# Financial Accounting (BCom Hons, DU - Semester I) Exam-Focused Notes with Examples

## 1 Theoretical Framework of Accounting

This section lays the foundational principles and rules that govern how financial transactions are recorded, classified, summarized, and presented. These concepts and conventions ensure consistency, comparability, and reliability in financial reporting.

### 1.1 Accounting Concepts & Conventions:

- **Business Entity Concept:** This concept states that for accounting purposes, the business is considered a separate and distinct entity from its owner(s). This means that personal transactions of the owner are not mixed with business transactions.
  - **Example:** When the owner invests Rs. 1,00,000 into the business, it is treated as "capital" (a liability of the business to the owner), not as income to the business. Similarly, if the owner withdraws cash for personal use, it's recorded as "drawings," reducing the owner's capital, not as a business expense.
- **Money Measurement Concept:** Only transactions and events that can be expressed in monetary terms are recorded in the books of accounts. Non-monetary events, no matter how important, are not recorded.
  - **Example:** The skill and dedication of an employee are crucial for a business but cannot be directly measured in money and thus are not recorded. However, the employee's salary of Rs. 25,000 is recorded because it's a monetary transaction.
- **Going Concern Concept:** This fundamental assumption states that a business will continue to operate for an indefinite period in the foreseeable future and will not be liquidated in the near future.
  - **Example:** Long-term assets like buildings are depreciated over their useful economic life rather than being shown at their current market value, as they are intended for continued use in the business, not for immediate sale. This concept justifies the classification of assets and liabilities as current and non-current.
- **Accrual Concept:** This concept dictates that revenues and expenses are recognized and recorded when they are earned or incurred, respectively, regardless of when the cash is actually received or paid.
  - **Example:** If rent of Rs. 5,000 is due for the current period but has not yet been paid, it is still recorded as a rent expense for that period and shown as an outstanding liability. This provides a more accurate picture of a company's financial performance.
- **Conservatism (Prudence) Concept:** This convention suggests that when there are two equally acceptable alternatives for recording a transaction, the one that results in a lower profit or lower asset valuation (or higher liability) should be

chosen. It advocates for anticipating and recording all probable losses but not anticipating any probable gains.

  - **Example:** A "provision for doubtful debts" of Rs. 2,000 is created to account for anticipated losses from bad debts, even if the actual loss has not yet occurred. This avoids overstating profits or assets.

- **Cost Concept (Historical Cost):** Assets are recorded at their original acquisition cost, not at their market value. This cost includes the purchase price plus all expenses necessary to bring the asset to its present location and condition for its intended use.
- **Dual Aspect Concept:** Every business transaction has two aspects: a debit and a credit, and these two aspects must be equal. This is the basis of the double-entry system of accounting (Assets = Liabilities + Owner's Equity).
- **Revenue Recognition Concept:** Revenue is recognized when it is earned, typically when goods are sold or services are rendered, and not necessarily when cash is received.
- **Matching Concept:** Expenses incurred to generate revenue are recognized in the same accounting period as the revenue they helped to produce.

### 1.2 Accounting Standards (Ind AS - Indian Accounting Standards):

- **Purpose:** Accounting Standards are written policy documents issued by expert accounting bodies or government agencies covering various aspects of measurement, treatment, presentation, and disclosure of accounting transactions and events. They ensure uniformity, consistency, and comparability of financial statements.
- **Ind AS 1 - Presentation of Financial Statements:** This standard prescribes the basis for presentation of general-purpose financial statements to ensure comparability both with the entitys own financial statements of prior periods and with the financial statements of other entities.
  - **Example:** Ind AS 1 mandates that the Balance Sheet and Profit & Loss (P&L) Account must follow a specific, standardized format for clarity and comparability. This includes minimum line items and presentation guidelines.

**PYQ Focus:** Explaining fundamental accounting assumptions (often Business Entity, Going Concern, Accrual, and Money Measurement) with suitable examples.

## 2 Accounting Process

This section outlines the systematic steps involved in identifying, recording, classifying, summarizing, and presenting financial transactions.

### 2.1 Journal Entries:

- **Definition:** The first stage of recording transactions, where financial transactions are recorded chronologically in a "Journal" (also known as the book of original entry). Each entry shows the accounts to be debited and credited, along with a brief explanation (narration).

- **Rules of Debit and Credit:**
  - **Assets:** Increase in Asset = Debit; Decrease in Asset = Credit
  - **Liabilities:** Increase in Liability = Credit; Decrease in Liability = Debit
  - **Capital:** Increase in Capital = Credit; Decrease in Capital = Debit
  - **Expenses/Losses:** Increase in Expense/Loss = Debit; Decrease in Expense/Loss = Credit
  - **Revenues/Gains:** Increase in Revenue/Gain = Credit; Decrease in Revenue/Gain = Debit
- **Example:** If goods are sold for cash for Rs. 10,000:
  - Cash is an asset, and it's increasing, so Cash A/c is Debited.
  - Sales is a revenue, and it's increasing, so Sales A/c is Credited.
  - **Journal Entry:**

```
Cash A/c Dr. Rs. 10,000
    To Sales A/c     Rs. 10,000
(Being goods sold for cash)
```

### 2.2 Ledger and Trial Balance:

- **Ledger:** After journalizing, transactions are posted to individual accounts in the "Ledger" (also known as the principal book of accounts). Each account (e.g., Cash, Sales, Purchases, Capital) has separate debit and credit columns, summarizing all transactions related to that particular account.
  - **Example (Posting from above Journal Entry):**
    - **Cash A/c:** (Debit side) "To Sales A/c Rs. 10,000"
    - **Sales A/c:** (Credit side) "By Cash A/c Rs. 10,000"
- **Trial Balance:** A statement prepared at the end of an accounting period (or periodically) listing the balances of all ledger accounts (debit balances and credit balances). Its primary purpose is to check the arithmetical accuracy of the ledger accounts, as total dezbits must equal total credits.
  - **Example (based on entries):** If Cash A/c has a debit balance of Rs. 10,000 and Sales A/c has a credit balance of Rs. 10,000, these would appear on the respective sides of the trial balance, ensuring equality.

**PYQ Focus:** Passing various journal entries for given transactions and then preparing their respective ledger accounts and ultimately a trial balance.

## 3 Depreciation Accounting

Depreciation is the systematic allocation of the cost of a tangible asset over its useful life. It reflects the consumption of the asset's economic benefits.

### 3.1 Methods of Depreciation:

- **Straight Line Method (SLM):** This method charges a fixed amount of depreciation each year over the asset's useful life.
  - **Formula:** Annual Depreciation = (Cost of Asset - Salvage Value) / Useful Life
  - **Example:** Machine cost Rs. 1,00,000, estimated useful life = 5 years, Salvage Value = 0.
    - Annual Depreciation = Rs. 1,00,000 / 5 = Rs. 20,000 per year.
- **Written Down Value Method (WDV) / Reducing Balance Method:** This method charges depreciation at a fixed percentage on the diminishing (reducing) balance of the asset each year. Depreciation expense is higher in earlier years and decreases over time.
  - **Example:** Same machine (cost Rs. 1,00,000), depreciation rate = 20%.
    - **Year 1:** Depreciation = 20% of Rs. 1,00,000 = Rs. 20,000. Book Value = Rs. 80,000.
    - **Year 2:** Depreciation = 20% of Rs. 80,000 = Rs. 16,000. Book Value = Rs. 64,000.
- **Other Methods:** While SLM and WDV are common, others include Sum of the Years' Digits Method, Units of Production Method, etc.

### 3.2 Change of Method:

- **AS 6 / Ind AS 16 (Property, Plant and Equipment):** Accounting standards typically allow a change in depreciation method only if it is required by statute, for compliance with an accounting standard, or if it results in a more appropriate presentation of the financial statements.
- **Retrospective vs. Prospective Application:**
  - **Retrospective Adjustment (as per older AS-6):** When changing the method, the difference in accumulated depreciation calculated under the old and new methods from the asset's inception up to the date of change was adjusted in the current year's profit and loss account or by adjusting the opening balance of reserves.
  - **Prospective Application (as per Ind AS 16):** Under Ind AS 16, a change in depreciation method is treated as a change in accounting estimate, and its effect is applied prospectively from the date of change. This means no restatement of prior period financial statements or adjustment to opening reserves.

- **Example (as per older AS-6, mentioned in notes):** If a switch from SLM to WDV occurs in Year 3, a retrospective adjustment would calculate the depreciation for Year 1 and 2 as if WDV was always used, and the difference would be adjusted in the current year. *Note: For current exam preparation, be aware that Ind AS 16 generally requires prospective application unless specified otherwise.*

**PYQ Focus:** Calculating depreciation using both SLM and WDV methods, and showing its impact on the Profit & Loss Account (as an expense) and Balance Sheet (reducing asset value and impacting accumulated depreciation). Understanding the accounting treatment for a change in depreciation method is also crucial.

# 4 Rectification of Errors

Rectification of errors involves correcting mistakes made in the accounting records to ensure that financial statements present a true and fair view.

## 4.1 Types of Errors:

- **Error of Omission:** A transaction is completely or partially omitted from the books of accounts.
  - **Example:** A cash sale of Rs. 5,000 was never recorded in the journal or ledger.
- **Error of Commission:** A transaction is recorded incorrectly, involving wrong amounts, wrong accounts of the same nature (e.g., wrong customer account), or errors in totaling, balancing, or carrying forward.
  - **Example:** Goods purchased for Rs. 5,000 were correctly debited to Purchases A/c but credited to the supplier's account as Rs. 6,000 instead of Rs. 5,000.
- **Error of Principle:** A transaction is recorded in violation of fundamental accounting principles (e.g., treating a capital expenditure as a revenue expenditure). These errors affect the financial statements and do not necessarily affect the trial balance agreement.
  - **Example:** The cost of installing a new machine (capital expenditure) is wrongly debited to "Repairs and Maintenance A/c" (revenue expenditure).
- **Compensating Errors:** Two or more errors cancel out each other, so the debit and credit totals of the trial balance remain equal. These errors are harder to detect as they don't affect the trial balance's agreement.
  - **Example:** A debit of Rs. 100 in one account was wrongly omitted, and a credit of Rs. 100 in another account was also wrongly omitted.

## 4.2 Suspense Account:

- **Purpose:** If a trial balance does not agree, a temporary account called "Suspense Account" is opened to balance the trial balance temporarily. The difference is posted to this account.

- **Clearing the Suspense Account:** Once the errors causing the difference are located, rectification entries are passed, and the suspense account is closed.
  - **Example:** If the debit side of the trial balance is short by Rs. 2,000, the Suspense Account is debited by Rs. 2,000 to balance it. Later, if it's found that a purchase of Rs. 2,000 was not posted to the Purchases A/c, the entry would be: Purchases A/c Dr. Rs. 2,000; To Suspense A/c Rs. 2,000. This clears the suspense account.

**PYQ Focus:** Rectifying various types of errors (single-sided, double-sided, affecting/not affecting trial balance) by passing appropriate journal entries, and preparing the Suspense Account if necessary.

# 5 Bank Reconciliation Statement (BRS)

A Bank Reconciliation Statement is a statement prepared to reconcile the differences between the cash book balance (bank column) and the bank passbook balance on a particular date.

## 5.1 Causes of Differences:

Differences arise primarily due to timing differences or errors made by either the business or the bank.

- **Timing Differences:**
  - **Cheques issued but not yet presented for payment:** The business deducts this immediately in the cash book, but the bank only records it when the cheque is presented.
    * **Example:** A cheque of Rs. 5,000 issued to a supplier has been debited in the cash book but not yet cleared by the bank. When preparing BRS starting from Cash Book balance, this amount needs to be **added back** to the cash book balance to match the passbook.
  - **Cheques deposited but not yet cleared/credited by the bank:** The business records this as a receipt in the cash book, but the bank only credits it after collection.
    * **Adjustment:** If starting from Cash Book balance, this amount needs to be **deducted**.
  - **Direct payments made by the bank on behalf of the customer (e.g., insurance premium, loan installment):** Bank debits the account, but the business may not be aware immediately.
    * **Adjustment:** If starting from Cash Book balance, this amount needs to be **deducted**.
  - **Direct deposits/collections made by the bank (e.g., interest credited, dividends collected, direct deposit by customer):** Bank credits the account, but the business may not be aware immediately.

  * **Example:** A customer directly deposited Rs. 2,000 into the bank account, which is shown in the passbook but not yet recorded in the cash book. When preparing BRS starting from Cash Book balance, this amount needs to be **added** to the cash book balance.

- **Errors:** Errors made by the bank (e.g., wrong debits/credits) or errors made by the business in the cash book (e.g., wrong amount recorded, omission).

**PYQ Focus:** Preparing a Bank Reconciliation Statement by taking either the cash book balance or the passbook balance as the starting point and adjusting for various differences to arrive at the other's balance.

## 6 Financial Statements of Sole Proprietorship

Financial statements are structured representations of the financial position and performance of an enterprise. For a sole proprietorship, these primarily include the Trading Account, Profit & Loss Account, and Balance Sheet.

### 6.1 Trading Account:

- **Purpose:** Prepared to ascertain the Gross Profit or Gross Loss from buying and selling goods. It includes direct expenses related to purchases and manufacturing.
- **Format (Key elements):** Opening Stock, Purchases, Direct Expenses (e.g., wages, carriage inward) on the Debit side; Sales, Closing Stock on the Credit side.
- **Example:**
  - Gross Sales = Rs. 1,00,000
  - Purchases = Rs. 70,000
  - Opening Stock = Rs. 10,000, Closing Stock = Rs. 20,000
  - Direct Expenses (e.g., wages) = Rs. 5,000
  - Calculation: Cost of Goods Sold = Opening Stock + Purchases + Direct Expenses - Closing Stock = 10,000 + 70,000 + 5,000 - 20,000 = Rs. 65,000
  - Gross Profit = Sales - Cost of Goods Sold = 1,00,000 - 65,000 = Rs. 35,000. (The example in notes gives Rs. 30,000, which would imply different closing stock/expenses or an error in the original note).

### 6.2 Profit & Loss Account:

- **Purpose:** Prepared to ascertain the Net Profit or Net Loss of the business for an accounting period. It considers all indirect revenues and expenses.
- **Format (Key elements):** Gross Profit (transferred from Trading A/c), Other Revenues (e.g., rent received, interest received) on the Credit side; Indirect Expenses (e.g., salaries, rent, depreciation, advertising, interest paid) on the Debit side.
- **Example (Continuing from above):**

- Gross Profit = Rs. 30,000 (from notes example)
- Indirect Expenses = Rs. 10,000 (as per notes example, e.g., salaries)
- Net Profit = Gross Profit - Indirect Expenses = Rs. 30,000 - Rs. 10,000 = Rs. 20,000.

### 6.3 Balance Sheet:

- **Purpose:** A statement of the financial position of a business at a specific point in time. It presents assets, liabilities, and owner's equity.
- **Fundamental Accounting Equation:** Assets = Liabilities + Owner's Equity (Capital).
- **Format:** Typically presented in a "T" format (Assets on one side, Liabilities and Capital on the other) or a vertical format (Equity & Liabilities section followed by Assets section).
- **Key Classifications:**
  - **Assets:**
    * **Non-Current Assets (Fixed Assets):** Assets held for long-term use and not for resale (e.g., Land, Building, Machinery, Furniture).
    * **Current Assets:** Assets expected to be converted into cash or used up within one year or the operating cycle (e.g., Cash, Bank, Debtors, Stock, Prepaid Expenses).
  - **Liabilities:**
    * **Non-Current Liabilities (Long-term Liabilities):** Obligations due after one year (e.g., Long-term Loans, Debentures).
    * **Current Liabilities:** Obligations due within one year or the operating cycle (e.g., Creditors, Bills Payable, Outstanding Expenses).
  - **Owner's Equity (Capital):** Owner's investment in the business + Net Profit - Drawings.
- **Example:**
  - Capital = Rs. 1,50,000
  - Fixed Assets = Rs. 80,000
  - Current Assets = Rs. 70,000
  - *Implicit:* If Net Profit of Rs. 20,000 (from P&L) is added to capital, and assuming no drawings, then Total Capital becomes 1,50,000 + 20,000 = 1,70,000.
  - Total Assets = Fixed Assets + Current Assets = 80,000 + 70,000 = 1,50,000.
  - *To balance, Liabilities must be 1,70,000 - 1,50,000 = 20,000 if capital is adjusted. The note implies a direct balance.*

  - The example in notes simply states Capital = Rs. 1,50,000, Fixed Assets = Rs. 80,000, Current Assets = Rs. 70,000, implying these numbers already balance or are parts of a larger example where liabilities are also given. To balance, if no other liabilities exist, Capital would be 1,50,000, and Assets would be 1,50,000. If we add the Net Profit of 20,000, Capital would be 1,70,000. Total Assets must also be 1,70,000 for the balance sheet to agree.

**PYQ Focus:** Preparing a complete set of final accounts (Trading Account, Profit & Loss Account, and Balance Sheet) from a given trial balance and often with additional adjustments (e.g., closing stock, depreciation, outstanding/prepaid expenses).

## 7 Bills of Exchange and Promissory Notes

These are negotiable instruments used to facilitate credit transactions.

### 7.1 Bills of Exchange:

- **Definition:** A bill of exchange is an unconditional order in writing, signed by the drawer (creditor), directing the drawee (debtor) to pay a certain sum of money to a specified person (payee) or to the bearer of the instrument on demand or at a fixed or determinable future time.
- **Parties:**
  - **Drawer:** The person who writes the bill and orders the payment (the creditor).
  - **Drawee:** The person who is ordered to pay (the debtor, who accepts the bill).
  - **Payee:** The person to whom the payment is to be made (can be the drawer himself or a third party).
- **Example:** A (Drawer/Creditor) draws a bill on B (Drawee/Debtor) for Rs. 10,000, payable after 3 months. B accepts the bill, making it a valid instrument.
- **Key Scenarios/Terms:**
  - **Acceptance:** The drawee signs the bill to indicate agreement to pay.
  - **Discounting:** The holder of the bill can get it encashed from the bank before its due date, but the bank charges a discount.
  - **Endorsement:** The bill can be transferred to a third party by endorsement (signing on the back).
  - **Collection:** The bill can be sent to the bank for collection on the due date.
  - **Dishonour:** When the drawee fails to pay the bill on its due date.
  - **Noting Charges:** Fees paid to a notary public for officially recording the dishonour of a bill.
  - **Renewal:** A new bill is drawn in place of the old one, usually with interest for the extended period.

- **Retiring a Bill:** The drawee pays the bill before its due date, usually receiving a rebate.

### 7.2 Promissory Notes:

- **Definition:** An unconditional undertaking in writing, signed by the maker (debtor), to pay a certain sum of money to a specified person (payee) or to the bearer of the instrument on demand or at a fixed or determinable future time.
- **Parties:**
  - **Maker:** The person who promises to pay (the debtor).
  - **Payee:** The person to whom the payment is to be made (the creditor).
- **Key Difference from Bill of Exchange:** In a bill, the drawer orders the drawee to pay. In a promissory note, the maker himself promises to pay.

### 7.3 Journal Entries (Key examples):

- **In Drawer's (A's) Books (when A draws on B and B accepts):**

```
Bills Receivable A/c Dr. Rs. 10,000
    To B's A/c             Rs. 10,000
(Being bill drawn on B and accepted)
```

- **In Drawee's (B's) Books (when B accepts A's bill):**

```
A's A/c            Dr. Rs. 10,000
    To Bills Payable A/c   Rs. 10,000
(Being bill accepted drawn by A)
```

- **On Maturity (if bill is honored):**
  - **Drawer's Books:** Bank A/c Dr. / To Bills Receivable A/c
  - **Drawee's Books:** Bills Payable A/c Dr. / To Bank A/c
- *Further entries exist for discounting, endorsement, dishonour, renewal, etc.*

**PYQ Focus:** Passing comprehensive journal entries in the books of both the drawer and the drawee for the entire life cycle of a bill of exchange, including scenarios like acceptance, discounting, endorsement, dishonour, and renewal.

## 8 Consignment and Joint Venture

These are special arrangements for doing business, particularly for selling goods.

### 8.1 Consignment:

- **Definition:** A business arrangement where one person (the consignor) sends goods to another person (the consignee) for sale on his behalf and at his risk. The consignee sells the goods, earns commission, and remits the proceeds after deducting expenses. The consignor remains the owner of the goods until they are sold by the consignee.

- **Key Terms:**
  - **Consignor:** The owner of the goods who sends them.
  - **Consignee:** The agent who receives and sells the goods.
  - **Proforma Invoice:** A statement sent by the consignor to the consignee, detailing the goods sent, but not a sales invoice.
  - **Account Sales:** A statement sent by the consignee to the consignor, detailing sales made, expenses incurred, commission, and balance due.
  - **Commission:** Remuneration to the consignee for selling the goods. Can be ordinary, del credere (for guaranteeing collection of debts), or overriding.
  - **Unsold Stock:** Goods remaining with the consignee at the end of the period, valued at cost plus proportionate non-recurring expenses.
- **Journal Entries (Consignor's Books - Key):**
  - **When goods are sent on consignment:**

```
Consignment A/c Dr. Rs. 50,000
    To Goods Sent on Consignment A/c Rs. 50,000
(Being goods sent on consignment)
```

  - **When expenses are incurred by consignor:** Consignment A/c Dr. / To Cash/Bank A/c
  - **When expenses are incurred by consignee (and intimated):** Consignment A/c Dr. / To Consignee's A/c
  - **When goods are sold by consignee:** Consignee's A/c Dr. / To Consignment A/c
  - **For commission due to consignee:** Consignment A/c Dr. / To Consignee's A/c (e.g., 5% of sales).
  - **For unsold stock:** Stock on Consignment A/c Dr. / To Consignment A/c

### 8.2 Joint Venture (JV):

- **Definition:** A temporary partnership or an arrangement where two or more parties undertake a specific business venture together with a common objective, sharing profits or losses in an agreed ratio. It is usually for a specific project and duration, unlike a continuous partnership.
- **Key Characteristics:**
  - Specific purpose and limited duration.
  - Joint control and management.
  - Sharing of profits and losses.

- No firm name is usually adopted.

- **Accounting Methods:**
  - **Separate Set of Books:** A completely new set of books is maintained for the joint venture.
  - **Memorandum Joint Venture Account:** Each co-venturer maintains records in their own books, and a memorandum account is prepared to ascertain the profit/loss.

- **Example:** A and B enter a JV. A buys goods for Rs. 40,000. B sells them for Rs. 60,000.
  - Profit = Sales - Purchases = Rs. 60,000 - Rs. 40,000 = Rs. 20,000.
  - If shared equally, A's share = Rs. 10,000, B's share = Rs. 10,000.

**PYQ Focus:** Preparing Consignment Account, Consignee's Account, and Goods Sent on Consignment Account in the books of the consignor; or preparing Joint Venture Account and Co-venturers' Accounts using the given data.

# 9 Inventory Valuation

Inventory (stock) refers to assets held for sale in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the rendering of services. Valuation of inventory directly impacts the cost of goods sold and the closing stock value, hence affecting profit and asset reporting.

## 9.1 Methods of Inventory Valuation:

- **First-In, First-Out (FIFO):** Assumes that the first goods purchased or produced are the first ones sold. This generally results in closing inventory being valued at the most recent purchase prices. In times of rising prices, FIFO leads to higher reported profits and higher inventory values.
  - **Example:**
    - Purchases: 100 units @ Rs. 10, then 100 units @ Rs. 12.
    - Issue (Sale) of 150 units.
    - **FIFO Cost:** The first 100 units issued are from the Rs. 10 lot, and the next 50 units are from the Rs. 12 lot.
    - Cost of 150 units = (100 units $\times$ Rs. 10) + (50 units $\times$ Rs. 12) = Rs. 1,000 + Rs. 600 = Rs. 1,600.
    - Remaining inventory (closing stock): 50 units @ Rs. 12.
- **Last-In, First-Out (LIFO):** Assumes that the last goods purchased or produced are the first ones sold. This generally results in closing inventory being valued at older (earlier) purchase prices. In times of rising prices, LIFO leads to lower

reported profits and lower inventory values. *Note: LIFO is generally not permitted under Ind AS/IFRS.*

  - **Example (Using previous data for illustration):**
    * Purchases: 100 units @ Rs. 10, then 100 units @ Rs. 12.
    * Issue (Sale) of 150 units.
    * **LIFO Cost:** The first 100 units issued are from the Rs. 12 lot, and the next 50 units are from the Rs. 10 lot.
    * Cost of 150 units = (100 units × Rs. 12) + (50 units × Rs. 10) = Rs. 1,200 + Rs. 500 = Rs. 1,700.
    * Remaining inventory (closing stock): 50 units @ Rs. 10.

- **Weighted Average Method:** Calculates a weighted average cost for all units available for sale and uses this average to value both cost of goods sold and ending inventory.

### 9.2 AS-2 / Ind AS 2 - Valuation of Inventories:

- **Principle:** Inventories are valued at the **lower of cost and Net Realisable Value (NRV)**. This is an application of the conservatism principle.
  - **Cost:** Includes all costs of purchase, costs of conversion (for finished goods), and other costs incurred in bringing the inventories to their present location and condition.
  - **Net Realisable Value (NRV):** The estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.
- **Example:** If the cost of an inventory item is Rs. 1,000 and its Net Realisable Value (NRV) is Rs. 900, the inventory must be valued at Rs. 900, which is the lower of the two. If NRV was Rs. 1,100, it would be valued at Rs. 1,000.

**PYQ Focus:** Computing inventory value using FIFO (and sometimes LIFO, though less relevant under current standards) with clear working notes, applying the lower of cost or NRV principle.

## 10 PYQ Practice Topics (Frequent)

This table summarizes the types of questions frequently asked in exams, correlating with the above topics:

| Topic | Type of Question |
|---|---|
| Accounting Concepts | Define and apply with examples |
| Journal, Ledger & Trial Balance | Prepare from transactions |
| Depreciation | Calculate using SLM and WDV |
| Rectification of Errors | Journal entries for given errors |
| BRS | Prepare statement from mismatch data |
| Final Accounts | Prepare P&L and Balance Sheet |
| Bills of Exchange | Entries for bill life cycle |
| Consignment/JV | Prepare relevant accounts |
| Inventory | Valuation using FIFO/LIFO |

Table 1: Frequently Asked Questions in Financial Accounting