be legal.
g) Consideration need not be adequate.
h) Executed or executory consideration.

3. **Exceptions to "no consideration no contract"** - (a) Written and registered agreements arising out of love and affection between parties standing in near relation, (b) Past Voluntary service, (c) Promise to pay a time barred debt, (d) Completed gifts, (e) Bailment, (f) Contract of agency, and (g) Charity - If a person promises to contribute to charity and on this faith, the promisee undertakes a liability to the extent not exceeding the promised subscription, the contract shall be valid.
4. **Doctrine of Privity of Contract:** Only those persons, who are parties to a contract, can sue and be sued upon the contract. Third party to a contract cannot sue upon it, even though the contract may be for his benefit.
5. **Exceptions to Doctrine of Privity of Contract:** (a) Trust or charge, (b) Marriage settlement, partition and other family arrangements, (c) Acknowledgement of liability, (d) Assignment of a contract, (e) Contracts entered into through an Agent, and (f) Covenants running with land/ agreement with land.

CAPACITY OF CONTRACT

1. **Persons competent:** Person attained the age of majority, Person of sound mind and Person not disqualified by law.
Person disqualified by law:
i. Allen enemy (ii) Foreign soverignsy and Ambassadors (iii) convicts (iv) statutatory corporation, company (v) Insolvency.

2. Position of minor
a) Agreement is void ab initio
b) Acts cannot be ratified on attaining majority
c) No refunds of benefit received
d) Not liable even in case of fraudulent representation of age.
e) Cannot be a partner - except for benefits
f) Partners or Guardian not liable for breach of contract by minor
g) Cannot ask for specific performance of contract exception – skilled and beneficial to minor.
h) Cannot be adjudged insolvent.
i) Not liable to tort.
j) Minor's property is liable for necessaries.
Eg: Mohiri Bibii Vs Dharmodaus Ghose.

3. Necessaries
a) Essentials to run a life. For women including marriage.
b) Necessaries include services. i.e., health and secondary education.
c) Minor is not personally liable. He cannot be asked to expend labour in exchange. Cannot attach his income.

4. **Sound and unsound mind: Generally unsound** - Occasionally sound: can enter into a Contract when he is of Sound Mind. Generally Sound - Occasionally Unsound: cannot make a contract when he is of Unsound Mind.

5. Others
a) Lunatic - suffers from intermittent intervals of sanity and insanity.
b) Idiot-Completely lost his mental balance
c) Drunken-similar to lunatic

Major – On attaining 18 years, in case of superintence i.e., minor's property under court/ gaurdian's control on attaining 21 years.

FREE CONSENT Sec(13)

Coercion s/15.

1. Forcibly compelling a person to enter into a contract. Committing an act forbidden by IPC. Whether IPC is in force or not
2. Both threat to person and goods
3. Duress in English law - covers only person and not property.
4. Threat to commit suicide = coercion.

5. Consequences - Voidable at the option of the party whose consent was so obtained. Burden of proof lies on the person who wants to relieve himself from consequences of coercion. Repay the money or thing obtained under coercion.

Undue influence Sec(16)

1. Improper or unfair use of one's superior power in order to obtain the consent of a person who is in a weaker position.
2. points to remember – (i) position to dominate; (ii) use of such position to obtain an unfair advantage over the other.
3. Consequence - Voidable contract; Contract may be set aside absolutely or upon satisfaction of the conditions.
4. No Presumption - Husband and Wife, Landlord and Tenant, Creditor and Debtor.
5. Absence of free consent – voidable.

Fraud Sec[17], Punishable and claim damages.

1. False representation made to deceive the other parson.
2. Effects - Right to rescind, right to claim damages.
3. Silence is not equal to fraud. Exception-duty to speak and silence = speech.

Misrepresentation Not punichable

1. Representation wrongly made, either innocently or intentionally.
2. Consequence - contract is voidable no right for damages.

Mistake

1. Mistake of Fact
   a) Unilateral - cannot avoid contract. Exceptions - Void when mistake is as to nature, quality and identity.
   b) Bilateral - Void
2. Mistake of law - Law of land - will not affect validity of contract. Foreign Law - Treated as mistake of fact = void. An Erroneous opinion as to value of an article, forming subject matter cannot be treated as mistake of fact.

VOID AGREEMENTS/CONTRACTS

1. Consideration or object is unlawful
   a) Contract is forbidden by law.
   b) Contract if permitted will defeat the purpose of law.
   c) Fraudulent – void Fraud – voidable.
   d) Involves or implies injury to the person or property of another.
   e) Court regards it as immoral or opposed to public policy.
   f) Defeat on any law for time being in India.
2. **Partially illegal:**
   a) If illegal part cannot be severed from legal part - Total contract is void.
   b) If it is possible to sever illegal from legal - Enforce legal part only.
3. **Unlawful and illegal agreements**
   a) Unlawful agreements - Collateral agreements are not affected.
   b) Illegal agreements - Collateral agreements are tainted with illegality.
   c) Effects of illegality
      - Law discourages people from entering into illegal agreements.
      - In cases of equal guilt, the defendant is in a better position
4. Agreements in restraint of trade is void. Exceptions - Agreement with buyer of goodwill, trade combinations(without monopoly), service agreements with employees, agreements under Partnership Act, 1932.
5. **In restraint of legal proceedings**: Agreement restricting enforcement of rights and Agreement which curtail the period of limitation. Exceptions - Restricting jurisdiction, disputes arising in the contract to be referred to arbitration.
6. **Uncertain agreements**: Agreements, the meaning of which is not certain or not capable of being made certain is void. Uncertainty may relate to subject matter/ terms of contract.
7. **Wagering Agreement**
   a) Promise to pay money or money's worth by one person to another on the happening or non happening of a future uncertain event.
   b) Essentials - Uncertain event, mutual chances of gain or loss, neither party to have control over event, no other interest in the event, and money or money's worth.
   c) Effects-Contract is void. No action for recovery. No suit for breach.
   d) Whether wagering agreements are illegal? Yes. In Gujarat and Maharashtra. Other places it is void.

e) Not wagering agreements - (i) sale and purchase of shares, stock and goods, (ii) Prize competitions not exceeding Rs.1000, (iii) Horse race contributions for Rs.500 or more.

f) Lottery = Wagering (except when conducted by government)

8. **Agreements opposed to public policy:** (a) Trading with enemy, (b) Committing a Crime, (c) Interference with course of justice, (d) Stifling Prosecution, (e) Champerty and maintenance, (f) Restraint of Marriage, other than minor (g) Restraint of Marital duties, Restraint of trade, (I) Restraint of legal proceedings, (j) Restraint of Parental rights, (k) Restraint of personal liberty, (I) Marriage brokerage, (m) Sale of public offices and titles, (n) Creation of monopolies, (o) Creation of interest opposed to public policy and (p) Defrauding creditors.
9. **Contingent Contract:** Contract to do or not to do something if some event, collateral to such contract, does or does not happen. Essentials -1. Happening or non happening of event, 2. collateral event and 3. Uncertain event.
   Dependent on happening – when happens, (enforces) (or) void.
   Dependent on non – happening – when becomes impossible / does not happen - valid.

PERFORMANCE OF CONTRACTS

1. Performance of a Contract takes place when the parties to the contract fulfill their obligations arising under the contract within the time and prescribed manner.
2. Duties of Parties: Perform, or Offer to Perform (attempt performance), their respective promises.
3. Offer to perform: Conditions - (a) Unconditional, (b) Made to the Promisee or one of the joint promisees or his authorised agent, (c) Made at the proper place, time and form, (d) Promisee should have reasonable opportunity to ascertain that Promisor is able and willing to do the whole of his promise, and (e) In case of delivery of goods, the Promisee should be given reasonable opportunity of inspecting those goods.
4. Effect of neglelirnce of Promisee:
   a) The Promisee is bound to afford reasonable facilities for the performance.
   b) If the promisee does not provide reasonable facilities, Promisor is excused from such neglect as to any non-performance caused thereby.
5. Who can demand performance? Only Promisee. Exceptions- same as doctrine of Privity to contract. On the death of Promisee - representatives can demand performance.
6. Who can perform? Only by promisor considering nature of case, personal skill or personal confidence.
7. Performance by Joint Promisors:
   a) Joint lives - all of them, (ii) death of one promisor - Representative + others, (iii) death of last survivor - representative of all promisors.
   b) Liability - joint and several. Default by 1 promisor - others to share the loss equally.
   c) Release of 1 joint promisor does not release others. Released promisor liable to other promisors.
8. **Joint Promisees:**
   a) Joint lives - all of them, (ii) death of one promisor - representative + others, (iii) death of last survivor - representative of all promisors.
   b) Right-JOINT ONLY.
9. **Time and Place:**
   a) Promisor has not undertaken to perform without application by promise - then, duty of the promisee to apply for proper place and within business hours.
   b) When no application is made: Time not specified - perform within reasonable time, Day is specified - perform during normal business hours, Place not specified - promisor to apply for appointment.
10. **Time as essence of contract:**
    a) Performance of promise is to be made within the specified time period
    b) Upon default, the party can rescind the Contract and claim damages
    c) When time is essence - At the option of the Promisee, the contract, or so much of contract as has NOT been performed, becomes voidable.
    d) Compensation: Cannot be claimed If promisee accepts delayed performance. When notice was given, compensation
    e) When time is not essence - Not voidable. Promisee entitled for compensation.
11. **Appropriation of Payment**
    a. When a debtor owes several distinct debts to a Creditor and makes a payment insufficient to satisfy the whole indebtedness, a question arises: To which debt should the payment be appropriated? 3 rules -
       - Debtor intimates the order - Creditor must do so.

- No intimation from the debtor - at the discretion of Creditor including time barred debts.
- No intimation from debtor and Creditor fails to appropriate - Discharge the debts in chronological order.

b. Creditors can apply the payment against Time Barred Debt.

Apply the payment FIRST against Interest and when fully paid off apply the payment against Principal.

DISCHARGE OF CONTRACT

1. By performance
2. By lapse of time
3. By operation of law-death, insolvency, merger, unauthorized alteration of terms and vesting of rights.
4. By mutual agreement - Novation (substitution), Rescission (termination), Alteration (change in terms), Remission (accepting lesser fulfillment of promise) and Waiver (relinquishment of right)
5. Impossibility of performance - initial impossibility (void ab initio), subsequent impossibility - void. (English law it is called Doctrine of Frustration)
6. Not an impossibility - Partial impossibility, commercial impossibility, difficulty, default of third party, strikes and lock out.
7. Actual Breach and Anticipatory Breach

Remedies for breach

1. Recession of Contract
2. Suit for specific performance - when monetary compensation is not an adequate relief.
3. Suit for injunction - order of the court restraining a person from doing what he promised not to do.
4. Quantum merit.
5. Suit for damages - Ordinary damages (Contract price - market price), special damages, vindictive damages (nature of punishment), Nominal damages (only technical violation), Liquidated damages (Reasonable damages), Penalty (disproportionate to loss).
6. English law recognizes liquidated damages only.

QUASI – CONTRACTS

Quasi contracts

- Not a contract at all. Obligation created by law due to absence of agreement.
- "Money or money equivalent received by one person - not belonging to him - and to be restored under justice and fairness.
- Doctrine of unjust enrichment
- Applicability - supply of necessaries to minor, payment by interested party, person enjoying benefits under non gratuitous act, responsibility of finder of goods, and obligation of a person to whom money is paid by mistake/coercion.

INDIAN PARTNERSHIP ACT, 1932
BASICS

1. Partnership extends to whole of India except the State of Jammu and Kashmir. Came into force 1st Oct, 1932.
2. Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.
3. Persons competent to be Partners - (a) Persons competent to enter into a Valid Contract can become Partners, (b) A Minor cannot be a Partner, (c) Company can be a Partner, (d) Partnership between Indian Nationals and Alien Friends is possible, and (e) Two Partnership Firms cannot enter into Partnership.
4. Relation of Partnership arises from an agreement and not from status.
5. **Essentials of Partnership**
   a. Association of two or more persons: As per Companies Act - Minimum 2, Maximum - For Banking business 10, For Other Business 20. If exceeds it becomes illegal association.
   b. Agreement: Partnership originates from an Agreement. (Written/ Oral)
   c. Carrying on business: Business includes trade, occupation and profession. Association created for charitable, religious and social purposes are not Partnership. (Lawful)
   d. Sharing the profits of the business: Sharing cannot be conclusive proof. It is only an evidence.
   e. Mutual agency among Partners - Test of Partnership. Capacity of a Partner to bind other Partners by his acts done in Firm's name and be bound by the acts of the other Partners.

Note: The law of Partnership is regarded as an extension of law of agency because of existence of mutual agency.

- **Firm Name:**
  The collective name under which it carries on business.
- **Minors Rights:**
  - ✓ Right to agreed share of profits of firm.
  - ✓ Can access, inspect and take copy of the accounts.
  - ✓ He has a right to file a suit for his share of profits only when he decides to sever his connections with the firm.
- **Mino's Liabilities:**
  - ✓ His share is liable for the act of the firm.
  - ✓ He cannot be declared as insolvent on declaration of firm's insolvency.

PARTNERS RIGHTS, DUTIES AND LIABILITIES

1. **Types of Partnership:**
   a. Particular Partnership - For a particular adventure or undertaking. Sec (8)
   b. Sub-Partnership - Partner of a Firm agrees to share his own share of profits with an outsider, called Sub-Partner, Sub-Partner - (i) no connection with Firm, (ii) no relationship with other Partners, (iii) no right to take part in the business, (iv) can claim his agreed share, and (v) On dissolution - he is In the same position of that of a transferee of a Partner's share.
   c. Partnership at Will - Duration of Partnership is not fixed. No provision is made as to how the Partnership will at will come to an end.
   d. Partnership for a Fixed Term: Partnership entered for a Fixed Period, after the expiry of which it comes to an end.
2. **Kinds of Partners:** (a) Actual Partner - Partner by agreement, (b) Nominal Partner - Partner only by name, (c) Sleeping Partner - One who contributes to capital, no active participation in the business, (d) Sub-Partner - A third party with whom the Partner shares his profits, (e) Minor - can be admitted only for benefits, (f) Incoming Partner - admitted to a Firm already in existence; not liable for the Firm's act done before his admission, (g) Outgoing Partner - Partner who leave the Firm due to retirement, death, insolvency or expulsion, (h) Partner by Holding Out, and (i) Partner in profits only - Partner shall get a share only in the Profits and shall not be liable to contribute towards losses. Partner by holding out also known as partner by estoppel.
3. **Duties of a Partner:** (a) Mandatory Duties - (i) to carry on business of the Firm to the greatest common advantage of the Firm, to be Just and faithful, and (iii) to render true accounts and full information, (b) Duty to indemnify for loss caused by fraud, (c) General Duties: Not to carry on other business when there is a restraint in the contract, (d) To act diligently, (e) Not to claim remuneration, (f) Contribute for the Firm's fosses, (g) Indemnify for loss due to willful neglect, (h) No personal profits, (i) No competing business, (j) Not to assign his rights, and (k) act within authority.
4. **Rights of a Partner:** (a) take part in Business, (b) to be heard and consulted, (c) access to books, (d) equal share of profits, to receive interest on capital, (f) to receive interest on advance - either as agreed or at 6% p,a., (g) indemnification by Firm for protecting it from loss, (h) entitled to use the property of the Firm for the purpose of business, (i) Agent of the Firm, (j) take all actions during emergency, (k) object admission of new partner, (l) to carry on competing business after coming out of Partnership.
5. **Implied Authority:** Act of a Partner which is done to carry on, in the usual way, business of the kind carried on by the Firm, binds the Firm. Conditions - (i) act must relate to normal business, (ii) done in the usual way of carrying on the Firm's business, and (iii) done in the name of the Firm.
6. **Liabilities:** (a) Failure of general duties, (b) indemnify the Firm for loss caused by his fraud, (c) contribute to losses equally, (d) indemnify for willful neglect, (e) surrender personal profits, (f) account for profits from competing business, (g) jointly and severally liable for all acts of the Firm, (h) liable to third parties for acts of the Firm.
7. **Property of Partnership Firm:** The Partners, by agreement, are free to determine as to what shall be the property of the Firm and what shall be treated as a separate property of one or more of the Partners. Every Partner is, as a rule, a joint owner of the Partnership Property and is entitled to hold and apply the same exclusively for the purpose of business.
8. Notice to a Partner, who habitually acts in the business of the Firm, of any matter relating to the affairs of the Firm operates as notice to the Firm.
9. **Position of Minor on attaining majority:** The Minor Partner has to decide whether he shall remain a Partner or leave the Firm, within 6 months of his attaining majority, or his obtaining knowledge that he had been admitted to the benefits of the Firm. He shall give Public Notice of his intention. Where he fails to give notice, he becomes a Partner in the Firm on the expiry of such period.
10. **Extension or Restriction of Partners implied Authority:** The Partner may either extend (or) restrict the implied authority of any partner. But a third party is not affected by a secret limitation of a partners implied authority unless he has actual notice of it.
11. **Acts in Emergency:**
    - ✓ Such act must be done to protect the firm from loss.
    - ✓ Such act must be done as a prudent man would undertake under similar circumstances in his own care .

RECONSTITUTION AND DISSOLUTION

MODES OF RECONSTITUTION

1. **Admission:** Consent of all the Partners is required for admitting a new Partner. New Partner not liable for the acts done by the Firm before his admission.
2. **Retirement:** Partner may retire - (a) with other Partner's Consent, (b) in accordance with express agreement, (c) by giving written notice of his intention to retire in case of partnership at will. Public Notice has to be given on retirement either by Retiring Partner or any Partner of Reconstituted Firm.
3. **Expulsion:** Partner may be expelled by majority rule, where the contract provides for it and such right is exercised in good faith and for Firm's benefit Partner expelled otherwise than in good faith is null and void.
4. **Insolvency:** The Partner ceases to be a Partner on the date of the order, irrespective of whether the Firm is dissolved or not. Public Notice is not required.
5. **Death:** The Firm is generally dissolved on the death of a Partner. If it is not dissolved, the estate of the deceased Partner is not liable for the Firm's act after the death of the Partner.
6. **Transfer of Interest:** Grounds for reconstitution - (a) Partner's interest transferred to a third party, (b) charges on account of decree passed by a court towards payment of liabilities of that partnership, (c) sold in the recovery of arrears of land revenue

Matters requiring unanimous consent of the Partners

- Making a change nature of the business
- For admission of a new Partner
- Transfer by a Partner of his interest in the Firm
- Sec 30(1) - Admission of a in the minor into the benefits of Firm

✓ The rights and duties of a partner after changing the constitution of the firm as same as they before change in the constitution of the firm.

DISSOLUTION

1. **Dissolution of Firm:** Dissolution of Partnership between all the Partners of a Firm is called Dissolution of the Firm.
2. **Dissolution of Partnership:** Any change in the relations of Partners is called Dissolution of Partnership.
3. **Modes of Dissolution:**
   (a) **By Order of the Court:** (i) Partner's insanity, (ii) Incapacity of Partner, (iii) Partner guilty of misconduct, (iv) Breach of agreement, (v) Transfer of interest by Partner, (vi) Heavy losses of Firm, (vii) Just and Equitable Grounds.
   (b) **Other Modes:** (i) Mutual Agreement, (ii) Compulsory Dissolution, (iii) Happening of Certain contingencies, and (d) Notice of Partnership at will.
   (c) The partners are liable until the public notice is given.

➢ **Rights:**
- ✓ To restrict the partner from using the firm and the firm property.
- ✓ Right to where the contract is to be resigned by any other partner for fraud (or) misrepresentation sec 52.

➢ **Leadig cares :**
- ✓ Garner vs Murray
  Accounting rule in respect of deficiencies arising due to the insolvency of a partner.
- ✓ Cox vs Kickman
  Test of partnership

REGISTRATION OF FIRMS

1. Registration of the Firm is not mandatory under the Act.
2. Registration does not create Partnership, but it is only the evidence of existence of a Partnership.
3. Registration is effective from the date when the Registrar files the statement and makes entries in the Register of Firms and not from the date of presentation of the Statement to him.
4. Disabilities of Unregistered Firms - (a) Cannot sue the Firm or any other Partner, (b) cannot file a suit against third party, and (c) cannot claim a set off.
5. Non Registration of Firm does not affect -
   a. Right of third parties to sue the Firm
   b. Right of Partners to sue for dissolution
   c. Power of Official Assignee to bring a suit on behalf of the Insolvent Partner
   d. Rights of Firm or Partners in a place where the Act does not apply
   e. Right of the Firm to institute a suit or claim of set-off not exceeding Rs.100

f. Right to bring a suit against a third party to enforce a right arising otherwise than out of a contract.

SALE OF GOODS ACT, 1930

PRELIMINARIES

1. **Applicability:** The Sale of Goods Act, 1930 extends to whole of India, except the State of Jammu and Kashmir.
2. **Important Terms:**
   (a) **Buyer:** Person who buys or agrees to buy goods.
   (b) **Seller:** Person who sells or agrees to sell goods.
   (c) **Goods means:** Every kind of movable property. Excludes - Actionable Claims and Money (but not old rare coins). Includes - Stock and Shares, Growing Crops, Grass & things agreed to be severed under contract of sale.
   - It deals with sale and not with mortgage (or) pledge (or) hypothecation.

   (d) **Existing goods:** Goods that are in existence at the time of contract of sale, i.e. owned or possessed by the Seller.
   (e) **Future goods:** Goods to be manufactured or produced or acquired by the seller after making the contract of sale.
   (f) **Specific Goods:** Goods identified and agreed upon, at the time the contract of sale.
   (g) Delivery means voluntary transfer of possession by one person to another. Delivery may be of three kinds -
   - **Actual Delivery:** When the goods are physically delivered to the Buyer.
   - **Constructive Delivery:** When it is effected without any change in the custody or actual possession of the thing, as in the case of delivery by attornment (acknowledgement)
   - **Symbolic Delivery:** When there is a delivery of a thing in token of a transfer of something else, i.e. delivery of goods in transit may be made by handing over documents of title to goods, e.g. Bill of Lading or Railway Receipt or Delivery Orders, or when key of a warehouse containing the goods is handed over to buyer.

   (h) **Document of Title to goods:**
   - It includes Bill of Lading, Dock-Warrant, Warehouse Keeper's Certificate, Wharfinger's Certificate, Railway Receipt, Multimodal Transport Document, Warrant or order for the delivery of goods and any other document used in the ordinary course of business, as proof of the possession or control of goods, or authorizing or purporting to authorize, either by endorsement or by delivery, the possessor of the document, to transfer or receive goods thereby represented by it.
   - There is a difference between a 'document showing title' and 'document of title'. A Share Certificate is a 'document' showing title, but not a document of title. It merely shows that the person named in the Share Certificate is entitles to the share represented by it, but it does not allow that person to transfer the Share mentioned therein by mere endorsement on the back of the certificate and the delivery of the certificate.

   (i) **Mercantile Agent:** An agent having in the customary course of business, an authority - (i) either to sell goods, or (ii) to consign goods for the purpose of sale, or (iii) to buy goods, or (iv) to raise money on the security of the goods.
   (j) **Property:** It means the general property (right of ownership in goods) and not merely a special property.
   (k) Insolvent: A person is said to be insolvent when he ceases 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.
3. **Contract of Sale:** A contract of sale of goods is a contract whereby the Seller transfers or agrees to transfer the property in goods to the Buyer, for a price.
4. **Essentials of Contract of Sale:** (a) There must be atleast two parties, (b) The subject matter of the contract must necessarily be goods, (c) A price in money (not in kind) should be paid or promised, (d) A transfer of property in goods from Seller to the Buyer must take place, (e) A contract of sale must be absolute or conditional, and (f) All other essential elements of a valid contract must be present in the contract of sale.
5. **Sale and an Agreement to Sell:** The consideration for contract of sale can be partly in money and partly in goods.
   (a) Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called sale.
   (b) Where under a contract of sale the transfer of the property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called an Agreement to Sell.
6. **Delivery/ Payment in a Contract of Sale:**
   (a) There may be immediate delivery of the goods, or
   (b) There may be immediate payment of price, but it may be agreed that the delivery is to be made at some future date, or
   (c) There may be immediate delivery of the goods and an immediate payment of price, or
   (d) it may be agreed that the delivery or payment or both are to be made in instalments, or
   (e) It may be agreed that the delivery or payment or both are to be made at some future date.
7. **Subject matter of Contract of Sale** - The subject matter of contract must always be goods. The goods may be existing or

future goods. When the Seller purports by his contract of sale to effect a sale of future goods, the contract will operate only as an Agreement to Sell the goods, and not as Sale.

8. **Destruction of subject matter of Contract:**
   (a) Goods not existing at the time of contract: If at the time a contract of sale is entered into, the subject-matter of a contract being specific goods, which without the knowledge of the Seller have teen destroyed or so damaged as not to answer to the description in the contract, then the contract is void ab initio.
   (b) Goods perishing after the contract is made: Where there is an agreement to sell specific goods and the goods, subsequently without any fault of the Seller or the Buyer perish or suffer such damages as not to answer to the description in the agreement before the risk passes to the Buyer, the agreement becomes void.
9. **Ascertainment of Price:** Price is the monetary consideration for sale of goods. The Price may be - (a) fixed by the contract, (b) agreed to be fixed in a manner provided by the contract, e.g. Valuer, or (c) determined by the course of dealings between the parties.
10. **Price fixed by third party:**
    (a) When Third party does not or cannot make such valuation - Agreement will be void.
    (b) When Third party is prevented by the default of the either of the parties - Party at default will be liable for damages.
11. **Stipulation as to time:**
    (a) Payment: Unless a different intention appears from the terms of contract, a stipulation as regards time for payment is not deemed to be essence of contract of sale.
    (b) **Delivery:** Whether or not a stipulation is an essence of the contract depends on the terms agreed upon. delivery of goods must be made without delay.

CONDITIONS AND WARRANTIES

A stipulation in a contract of sale with reference to the goods may be condition or warranty.

1. Conditions and Warranties

Condition	Warranty
A Condition is a stipulation essential to the main purpose of the contract	A Condition is a stipulation collateral to the main purpose of the contract.
The aggrieved party can repudiate the contract or claim damages or both in case of breach.;	The aggrieved party can only claim damages in case of breach. The aggrieved party cannot repudiate the contract.
Breach of Condition may be treated as Breach of Warranty.	Breach of Warranty cannot be treated as Breach of Condition.

2. **When Condition may be treated as Warranty?**
   (a) Buyer waives the performance of the condition.
   (b) Buyer elects to treat the breach of condition as breach of warranty.
   (c) Contract is non-severable, and the Buyer has accepted either the whole goods or any part thereof.
   (d) Fulfillment of any condition or warranty is excused by law by reason of impossibility or otherwise.
3. **Implied Conditions:** Implied conditions are those which are presumed by law.(a) Condition as to Title - Seller must be the true owner, (b) Sale by description - Goods should correspond with the description, (c) Sale by sample - Bulk shall correspond with the sample in quality, (d) Sale by sample as well as description - Bulk shall correspond both with sample and description, (e) Condition as to quality and fitness - Condition applies only if Buyer had made known to the Seller the purpose of his purchase and relied upon the skill and judgement of the Seller, and (f) Condition as to wholesomeness - In case of eatables and provisions, the goods shall be wholesome
4. **Implied Warranties:** (a) Warranty as to undisturbed possession - Buyer shall have and enjoy quiet possession of the goods, (b) Warranty as to non-existence of encumbrances - Goods shall be free from any charge in favour of any third party, (c) Disclosure of dangerous nature of goods - Seller must warn the Buyer of the probable danger when goods are inherently dangerous, and (d) Warranty as to quality or fitness by usage or trade - Implied Warranty as to quality and fitness for a particular purpose may be annexed by the usage of trade.
5. **Caveat Emptor = Let the Buyer beware:**
   (a) **Meaning:** The Seller is not bound to disclose the defects in the goods which he is selling. It is the duty of the buyer to satisfy himself before buying the goods that it will serve the purpose for which they are being bought
   (b) **Exceptions to the Rule:** (i) Purpose is made known to the Seller, (ii) Goods purchased under its Patent or Brand name, (iii) Goods sold by description, (iv) Goods bought by sample, (v) Implied warranty or condition as to quality or fitness annexed by the usage of trade, and (vi) Seller sells the goods by making some misrepresentation or fraud.

TRANSFER OF PROPERTY AND RISK IN GOODS

1. **Meaning of "Passing of Property":** it implies passing of ownership, if the property has passed to the Buyer, the risk in the goods sold is that of the buyer and not of the seller, though the goods may still be in the Seller's possession.
2. **Rules for "Passing of Property":** (i) Property will be transferred only when the goods are appropriate ascertained, and (ii) For Specific and Ascertained goods, property passes to the Buyer at the time when parties intend it to pass.
3. **Passing of Property for different types of goods:**

Situation	Passing of Property
Specific Goods	• Deliverable State-At the time when Contract is made, • Non-deliverable state - After completion of process to make it deliverable.
Unascertained Goods	Either when goods are ascertained or unconditionally appropriated.
Goods sent on approval	• On approval by the buyer, or • When the buyer does an act adopting the transactions, or • Does not signify his approval beyond a reasonable time. • When he signifies his approval or acceptance to the seller.

4. **Reservation of Right to Disposal:**
   - (a) In a contract of sale of specific goods, the Seller may reserve the right to dispose the goods until certain conditions are fulfilled.
   - (b) In such case, even if delivery has been made to the Buyer, or Carrier or Bailee for the purpose of transmitting the same to the Buyer, the property therein will not pass to the Buyer, till the condition imposed by the Seller has been fulfilled. Eg: Bill of loading & railway receipt.
5. **Passing of Risk:** <u>Risk follows the ownership</u>
   - (a) Unless otherwise agreed, the goods remain at the Seller's risk until the property therein is transferred to the buyer.
   - (b) But when the property in goods is transferred to the Buyer, the goods are at the Buyer's risk, whether delivery has been made or not.
6. **Sale by Non-owner:**
   - (a) "Nemo dat quod non habet" - it means that no one can give what he has not got. If the Seller is not the owner of goods, then the Buyer also will not become the owner.
   - (b) Exceptions to the Rule: (i) Sale by Mercantile Agent, (ii) Sale by one of the Joint Owners, (iii) Sale by a person in possession under a voidable contract, (iv) Sale by one who has already sold the goods but continues possession thereof, (v) Sale by Buyer obtaining possession before the property in goods has vested in him, (vi) Effect of Estoppel, (vii) Sale by an Unpaid Seller, and (viii) Sale by Official Assignee / pawnee.
7. **Rules regarding Delivery of Goods:**
   - (a) **Effect of part delivery -** Unless otherwise intended, part delivery = whole delivery,
   - (b) Buyer to apply for delivery, unless otherwise agreed,
   - (c) **Place of delivery** - Unless otherwise agreed, Place of sale/ place of agreement to sell/ place of manufacture,
   - (d) **Time of delivery** - fixed time or within reasonable time,
   - (e) Goods in possession of a third party - No delivery unless the third party acknowledges to the buyer that he holds the goods on his behalf,
   - (f) **Time for tender of delivery -** to be made at a reasonable hour,
   - (g) **Expenses for delivery -** unless otherwise agreed, borne by the seller,
   - (h) **Delivery of wrong quantity** - (i) lesser quantity - buyer may accept/ reject, (ii) excess quantity - accept or reject, (iii) Mixed with other goods - accept relevant goods and reject rest or reject the whole, [Note: this does not cover mixing of inferior variety of goods]
   - (i) **Installment delivery -** unless agreed, buyer is not bound to accept,
   - (j) **Delivery to carrier -** subject to terms of contract, deemed to be delivered to buyer,

(k) **Deterioration during transit** - liability shall fall on the buyer, and
(l) Buyer has the right to examine the goods.

8. **Acceptance of delivery Sale on Approval Basis Acceptance is deemed to take place when the Buyer -**
   (a) Intimates to the Seller that he had accepted the goods, or
   (b) Does any act to the goods, which is inconsistent with the ownership of the Seller, or
   (c) Retains the goods after the lapse of a reasonable time, without intimating to the Seller that he has rejected them.

UNPAID SELLER – RIGHTS & DUTIES and MISC.

1. **Meaning:** Seller is deemed to be an Unpaid Seller when - (a) whole of the price has not been paid or tendered, and Seller had an immediate right of action for the price, or (b) Dishonour of *a* Bill of Exchange or Negotiable Instrument, but same has been dishonored unless payment was an absolute and not a conditional payment.
2. **Rights of Unpaid Seller:**
   (a) **Rights against Goods:**
   - **Right of Lien - Exercise of Right:** For recovery of price, when he is in possession of goods. Conditions - (i) Goods are sold without any stipulation of credit, (ii) goods are sold on credit, but the term has expired, or (iii) buyer becomes insolvent. Right is lost when - (i) Seller delivers the goods to Carrier for transmitting to the buyer without reserving the right of disposal of the goods, (ii) Buyer or his agent lawfully obtains possession, (iii) Seller has waived the right of lien, or (iv) by estoppel.
   - **Right of stoppage in transit:** Exercise of Right: Unpaid Seller has parted with the goods and buyer has become insolvent. Conditions - (i) Seller must be unpaid, (ii) he must have parted with the goods, (iii) goods are in transit, (ii) buyer has become insolvent, and (v) right is subject to provisions of the Act. (vi) To return the goods back.
   - **Right of Re-sale: Conditions:** (I) Goods are of perishable nature (buyer need not be informed), or (ii) he gives notice to the buyer about the re-sale and buyer does not make the payment within reasonable time.

   (b) **Rights against Buyer:** (i) Suit for Price, (ii) Suit for damages for non-acceptance, (iii) Repudiation of contract before due date, and (iv) Suit for Interest.
3. **Effect of Sub-sale or Pledge by the Buyer:** Unpaid Seller's right is not affected, except - (i) when he has assented to the sale made by the Buyer, or (ii) Document of Title to goods has been transferred to the Buyer and he in turn has transferred it to the subsequent Buyer.
4. **Rights of Parties in case of Breach of Contract:**
   (a) Buyer's Right against the Seller: (i) Suit for non-delivery, (ii) Suit for specific performance, (iii) Suit for damages for breach of warranty, and (iv) Suit for recovery of Price.
   (b) Seller's Right against the Buyer: (i) Suit for Price, and (ii) Damages for non-acceptance.
5. **Auction Sale;**
   (a) It is a mode of selling property by inviting bids publicly and the property is sold to the highest bidder.
   (b) An Auctioneer is only an Agent of the Seller governed by law of agency.
   (c) Sale is complete when the Auctioneer announces its completion by the fall of hammer.
   (d) Right to bid may be reserved expressly by or on behalf of the Seller.
   (e) If the Seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the Buyer.
   (f) The seller can appoint only one puffer to rise the bid. If exceeds it is voidable.
   (g) The seller will not sell the goods if the price is below the resume price (or) upset price.

ECONOMICS

INTRODUCTION

1. The origin of economics can be traced to Adam Smith book *An Inquiry into the Nature and Causes of Wealth of Nations* published in the year 1776. Adam Smith is the father of Economics. At its birth it was called 'Political Economy'.
2. Economics has been defined in four different ways: wealth, welfare, scarcity and growth.
   - ***Wealth Definition**: Adam Smith*, defined economics as a science of wealth—which meant production and consumption of wealth.
   - ***Welfare Definition**: Marshall* defined the welfare aspect of economics as attainment and use of material things. He defines economics in its normative aspect.
   - ***Scarcity Definition**: Robbins* emphasises that economics is a study of human behaviour, where there is a relationship between ends and scarce means and that the scarce means have alternative uses. He said economics is neutral between ends.
   - ***Growth Definition**: Samuelson's* definition of economics is most comprehensive, relevant and accepted. The definition includes both the aspects of economics, i.e., distribution of limited resources and problem of economic development.
3. ***Economics as a Science:*** Economics is a science where various facts are systematically collected, classified and analysed. Economics is a social science whose subject matter is man who cannot be controlled and predicted. Chemistry and biology are physical sciences where experiments can be conducted in a laboratory under controlled conditions.
4. ***Economics as an Art:*** Economics is an art as it has several branches which give practical direction to some economic problems of the society.
5. Economics is a science having both ***, positive and normative sides.*** The role of an economist is not only to explain and explore but also to admire and condemn. This role of an economist is essential for healthy and rapid growth of an economy. Positive economics deals with what is, and normative economics deals with *what ought to be.* Positive economics deals with facts and normative economics deals with *ethics.*
6. ***Microeconomics*** deals with behavior of individual decision making units such as consumers, resource owners, etc. It is also called ***Price Theory. Macroeconomics*** deals with aggregates such as national income, aggregate consumption, etc. It is also called ***Theory of Income and Employment.*** Both micro and macro economics are complementary and should be fully utilised for proper understanding of an economy.
7. There are two methods of constructing an economic theory *(a)* Deductive method *(b)* Inductive method. In the ***deductive*** method, the process of reasoning goes from general assumptions to particular predictions. It was adopted by classical economists and is simple, universal and accurate. The method is more suitable when facts and data are not available. In the ***inductive method***, the process of reasoning goes from particular facts to general theory. It was popular among modern economists and is more precise, realistic and scientific. The method is more suitable when facts and data are available. Deductive and inductive methods are not alternative of each other. Both the methods are needed for constructing an economic theory.
8. The ***central problem*** is the problem of choice or the problem of economising. Three main causes of central problems are
   - unlimited human wants
   - limited economic resources
   - alternative uses of resources
   - The central problems are
     - What to produce and how much to produce?
     - How to produce
     - For whom to produce
     - Economic growth
9. All point on Production Possibility curve (PPC) solve the first two problems and points on a higher PPC solve the problem of economic growth. PPC cannot solve the problem of 'For whom to produce'.
   - PPC shows various alternative combinations of goods and services that an economy can produce when the resources are all fully and efficiently employed.
   - The slope of PPC measures opportunity cost of the commodity in terms of alternative opportunity given up. Since the slope of PPC is rising, it is called law of increasing marginal opportunity cost. [Opportunity cost is cost of alternative opportunity given up.]
10. There are three forms of economic organisation:
    (a) Capitalist economy
    (b) Socialist economy
    (c) Mixed economy.

    Capitalism is the system that advocates price mechanism to solve the basic economic problems of what, how and for whom to produce. In a price mechanism, prices are determined by the market forces of demand and supply. The only aim is profit maximisation and the consumers are free to consume whatever they like.

    Socialism is the system where government or public sector owns the factors of production (land, labour, capital and'enterprise) and the central planning authority decides what, how and for whom to produce. The aim is to maximise welfare of the society and the consumers can consume only those goods which are produced by the government.

In a ***mixed economy***, public and private sectors exist side by side. Both price mechanism and central planning authority decide what, how and for whom to produce. India is a mixed economy. In addition to the problem of allocation problem of economic growth.

THEORY OF DEMAND AND SUPPLY

1. The demand for a commodity is the quantity of the commodity which is demanded at a certain price during any particular period of time.
2. In economics, demand means *effective demand* which means there should be *desire* to own the good, *sufficient money* to buy it and *willingness* to spend the money.
3. The *determinants* of an individual household demand are (i) price of the good (P_x), *(ii)* price of related goods *(P_z)*, *(iii)* income of the consumers (Y), and *(iv)* tastes and preferences of the consumers (T).
4. The *law of demand states* that there is an inverse relationship between price and quantity bought of a commodity, *ceteris paribus.* The assumptions of the law of demand are that P_z, *Y* and *T* are constant.
   - The demand schedule gives the data on changes in quantity bought at different prices in a particular time period.
   - Data is plotted on price—quantity axes to derive the demand curve. The demand curve slopes downward because of *(i)* law of diminishing marginal utility (as given by Marshall), *(ii)* income effect, *(iii)* substitution effect, and new consumers creating demand.
5. *Exception* to the law of demand are found in the following cases *(i)* Giffen goods, *(ii)* Conspicuous goods or goods of status, *(iii)* Expectation of a price rise in future, *(iv)* Demonstration effect, and *(v)* Emergency.
6. *Individual demand* is the demand on the part of a single consumer at various prices per time period. *Market demand* is the aggregate of the demand of all the consumers taken together at various prices per time period.
   - Factors influencing the individual demand are price of the good, price of related goods, income of the consumers and tastes of the consumers. The three additional factors determining the market demand are *(i)* Number of consumers in the market, *(ii)* Distribution of income, and *(iii)*Age and sex composition of the population.
   - Market demand curve is constructed by *horizontally* summing all the individual demand curves at each and every price.
7. Movement along a demand curve occurs due to changes in the price of the good *(P_x)* itself. Shift of the demand curve occurs due to changes in *(i)* price of other good (P_z), *(ii)* income of the consumers (Y) and *(iii)* tastes of the consumers *(T).*
   - Movement can be *expansion or contraction* of demand whereas shift can be increase or decrease in demand.
8. *Price Elasticity of Demand (E_d)* measures percentage change in the quantity demanded of a good due to a percentage change in its price. Therefore, E_d can be calculated as:

$$E_d = \frac{\text{Percentage change in demand}}{\text{Percentage change inprice}}$$

Or $-\frac{\Delta Q}{\Delta P}.\frac{P}{Q}$

9. The major 'determinants of price elasticity of demand are:
   (i) Availability of substitutes
   (ii) Income of the consumers
   (iii) Luxuries *versus* necessities
   (iv) Cost of the good relative to total income
   (v) Number of uses of the commodity
   (vi) Level of price.
10. There are five degrees of E_d.
   (i) Perfectly inelastic demand *(E_d* = 0)
   (ii) Inelastic demand *(E_d* < 1)
   (iii) Unitary elastic demand *(E_d* = 1)
   (iv) Elastic demand *(E_d* > 1)
   (v) Perfectly elastic demand *(E_d* = <=∞).

11. *Measurement of Price Elasticity of Demand*

The three methods of measuring E_d are:
(i) Outlay or expenditure method
(ii) Percentage or proportionate method
(iii) Geometric (or point) method.

(i) In the outlay method, the Ed is measured on the basis of change in total expenditure *(i.e..* PxQ) due to change in the price *(ie., P)* of the good. If the price of a good falls and, as a result, total outlay increases then $E_d > 1$; if total outlay remains unchanged, then $E_d = 1$ and if total outlay falls, then $E_d < 1$.

(ii) In the percentage method, E_d is calculated by the formula;

$$E_d = -\frac{\Delta Q}{\Delta P} \cdot \frac{P}{Q}$$

For Arc elasticity, the formula is

$$E_d = -\frac{Q_1 - Q_2}{Q_1 + Q_2} \cdot \frac{P_1 + P_2}{P_1 - P_2}$$

(iii) In the geometric method, E_d at a point on a linear (straight) demand curve is calculated as:

$$E_d = -\frac{\text{Lower side segment of the demand curve}}{\text{Upper side segment of the demand curve}}$$

12. ***Income Elasticity of Demand*** measures changes in quantity demanded due to change in income of the consumer. The formula for calculating e_Y is:

$$e_y = \frac{\Delta Q}{\Delta Y} \cdot \frac{Y}{Q}$$

Income elasticity can be positive or negative, when $e_Y > 1$, the good is a luxury; when $0 < e_y < 1$, it is a necessity; and when $e_Y<0$, the good is an inferior good.

13. ***Cross-Elasticity of Demand*** It measures changes in the quantity demanded of good *x* due to change in price of good z. The formula for calculating e_{xz} is:

$$e_{xz} = \frac{\Delta Q_x}{\Delta P_z} \cdot \frac{P_z}{Q_x}$$

The value of cross elasticity ranges from minus infinity to plus infinity

- When e_{yz} =positive x and z are perfect substitutes
- When e_{xz} = zero and z are not related
- When e_{xz} = positive or negative ∞, x and z are perfect complements.

THEORIES OF CONSUMER BEHAVIOUR

1. The logical basis of consumer behaviour has been explained by different theories. Some of the most important theories of consumer behaviour are:
   i. Marshall's Marginal Utility Theory
   ii. Hicks and Allen's Indifference Curve Theory.

2. *Marginal Utility Theory*

- The law of diminishing marginal utility states that as the consumer has more and more units of a commodity, its marginal utility falls.
- Utility is expected satisfaction to a consumer when he is willing to spend money on a stock of commodity which has the capacity to satisfy his want.
- Marginal utility (MU) is addition made to total utility (TU) consumption is increased by one more unit.
- When TU is maximum, MU is zero. It is called saturation point.
- When TU is rising, MU is falling.
- The law of DMU is based on the assumptions that:
  a) Standard unit of measurement is used
  b) All units of the good are homogeneous
  c) Consumption is continuous
  d) Mental and social condition of the consumer is normal.
- ***Assumptions of the theory:***
  a) Rationality
  b) Cardinality
  c) Constant marginal utility of money
  d) Law of DMU
  e) Partial equilibrium method
  f) Utility is additive.
- Marshall's consumer surplus = The amount consumer is *willing* to pay – Actually he pays.
- C.S.. = Area between the demand curve and the price axis above the price. Main *limitations* of this concept are:
  (i) Utility or satisfaction cannot be measured in money units.
  (ii) It is difficult to clearly define , the amount consumer is willing to pay.
  Usefulness of the concept are observed in discriminating monopoly and taxation policy.

3. *Indifference Curve Theory*

- Assumptions of the theory are:
  (i) Rationality

(ii) Ordinality
(iii) Diminishing marginal return of substitution
(iv) Consistency and transitivity of choice
(v) More is better

- *Indifference curve* shows different combinations of goods that yield the same level of satisfaction to the consumer. A family of indifference curves is called an *indifference map.*
- Features of indifference curve are:
  (i) Downward sloping to the right
  (ii) Convex to the origin
- They are non intersecting*Budget line* shows all the possible combinations of the two goods that can be bought by a consumer given income and prices of goods.
- Slope of the budget line is the price ratio, *i.e.,* $\frac{P_x}{P_y}$
- Slope of an indifference curve is called Marginal Rate of Substitution *(MRS_{xy}).*
- A consumer is in equilibrium when he maximises his utility, given income and prices. Equilibrium is reached at the point of *tangency* between indifference curve and budget line. Consumer equilibrium conditions are:

$$MRS_{xy} = \frac{P_x}{P_y}$$

Or $\frac{MU_x}{MU_y} = \frac{P_x}{P_y}$ ....(1)

and Diminishing *MRS.... (2)*

- Elasticity of substitution between two goods X and Y measure the ease with which one good can be substituted for the other. When two goods are perfect substitutes, indifference curve is straight downward sloping line. When two goods are perfect complements, indifference curve is L-shaped.

Comparison of Marginal Utility Theory with Indifference Curve Theory

Hicks indifference curve theory is superior to Marshall's marginal utility theory. It is clear from the following points:

(i) Hicks does not measure utility in money units but only ranks them.
(ii) Hicks takes into account income effect which is ignored by Marshall.
(iii) Hicks concept of *MRS* was with references to two goods X and Y; Marshall's concept of *MU* was with reference to one good.
(iv) Hicks analysis can classify the goods into substitutes and complements, which Marshall ignores.
(v) Hicks analysis can explain giffen paradox. Marshall's analysis fails to explain giffen paradox.
(vi) Hicks analysis splits price effect into pure substitution effect and pure income effet. The analysis is far superior to Marshall's analysis which ignores income effect.

SUPPLY

1. Supply of a commodity at a given price is the quantity of the commodity which is actually offered for sale per unit of time.
2. There is difference between supply and stock. Supply is that part of stock which is actually brought in the market.
3. The major factors affecting supply of a good are:
   a) Price of the good
   b) Price of related goods
   c) Cost of production
   d) State of technology
   e) Expected price of the good
   f) Government policy.

   Symbolically, a supply function can be expressed as:

   $S_{x=}f(P_x, P_z, T, G, C, E_x, G_P)$
4. The law of supply states that there is a direct relationship between price and quantity supplied of a commodity, other things remaining constant. The assumptions of the law are that P_z, T, G, C, E_x and G_P are constant.
5. The *supply schedule* shows the different quantities of a commodity supplied by a firm within a given period of time at different prices.
6. The data of supply schedule is plotted on price-quantity axes to derive the supply curve. The supply curve is upward sloping because of:
   i. law of diminishing marginal productivity
   ii. goal of profit maximisation.

7. *Individual supply* is the supply on the part of a single producer at various prices per time period. *Market supply* is the aggregate of the quantity supplied by all the producers at various prices per time period. Market supply curve is constructed by horizontal summation of individual supply curves.
8. Movement along a supply curve occurs due to changes in the price of good *(P_x)* itself. Shift of the supply curve occurs due to changes in P_z, *T*, G, C, E_x or G_P. Movement can be expansion (extension) or contraction of supply whereas shift can be increase or decrease in supply
9. The concept of *Elasticity of supply (E_s)* was developed by Marshall. Elasticity of supply is defined as the responsiveness of quantity supplied of a good to changes in its own price. Symbolically,

$$E_s = +\frac{\Delta Q}{\Delta P}.\frac{P}{Q}$$

10. There are five degrees of E_s:

i. Perfectly inelastic supply (E_s = 0)
ii. Inelastic supply *($0<E_S<1$)*
iii. Unitary elastic supply *(E_s = 1)*
iv. Elastic supply ($1 < E_s < \infty$)
v. Perfectly elastic supply *($E_s = \infty$)*.

11. **For *point elasticity*** *there* is no change in the formula. For *arc elasticity* the formula is modified

$$E_s = +\frac{q_1 - q_2}{q_2 + q_1} x \frac{P_1 - P_2}{P_1 + P_2}$$

12. Diagrammatic Method.

The rule is if the supply curve passes through the point of origin, E_s is equal to unity; if the supply curve intercepts the x-axis, E_s is less than unity; and if supply curve intercepts the *y*-axis, E_s is greater than unity.

THEORY OF PRODUCTION

1. Production means creation of economic utilities which can he form utility, time utility and place utility.
2. Production level decides the economic growth, prosperity level and standard of living of people of a nation.
3. There are four factors of production namely land, labour, capital and organisation.
4. ***Land***
   - Land is a primary factor which includes besides physical territory, all natural resources such as water, soil, climate, wind, sea, etc.
   - Features of land are:
   a) Its supply is perfectly inelastic.
   b) It is a free gift of nature.
   c) It is imperishable.
   d) It is immobile.
   e) It is a passive factor.
   f) It is hetrogeneous.
   - Land is a very significant factor. It is the original source of all material wealth. It affects all aspects of economic life.
5. ***Labour***
   - Labour is any physical or mental exertion undertaken to create or produce goods or services.
   - Features of labour are:
   (a) It is perishable.
   (b) It is an active factor.
   (c) It is inseparable from a labourer.
   (d) Labour is a man, not a machine.
   (e) He sells his services and not himself.
   (f) It is difficult to calculate cost of labour.
   (g) All labourers are not equally efficient.
   (h) Supply curve of labour is backward bending.
   (i) Labour is mobile.
6. *Capital* Capital is defined as man made goods that are used for further production of wealth.
7. *Capital formation* or investment is defined as the surplus of production over consumption in an accounting year which is further used for production.
   - Significance of capital formation lies in the following points:
   a. It determines the growth rate of an economy.
   b. It increases production.
   c. It raises productive capacity.
   d. It raises employment opportunities.
   - There are three *stages of capital formation* which should be systematically linked. These are:

Stage I : Creation of Savings
Stage II: Mobilisation of Savings
Stage III: Investment of Savings.

8. ***Entrepreneur***
   (a) Entrepreneur is the person who organises, manages and coordinates all factors of production.
   (b) Functions of an entrepreneur are:
   i. Initiating a business enterprise and resource coordinator
   ii. To take advantage of changes in a dynamic economy
   iii. To bring about innovations
   iv. To bear uncertainties.
9. Production function is the process of getting the maximum output from a given quantity of inputs in a particular time period.
   - There are two types of production function:
     (a) Short-run production function: where some factors are in fixed supply. (Atleast '1' factor will be fixed.)
     (b) Long-run production function: where all factors are in variable supply.
10. Law of variable proportions
    - The three concepts of production are total, average and marginal product. *Total product* is total quantity of goods produced by a firm with the given inputs, during a specified period of time.
    - *Average* product is the amount of output per unit of the variable factor employed. *Marginal* product is the change in total product resulting from the employment of one more unit of variable factor.
    - *TP* curve starts from the origin, rises at an increasing rate, then rises at a decreasing rate, reaches a maximum and then starts falling.
    - Both *AP* and *MP* curves are graphically derived from the *TP* curve. Both *AP* and *MP* curves are inverted-U shaped. They have special relationship which is as follows:
      (a) When *AP* is rising, *MP > AP.*
      (b) When *AP* is at its maximum, MP = *AP.*
      (c) When *AP* is falling, *MP < AP.*

      Law of variable proportions. It is a widely observed short-run law. It states that 'when total output of a commodity is increased by adding units of a variable factor, while the quantities of other inputs are held constant, the increase in total production becomes, after some point, smaller and smaller'. The three product curves are drawn to graphically illustrate the law of variable proportions. The three stages are partitioned into increasing, diminishing and negative returns.

      A rational producer will always operate in Stage II with diminishing returns. In this stage both *AP* and MP are declining but positive. The reason for diminishing returns is optimal use of fixed factor and perfect substitution between factors.

      1st stage: Increase returns → TP↑, AP(max), MP↑
      2nd stage: Diminishing returns → TP(max), AP↓ '+'ive, MP(0)
      3rd Stage: Negetive Returns → TP↓, AP↓, MP(-ive).
11. ***Law of Returns to Scale***
    - It is a long-run law.
    - It states that 'when all factors of production are increased in the same proportion, output will increase, but the increase may be at an increasing rate or constant rate or decreasing rate'.
    - The three stages of law of returns to scale are increasing, constant and decreasing,
12. Reason behind increasing returns is economies of scale which can be internal or external. Reason behind decreasing returns are diseconomies of scale which can also be internal or external.
    1st Stage : Increase returns to scale → Rise of out put is grater than rise in input.
    2nd Stage : Constant return to scale → Rise of output is equal to rise in input.
    3rd Stage : Diminshing return to scale → Rise of out put is lesser than rise in input.
    - 'Constant return to scale is also called as linear homogeneous production function.

Cobb-Douglas Production Function

A famous statistical production function is Cobb-Douglas production function. Paul H. Douglas and C.W. Cobb of the U.S.A. studied the production function of the American manufacturing industries. In its original form, this production function applies not to an individual firm but to the whole of manufacturing in the United States. In this case, output is manufacturing production and inputs used are labour and capital.

Cobb-Douglas production function

$\mathbf{Q = KL_a C_{(1-a)}}$

where 'Q' is output, 'L' the quantity of labour and 'C' the quantity of capital. 'K' and 'a' are positive constants. The conclusion drawn from this famous statistical study is that labour contributed about 3/4th and capital about 1/4th of the increase in the manufacturing production.

THEORY OF COST

1. Cost theory helps to determine the supply curve, which together with the demand curve, determines equilibrium price and quantity
2. Opportunity Cost *vs.* Outlay Cost. Opportunity cost is defined as the cost of alternative opportunity given up or forgone. It is also called alternative cost or transfer earnings. Outlay cost is actual expenditure of firms.
3. Explicit Cost *vs.* Implicit Cost Explicit cost is the actual money expenditure incurred by a firm in the production process. It is also called direct cost or money cost. Implicit cost is the cost of factors owned by the firm and used by the firm in its own production process. It is also called imputed cost.
4. Direct Cost *vs.* Indirect Cost

   Direct cost can be traced to a particular product. Indirect cost cannot be traced to a particular product.
5. Accounting Cost *vs.* Economic Cost Accounting costs are explicit cost or actual cash payments. Economic cost is accounting cost plus implicit cost.
6. ***Short-Run Cost Curves***

   (1) Total Cost is inverse-S shaped starting from the level of fixed cost.

   (2) Average Cost.
   - *AFC,* is fixed cost per unit of output produced. It is a rectangular hyperbola.
   - *AVC* is variable cost per unit of output produced. It is U- shaped due to law of variable proportion.
   - *AC* is also called average total cost (*ATC*). It can be obtained in two ways:

     i. $AC = \frac{TC}{Q}$ It gives U- Shaped AC curve. The reason behind its shape is the law of variable proportions.

     ii. *AC* = *AFC* + *AVC.* By aggregating *AFC* and *AVC* values we get U-shaped *AC* curve. The minimum point of *AC* curve will always occur to the right of the minimum point of the *AVC* curve.

   (3) Marginal Cost

   MC is addition made to TC (or *TVC)* when one more unit of output is produced. MC = $MC = \frac{\Delta TC}{\Delta Q}$ is the slope of the *TC* curve at each and every point. MC curve is U-shaped reflecting the law of variable proportions.

   (4) Relationship between AC and MC

   1. Both *AC* and MC curves are derived from TC curve, since $AC = \frac{TC}{Q}$ and $MC = \frac{\Delta TC}{\Delta Q}$
   2. Both *AC* and MC curves are U- shaped reflecting the law of variable proportions.
   3. When *AC* is falling, MC is below it.
   4. When AC is rising, MC is above it.
   5. When *AC* is neither falling nor rising, MC = *AC.*
   6. There is a range over which *AC* is falling and MC is rising.
   7. MC curve cuts the *AC* curve at its minimum point.
7. Long run average Cost *(LAC)* curve is an enveloping curve. It envelopes infinite short run *AC* curves. Each point on *LAC* gives the minimum cost per unit of producing the desired level of output.

MEANING AND TYPES OF MARKETS

1. A market is a complex set of activities by which potential buyers and sellers interact to determine the price and quantity of a good or service.
2. Whether market is local, national or international depends upon:

   (a) Kind of commodity

   (b) Size of production

   (c) Extent of demand

   (d) Mean of communication and transport

(e) Peace and security

(f) Development of money, banking and financial institutions

(g) Trade policy of the government.

3. ***Value and Price:*** Price is the value of good in terms of money and value is economic worth of a good expressed in relation to another good.
4. ***Market Structures***

   On this basis of competition, markets can be classified into
   - *Perfect Competition*
   - *Monopoly*