



ACCOUNTANCY

12th Std

**Based on the New Syllabus and
New Textbook for the year 2019-20**

Salient Features

- Exhaustive Additional MCQs, VSA, SA, and Problems with answers are given in each chapter.
- All the objective type (1 Mark) questions, are given with 4 options.
 - (i) Choosing the Correct option
 - (ii) Matching
 - (iii) Fill in the Blanks
 - (iv) Picking the Odd one Out
 - (v) Correctly Matched / Not Correctly Matched
 - (vi) Assertion & Reason
 - (vii) Choosing the Correct Statement



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Chennai

2019-20 Edition

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Authors :

- Mrs. Sathiya Rathakrishnan, M.Com., M.Phil., MBA. Nagercoil
- Mr. Parameswaran, M.Com., M.Phil. Trichy
- Mr. Santhosh Kumar, M.Com., B.Ed. Chennai

Edited by :

- Mrs. Lalitha Krishnan, M.Com., B.Ed. Madurai
- Ms. Geetha, M.Com. Chennai

Reviewed by :

- Dr. Ramakrishnan, M.Com., M.Phil., Ph.D. Chennai
- Mrs. Vidya Chandrasekar, M.Com., M.Phil. Chennai

Head Office:

1620, J Block, 16th Main Road,
Anna Nagar, Chennai - 600 040.
Phones: 044-26162173, 26161099.
Mob : 81242 01000/ 81243 01000
Fax : (91) 44-26162173
e-mail : orders@surabooks.com
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(ii)

PREFACE

The woods are lovely, dark and deep.
But I have promises to keep, and
miles to go before I sleep

- *Robert Frost*

Respected Principals, Correspondents, Headmasters/ Headmistresses, Teachers,

From the bottom of our heart, we at SURA Publications sincerely thank you for the support and patronage that you have extended to us for more than a decade.

It is in our sincerest effort we take the pride of releasing **SURA's Accountancy** for +2 Standard - Edition 2019. This guide has been authored and edited by qualified teachers having teaching experience for over a decade in their respective subject fields. This Guide has been reviewed by reputed Professors who are currently serving as Head of the Department in esteemed Universities and Colleges.

With due respect to Teachers, I would like to mention that this guide will serve as a teaching companion to qualified teachers. Also, this guide will be an excellent learning companion to students with exhaustive exercises and in-text questions in addition to precise answers for textual questions.

In complete cognizance of the dedicated role of Teachers, I completely believe that our students will learn the subject effectively with this guide and prove their excellence in Board Examinations.

I once again sincerely thank the Teachers, Parents and Students for supporting and valuing our efforts.

God Bless all.

Subash Raj, B.E., M.S.

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(iv)

CONTENT

1. ACCOUNTS FROM INCOMPLETE RECORDS 1 - 34
2. ACCOUNTS OF NOT - FOR - PROFIT ORGANISATION 35 - 70
3. ACCOUNTS OF PARTNERSHIP FIRMS - FUNDAMENTAL 71 - 102
4. GOODWILL IN PARTNERSHIP ACCOUNTS 103 - 120
5. ADMISSION OF A PARTNER 121 - 158
6. RETIREMENT AND DEATH OF A PARTNER 159 - 196
7. COMPANY ACCOUNTS 197 - 236
8. FINANCIAL STATEMENT ANALYSIS 237 - 265
9. RATIO ANALYSIS 266 - 298
10. COMPUTERISED ACCOUNTING SYSTEM - TALLY 299 - 314

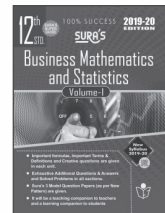
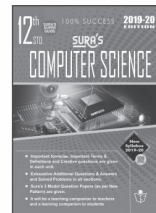
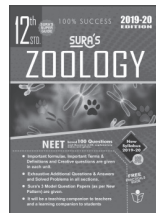
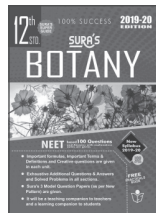
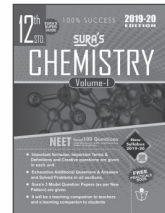
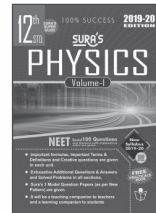
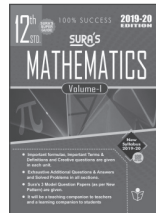
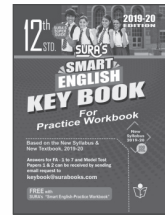
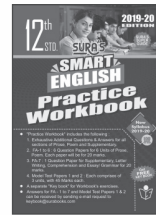
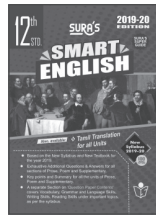


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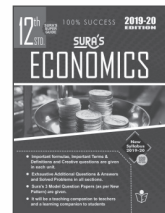
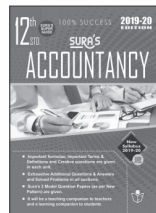
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UNIT

1

ACCOUNTS FROM
INCOMPLETE RECORDS

CHAPTER SNAPSHOT

- 1.1 Introduction
- 1.2 Meaning of incomplete records
- 1.3 Features of incomplete records
- 1.4 Limitations of incomplete records
- 1.5 Differences between double entry system and incomplete records
- 1.6 Accounts from incomplete records
- 1.7 Ascertaining profit or loss from incomplete records through statement of affairs
 - 1.7.1 Calculation of profit or loss through statement of affairs
 - 1.7.2 Steps to be followed to find out the profit or loss under the statement of affairs
 - 1.7.3 Statement of affairs
 - 1.7.4 Format of statement of affairs
 - 1.7.5 Differences between statement of affairs and balance sheet
- 1.8 Preparation of final accounts from incomplete records
 - 1.8.1 Steps to be followed to prepare final accounts from incomplete records

Important Points

- ❑ When accounting records are not strictly maintained according to double entry system they are called incomplete accounting records.
- ❑ In general, only cash and personal accounts are maintained fully.
- ❑ Any increase in capital is taken as profit while a decrease is regarded as loss.
- ❑ Closing capital + Drawings – Additional capital – Opening capital = Profit/ Loss.
- ❑ A statement of affairs is prepared to find out capital on a particular day by showing the balances of assets on the right side and the balances of liabilities on the left side.
- ❑ From the information available from incomplete records and from other documents, the missing figures can be found out and then the final accounts can be prepared.

SELF-EXAMINATION QUESTIONS

Unit - 1

I. MULTIPLE CHOICE QUESTIONS

CHOOSE THE CORRECT ANSWER

1. Incomplete records are generally maintained by

- (a) A company
- (b) Government
- (c) Small sized sole trader business
- (d) Multinational enterprises

[Ans. (c) Small sized sole trader business]

2. Statement of affairs is a

- (a) Statement of income and expenditure
- (b) Statement of assets and liabilities
- (c) Summary of cash transactions
- (d) Summary of credit transactions

[Ans. (b) Statement of assets and liabilities]

3. Opening statement of affairs is usually prepared to find out the

- (a) Capital in the beginning of the year
- (b) Capital at the end of the year
- (c) Profit made during the year
- (d) Loss occurred during the year

[Ans. (a) Capital in the beginning of the year]

4. The excess of assets over liabilities is

- (a) Loss
- (b) Cash
- (c) Capital
- (d) Profit

[Ans. (c) Capital]

5. Which of the following items relating to bills payable is transferred to total creditors account?

- (a) Opening balance of bills payable
- (b) Closing balance of bills payable
- (c) Bills payable accepted during the year
- (d) Cash paid for bills payable

[Ans. (c) Bills payable accepted during the year]

6. The amount of credit sales can be computed from

- (a) Total debtors account
- (b) Total creditors account
- (c) Bills receivables account
- (d) Bills payable account

[Ans. (a) Total debtors account]

7. Which one of the following statements is not true in relation to incomplete records?

- (a) It is an unscientific method of recording transactions
- (b) Records are maintained only for cash and personal accounts
- (c) It is suitable for all types of organisations
- (d) Tax authorities do not accept

[Ans. (c) It is suitable for all types of organisations]

ACCOUNTS FROM INCOMPLETE RECORDS

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8. What is the amount of capital of the proprietor, if his assets are ₹ 85,000 and liabilities are ₹ 21,000?.

- (a) ₹ 85,000 (b) ₹ 1,06,000
(c) ₹ 21,000 (d) ₹ 64,000

[Ans. (d) ₹ 64,000]

Hint:

$$\begin{aligned} \text{Capital} &= \text{Assets} - \text{Liabilities} \\ &= ₹ 85,000 - ₹ 21,000 = ₹ 64,000 \end{aligned}$$

9. When capital in the beginning is ₹ 10,000, drawings during the year is ₹ 6,000, profit made during the year is ₹ 2,000 and the additional capital introduced is ₹ 3,000, find the amount of capital at the end.

- (a) ₹ 9,000 (b) ₹ 11,000
(c) ₹ 21,000 (d) ₹ 3,000

[Ans. (a) ₹ 9,000]

Hint:

Particulars	₹
Capital at the end	9,000
Add: Drawings	6,000
	15,000
Less: Additional Capital introduced	3,000
	12,000
Less: Opening Capital	10,000
Profit	2,000

10. Opening balance of debtors: ₹ 30,000, cash received: ₹1,00,000, credit sales: ₹ 90,000; closing balance of debtors is

- (a) ₹ 30,000 (b) ₹ 1,30,000
(c) ₹ 40,000 (d) ₹ 20,000

[Ans. (d) ₹ 20,000]

Hint :

Total Debtors account			
Dr	₹	Cr	₹
Particulars	₹	Particulars	₹
To Balance c/d	30,000	By Cash A/c (Received)	1,00,000
To Credit Sales	90,000	By Balance b/d	20,000
	1,20,000		1,20,000

II. VERY SHORT ANSWER QUESTIONS

1. What is meant by incomplete records?

Ans. (i) When accounting records are not strictly maintained according to double entry system, these records are called as incomplete accounting records.

(ii) Generally, cash account and the personal accounts of customers and creditors are maintained fully and other accounts are maintained based on necessity.

2. State the accounts generally maintained by small sized sole trader when double entry accounting system is not followed.

Ans. Incomplete accounting records.

3. What is a statement of affairs?

Ans. A statement of affairs is a statement showing the balances of assets and liabilities on a particular date. This method of ascertaining profit is also called as statement of affairs method or networth method or capital comparison method.

III. SHORT ANSWER QUESTIONS

1. What are the features of incomplete records?.

Ans. (i) **Nature:**

It is an unscientific and unsystematic way of recording transactions. Accounting principles and accounting standards are not followed properly.

(ii) **Lack of uniformity:**

There is no uniformity in recording the transactions among different organisations. Different organisations record their transactions according to their needs and conveniences.

(iii) **Suitability:**

Only the business concerns which have no legal obligation to maintain books of accounts under double entry system may maintain incomplete records. Hence, it may be maintained by small sized sole traders and partnership firms.

2. What are the limitations of incomplete records?

Ans. (i) **Lack of proper maintenance of records:**

It is an unscientific and unsystematic way of maintaining records. Real and nominal accounts are not maintained properly.

(ii) **Difficulty in preparing trial balance:**

As accounts are not maintained for all items, the accounting records are incomplete. Hence, trial balance cannot be prepared to test the arithmetical accuracy of the accounts.

**(iii) Difficulty in ascertaining true profitability of the business:**

Profit is found out based on available information and estimates. Hence, it is difficult to ascertain true profit as the trading and profit and loss account cannot be prepared with accuracy.

(iv) Errors and frauds cannot be detected easily:

As only partial records are available, it may not be possible to have internal checks in maintaining accounts to detect errors and frauds.

3. State the differences between double entry system and incomplete records.**Ans.**

S. No.	Basis of distinction	Double entry system	Incomplete records
1.	Recording of transaction	Both debit and credit aspects of all the transactions are recorded	Debit and credit aspects of all the transactions are not recorded completely.
2.	Type of accounts maintained	Personal, real and nominal accounts are maintained fully	In general, Only personal and cash accounts are maintained fully. Real and nominal accounts are not maintained fully.
3.	Preparation of trial balance	Trial balance can be prepared to check the arithmetical accuracy of the entries made in the books of accounts.	Trial balance cannot be prepared to check arithmetic accuracy of entries made in the books of accounts.
4.	Suitability	It is suitable for all types of organisations	It may be suitable for small sized sole traders and partnership firms.
5.	Reliability	It is reliable	It is not reliable.

4. State the procedure for calculating profit or loss through statement of affairs.**Ans.** Following are the steps to be followed under the statement of affairs method to find out the profit or loss.

- (1) Ascertain the opening capital by preparing a statement of affairs at the beginning of the year by taking the opening balances of assets and liabilities.
- (2) Ascertain the closing capital by preparing a statement of affairs at the end of the accounting period after making all adjustments such as depreciation, bad debts, outstanding and prepaid expenses, outstanding income, interest on capital, interest on drawings, etc.
- (3) Add the amount of drawings (both in cash and/in kind) to the closing capital.
- (4) Deduct the amount of additional capital introduced, to get adjusted closing capital.
- (5) Ascertain profit or loss by subtracting opening capital from the adjusted closing capital.
 - a) If adjusted closing capital is more than the opening capital, it denotes profit
 - b) If adjusted closing capital is lesser than the opening capital, it denotes loss

Following format is used to find out the profit or loss:

ACCOUNTS FROM INCOMPLETE RECORDS

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Statement of Profit or loss for the year ended

Particulars	₹
Capital at the end of the year	XXXX
Add: Drawings during the year	XXXX
	XXXX
Less: Additional capital introduced during the year	XXXX
Adjusted closing capital	XXXX
Less: Opening Capital	XXXX
Profit or loss for the year	XXXX

5. Differentiate between statement of affairs and balance sheet.

Ans.

S. No.	Basis of distinction	Statement of affairs	Balance Sheet
1.	Objective	Statement of affairs is prepared to find out the capital of the business.	Balance sheet is prepared to ascertain the financial position of the business.
2.	Accounting system	Statement of affairs is prepared when double entry system is not strictly followed.	Balance sheet is prepared when accounts are maintained under double entry system.
3.	Basis of preparation	It is not fully based on ledger balances.	It is prepared exclusively on the basis of ledger balances.
4.	Reliability	It is not reliable as it is based on incomplete records.	It is reliable as it prepared under double entry system.
5.	Missing items	It is difficult to trace the items omitted as complete records are not maintained.	Since both the aspects of all transactions are duly recorded, items omitted can be traced easily.

6. How is the amount of credit sale ascertained from incomplete records?

Ans. Total sales are calculated by adding cash and credit sales. Cash sales are given in cash book. For ascertaining the amount of credit sales, the total debtors account should be prepared. The specimen of total debtors account is given below.

Dr Total debtors account Cr

Particulars	₹	Particulars	₹
To Balace b/d (Op. Bal.)	XXXX	By Cash received	XXXX
To Credit sales (Bal. Fi.)	XXXX	By Discount allowed	XXXX
		By Sales returns	XXXX
		By balance c/d (Clos. Bal)	XXXX
	XXXX		XXXX

**IV EXERCISES****1. From the following particulars ascertain profit or loss:**

Particulars	₹
Capital at the beginning of the year (1 st April, 2018)	5,00,000
Capital at the end of the year (31 st March, 2019)	8,50,000
Additional capital introduced during the year	1,20,000
Drawings during the year	70,000

Solution :**Statement of profit or loss for the year ending 31st March 2019**

Particulars	₹
Closing capital (as on 31.03.2019)	8,50,000
Add : Drawings during the year	70,000
	9,20,000
Less: Additional capital introduced during the year	1,20,000
Adjusted closing capital	8,00,000
Less: Opening capital (as on 1 st April, 2018)	5,00,000
Profit for the year	3,00,000

2. From the following particulars ascertain profit or loss.

Particulars	₹
Capital as on 1 st January 2018	2,20,000
Capital as on 31 st December 2018	1,80,000
Additional capital introduced during the year	40,000
Drawings made during the year	50,000

Solution :**Statement of profit or loss for the year ending 31st December 2018**

Particulars	₹
Closing capital as on 31 st December 2018	1,80,000
Add : Drawings during the year	50,000
	2,30,000
Less: Additional capital introduced during the year	40,000
Adjusted closing capital	1,90,000
Less: Opening capital as on 1 st January, 2018	2,20,000
Loss for the year	30,000

ACCOUNTS FROM INCOMPLETE RECORDS

Sura's XII Std - Accountancy

16. From the following details you are required to calculate credit sales and credit purchases by preparing total debtors account, total creditors account, bills receivable account and bills payable account.

Particulars	₹	Particulars	₹
Balances as on 1st April 2018		Balances as on 31st March 2019	
Sundry debtors	2,40,000	Sundry debtors	2,20,000
Bills receivable	30,000	Sundry creditors	1,50,000
Sundry creditors	1,20,000	Bills receivable	8,000
Bills payable	10,000	Bills payable	20,000
Other information:	₹		₹
Cash received from debtors	6,00,000	Payments against bill payable	30,000
Discount allowed to customers	25,000	Cash received for bills receivable	60,000
Cash paid to creditors	3,20,000	Bills receivable dishonoured	4,000
Discount allowed by suppliers	10,000	Bad debts	16,000

Solution :

Dr		Bills receivable account		Cr	
Particulars	₹	Particulars	₹		
To Balance b/d	30,000	By Cash	60,000		
To Debtors (Bills received - balancing figure)	42,000	By Debtors (Bills receivable dishonoured)	4,000		
		By Balance c/d	8,000		
	72,000		72,000		

Dr		Total Debtors account		Cr	
Particulars	₹	Particulars	₹		
To Balance b/d	2,40,000	By Cash received	6,00,000		
To Bills receivable (dishonoured)	4,000	By Discount allowed	25,000		
To Sales (credit) (balancing figure)	6,59,000	By Bad debts	16,000		
		By Bills receivable (bills received)	42,000		
		By Balance c/d	2,20,000		
	9,03,000		9,03,000		

Dr		Bills payable account		Cr	
Particulars	₹	Particulars	₹		
To Cash (Bills paid)	30,000	By Balance b/d	10,000		
To Balance c/d	20,000	By Sundry creditors (Bills accepted balancing figure)	40,000		
	50,000		50,000		

Dr		Total Creditors account		Cr	
Particulars	₹	Particulars	₹		
To Cash (paid)	3,20,000	By Balance b/d	1,20,000		
To Discount received	10,000	By purchases (credit)	4,00,000		
To Bills payable (Bills accepted)	40,000	(balancing figure)			
To Balance c/d	1,50,000				
	<u>5,20,000</u>				<u>5,20,000</u>

17. From the following details of Rakesh, prepare Trading and Profit and Loss account for the year ended 31st March, 2019 and a Balance Sheet as on that date.

Particulars	31.3.2018 ₹	31.3.2019 ₹
Stock of goods	2,20,000	1,60,000
Debtors	5,30,000	6,40,000
Cash at bank	60,000	10,000
Machinery	80,000	80,000
Sundry creditors	3,70,000	4,20,000

Other details :

Particulars	₹	Particulars	₹
Rent paid	1,20,000	Cash received from debtors	12,50,000
Discount received	35,000	Drawings	1,00,000
Discount allowed	25,000	Cash sales	20,000
Cash paid to creditors	11,00,000	Capital as on 1.4.2018	5,20,000

Solution :

Dr		Total Debtors account		Cr	
Particulars	₹	Particulars	₹		
To Balance b/d	5,30,000	By Cash received	12,50,000		
To Credit sales (balancing figure)	13,85,000	By Discounts allowed	25,000		
	<u>19,15,000</u>	By Balance c/d	6,40,000		
			<u>19,15,000</u>		

Dr		Total Creditors account		Cr	
Particulars	₹	Particulars	₹		
To Cash (paid)	11,00,000	By Balance b/d	3,70,000		
To Discount received	35,000	By Credit purchases	11,85,000		
To Balance c/d	4,20,000	(balancing figure)			
	<u>15,55,000</u>				<u>15,55,000</u>

Solution :

In the books of Mary
Total Debtors account

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Balance b/d	1,30,000	By Cash (received)	3,40,000
To Sales (Credit)	2,90,000	By Balance c/d (balancing figure)	80,000
	<u>4,20,000</u>		<u>4,20,000</u>
To Balance b/d	80,000		

Trading and Profit and loss account for the year ended 31st March 2019

Dr.			Cr.		
Particulars	₹	₹	Particulars	₹	₹
To Opening stock		1,10,000	By Sales		
To Purchases			Cash	3,60,000	
Cash	1,50,000		Credit	2,90,000	6,50,000
Credit	1,80,000	3,30,000	By Closing stock		1,80,000
To Wages		70,000			
To Gross profit c/d		3,20,000			
		<u>8,30,000</u>			<u>8,30,000</u>
To Sundry expenses		1,27,000	By Gross profits b/d		3,20,000
To Depreciation on machinery 10%		8,000			
To Net profit transferred to capital a/c		1,85,000			
		<u>3,20,000</u>			<u>3,20,000</u>

Balance sheet as on 31st March 2019

Liabilities	₹	₹	Assets	₹	₹
Capital	2,80,000		Cash		2,23,000
Add : Net profit	<u>1,85,000</u>	4,65,000	Stock of goods		1,80,000
			Debtors		80,000
Creditors		90,000	Furniture and fittings	80,000	
			Less : Depreciation	<u>8,000</u>	<u>72,000</u>
		<u>5,55,000</u>			<u>5,55,000</u>

19. Arun carries on hardware business and does not keep his books on double entry basis. The following particulars have been extracted from his books:

Particulars	31.12.2017 ₹	31.12.2018 ₹
Land and building	2,40,000	2,40,000
Stock-in-trade	1,20,000	1,70,000
Debtors	40,000	51,500
Creditors	50,000	45,000
Cash at bank	30,000	53,000

ACCOUNTS FROM INCOMPLETE RECORDS

Sura's XII Std - Accountancy

Other information for the year ending 31.12.2018 showed the following:

	₹
Wages	65,000
Carriage outwards	7,500
Sundry expense	28,000
Cash paid to creditors	6,00,000
Drawings	10,000

Total sales during the year were ₹7,70,000. Purchases returns during the year were ₹30,000 and sales returns were ₹25,000. Depreciate land and buildings by 5%. Provide ₹1,500 for doubtful debts. Prepare trading and profit and loss account for the year ending 31st December, 2018 and a balance sheet as on that date.

Solution :

In the books of Arun

Statement of affairs as on 1st December 2018

Liabilities	₹	Assets	₹
Creditors	50,000	Land and Building	2,40,000
Opening capital (balancing figure)	3,80,000	Stock in trade	1,20,000
		Debtors	40,000
		Cash at bank	30,000
	<u>4,30,000</u>		<u>4,30,000</u>

Dr		Total Creditors account		Cr	
Particulars	₹	Particulars	₹		
To Cash (paid)	6,00,000	By Balance b/d	50,000		
To Purchase returns	30,000	By Credit purchases (balancing figure)	6,25,000		
To Balance c/d	45,000				
	<u>6,75,000</u>				<u>6,75,000</u>

Trading and Profit and loss account for the year ended 31st December 2018

Dr.			Cr.		
Particulars	₹	₹	Particulars	₹	₹
To Opening stock		1,20,000	By sales	7,70,000	
To Purchases credit	6,25,000		Less : Sales returns	25,000	7,45,000
Less : Purchase returns	30,000	5,95,000	By Closing stock		1,70,000
To Wages		65,000			
To Gross profit c/d		1,35,000			
		<u>9,15,000</u>			<u>9,15,000</u>
To Carriage outwards		7,500	By Gross profits c/d		1,35,000
To Sundry expenses		28,000			
To Depreciation on land and building @ 5%		12,000			
To Provision for doubtful debts		1,500			
To Net profit transfered to capital account		86,000			
		<u>1,35,000</u>			<u>1,35,000</u>

Balance sheet as on 31st December 2018

Liabilities	₹	₹	Assets	₹	₹
Capital	3,80,000		Land and buildings	2,40,000	
Add : Net profit	86,000		Less : Depreciation 5%	12,000	2,28,000
	4,66,000		Closing stock		1,70,000
Less : Drawings	10,000	4,56,000	Debtors	51,500	
			Less : Provision for debtors	1,500	50,000
Creditors		45,000	Cash at bank		53,000
		5,01,000			5,01,000

20. Selvam does not keep his books under double entry system. From the following information prepare trading and P&L A/c and Balance Sheet as on 31-12-2018

Particulars	1.1.2018 ₹	31.12.2018 ₹
Machinery	60,000	60,000
Cash at bank	25,000	33,000
Sundry debtors	70,000	1,00,000
Stock	45,000	22,000
Bills receivable	20,000	38,000
Bank loan	45,000	45,000
Sundry creditors	25,000	21,000

	₹		₹
Cash sales	20,000	Credit sales	1,80,000
Cash purchases	8,000	Credit purchases	52,000
Wages	6,000	Salaries	23,500
Advertisement	7,000	Interest on bank loan	4,500
Drawings	60,000	Additional capital	21,000

Adjustments:

Write off depreciation of 10% on machinery. Create a reserve of 1% on debtors for doubtful debts.

Solution :**In the books of selvam****Statement of affairs as on 1st January 2018**

Liabilities	₹	Assets	₹
Bank Loan	45,000	Machinery	60,000
Sundry creditors	25,000	Cash at bank	25,000
Opening capital (Balancing figure)	1,50,000	Sundry debtors	70,000
		Stock	45,000
		Bills receivable	20,000
	2,20,000		2,20,000

Trading and Profit and loss account for the year ended 31st December 2018

Dr.			Cr.		
Particulars	₹	₹	Particulars	₹	₹
To Opening stock		45,000	By Sales		
To Purchase			Cash	20,000	
Cash	8,000		Credit	1,80,000	2,00,000
Credit	52,000	60,000	By Closing stock		22,000
To Wages		6,000			
To Gross profit c/d		1,11,000			
		<u>2,22,000</u>			<u>2,22,000</u>
To Advertisement		7,000	By Gross profit b/d		1,11,000
To Salaries		23,500			
To Depreciation 10%		6,000			
To Reserve on debtors 1 %		1,000			
To Interest on bank loan		4,500			
To Net profit transferred to capital a/c		69,000			
		<u>1,11,000</u>			<u>1,11,000</u>

Balance sheet as on 31st December 2018

Liabilities	₹	₹	Assets	₹	₹
Bank loan		45,000	Machinery	60,000	
Sundry creditors		21,000	Less: Depreciation 10%	6,000	54,000
Capital	1,50,000		Cash at bank		33,000
Add: Net profit	69,000		Sundry debtors	1,00,000	
	<u>2,19,000</u>		Less: Reserve for doubtful debts	1,000	99,000
Add: Additional capital	21,000		Closing stock		22,000
	<u>2,40,000</u>		Bills receivable		38,000
Less: Drawings	60,000	1,80,000			
		<u>2,46,000</u>			<u>2,46,000</u>

FILL IN THE MISSING INFORMATION

TEXT BOOK No. 38

Closing capital ₹	Drawings ₹	Additional capital ₹	Opening capital ₹	Profit / Loss ₹
1,00,000	40,000	20,000	90,000	?
?	30,000	40,000	80,000	20,000
70,000	?	30,000	40,000	10,000
60,000	20,000	?	50,000	-10,000
2,00,000	30,000	10,000	?	1,20,000

Solution :

Closing capital ₹	Drawings ₹	Additional capital ₹	Opening capital ₹	Profit / Loss ₹
1,00,000	40,000	20,000	90,000	30,000
1,10,000	30,000	40,000	80,000	20,000
70,000	10,000	30,000	40,000	10,000
60,000	20,000	40,000	50,000	-10,000
2,00,000	30,000	10,000	1,00,000	1,20,000

ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. The different between the total of assets and total of liabilities is taken as

- (a) drawings (b) capital
(c) profit (d) loss

[Ans. (b) capital]

2. The total assets of a proprietor are ₹5,00,000. His liabilities ₹3,50,000. Then his capital in the business is

- (a) ₹8,50,000 (b) ₹1,50,000
(c) ₹3,50,000 (d) ₹4,25,000

[Ans. (b) ₹1,50,000]

Hint: Capital = Assets – liabilities
= ₹ 5,00,000 – ₹ 3,50,000
= ₹ 1,50,000

3. A firm has assets worth ₹60,000 and capital ₹45,000. Then it's liabilities is

- (a) ₹45,000 (b) ₹1,05,000
(c) ₹60,000 (d) ₹15,000

[Ans. (d) ₹15,000]

Hint: Liabilities = Assets – Capital
= ₹ 60,000 – 45,000
= ₹ 15,000

4. Under the net worth method, the basis for ascertaining the profit is

- (a) the difference between the capital on two dates
(b) the difference between the liabilities on two dates
(c) the different between the gross assets on two dates
(d) the difference between the gross profit on two dates

[Ans. (a) the difference between the capital on two dates]

5. Credit sale is obtained from

- (a) Bills receivable account
(b) Bills payable account
(c) Total debtors account
(d) Total creditors account

[Ans. (c) Total debtors account]

6. The capital of a business is ascertained by preparing

- (a) Trading account
(b) Statement of profit or loss
(c) Balance sheet
(d) Statement of affairs

[Ans. (d) Statement of affairs]

7. Credit purchase is obtained from

- (a) Bills receivable account
(b) Bills payable account
(c) Total debtors account
(d) Total creditors account

[Ans. (d) Total creditors account]

8. Debtors on 1.4.2018 was ₹1,00,000 and on 31.3.2019 was ₹80,000 cash received from debtors during the year is ₹1,60,000. Then the credit sales during the year is

- (a) ₹3,40,000 (b) ₹2,40,000
(c) ₹1,40,000 (d) ₹1,60,000

[Ans. (c) ₹1,40,000]

Hint :

Dr **Total Debtors account** Cr

Particulars	₹	Particulars	₹
To Balance b/d	1,00,000	By Cash A/c (received)	1,60,000
To Sales A/c (Balancing figure)	1,40,000	By Balance c/d	80,000
	2,40,000		2,40,000

5. _____ capital can be found by preparing a statement of affairs at the beginning of the year.

- (a) Opening capital (b) Closing capital
(c) Both (a) and (b) (d) None of these

[Ans. (a) opening capital]

6. A statement of affairs resembles a _____

- (a) Trading account
(b) Profit and loss account
(c) Balance sheet
(d) Trial balance

[Ans. (c) Balance sheet]

7. Closing capital can be found by preparing a statement affairs at the _____ of the year.

- (a) opening (b) end
(c) centre (d) none of these

[Ans. (b) end]

8. In _____ system, only personal and cash accounts are opened.

- (a) Single entry (b) Double entry
(c) Trial balance (d) Balance Sheet

[Ans. (a) Single entry]

9. Creditors on 1.4.2016 was ₹80,000 and on 31.3.2017 was ₹65,000 cash paid to creditors during the year is ₹1,10,000. Then the credit purchases during the year is _____.

- (a) ₹95,000 (b) ₹1,75,000
(c) ₹1,95,000 (d) ₹1,50,000

[Ans. (a) ₹ 95,000]

Hint :

Dr	Total Creditors Account		Cr
Particulars	₹	Particulars	₹
To Cash (Paid)	1,10,000	By Balance b/d	80,000
To Balance c/d	65,000	By Credit Purchases A/c	95,000
		(Balancing figure)	
	1,75,000		1,75,000

10. _____ maintains only personal and cash accounts.

- (a) Single entry system
(b) Double entry system
(c) Both (a) and (b)
(d) None of these

[Ans. (a) Single entry system]

11. _____ is suitable only for sole traders and partnership firms.

- (a) Double entry system
(b) Single entry system
(c) Both (a) and (b)
(d) None of these

[Ans. (b) Single entry system]

12. Single entry system keeps one cash book which mixes up business as well as _____ transactions.

- (a) Private (b) Own
(c) Public (d) Capital

[Ans. (a) Private]

13. True financial position cannot be ascertained as _____ is not prepared due to the absence of nominal and real accounts.

- (a) Trading accounts
(b) Profit and loss account
(c) Balance sheet
(d) Trail balance

[Ans. (c) Balance sheet]

14. If it is desired to calculate profit by preparing trading and profit and loss account under single entry then it is called _____ method.

- (a) Networth
(b) Statement of affairs
(c) Conversion
(d) None of these

[Ans. (c) Conversion]

(iv) Pick the Odd one Out.

1. (a) Incomplete (b) Unsystematic
(c) Balance Sheet (d) Unscientific

[Ans. (c) Balance Sheet]

Reason : Balance sheet is a statement which gives the position of assets and liabilities on a particular date. Other three are limitations of incomplete records.

2. (a) Statement of affairs
(b) Net worth method method
(c) Annuity method
(d) Capital comparison method

[Ans. (c) Annuity method]

Reason : Annuity method, not only the original cost of the asset but also the amount of interest on the investment is taken into account while computing depreciation. Other three are methods of ascertaining profit or loss.

ACCOUNTS FROM INCOMPLETE RECORDS

Sura's XII Std - Accountancy

3. (a) Conversion method
(b) Statement of affairs method
(c) Straight line method
(d) Net worth method

[Ans. (c) Straight line method]

Reason : Under this method, a fixed percentage on the original cost of the asset is charged every year by way of depreciation. Other three are methods of ascertaining profit or loss.

(v) Which one of the Following is Correctly Matched?

1. (a)	Adjusted closing capital	=	Closing capital – Drawings – Additional capital
(b)	Profit/Loss	=	Closing capital + Drawings – Additional Capital – Opening capital
(c)	Capital	=	Assets + Liabilities
(d)	Closing capital	=	Opening capital + Drawings

[Ans. (b) Profit/Loss = Closing capital + Drawings – Additional Capital – opening capital]

(vi) Consider the Following Statement.

1. **Assertion (A) :** Single Entry System is an incomplete, inaccurate, unscientific and unsystematic system of book keeping.

Reason (R) : The name of the system itself shows that the double aspects of business transactions are recorded.

- (a) Both (A) and (R) are true and (R) is the correct explanation (A).
(b) Both (A) and (R) are true and (R) is not the correct explanation of (A).
(c) (A) is true, but (R) is false.
(d) (A) is false, but (R) is true.

[Ans. (b) Both (A) and (R) are true and (R) is not the correct explanation of (A)]

2. **Assertion (A) :** Single Entry System is a system of book keeping in which as a rule, only records of cash and personal accounts are maintained,
Reason (R) : It is always incomplete double entry varying with circumstances.

- (a) Both (A) and (R) are true and (R) is the correct explanation (A).
(b) Both (A) and (R) are true and (R) is not the correct explanation of (A).
(c) (A) is true, but (R) is false.
(d) (A) is false, but (R) is true.

[Ans. (b) Both (A) and (R) are true and (R) is not the correct explanation (A)]

3. **Assertion (A):** The single entry system is suitable only for sole traders and partnership firms.

Reason (R): Companies cannot keep books on Double entry system because of legal provisions.

- (a) Both (A) and (R) are true and (R) is the correct explanation (A).
(b) Both (A) and (R) are true and (R) is not the correct explanation of (A).
(c) (A) is true, but (R) is false.
(d) (A) is false, but (R) is true.

[Ans. (c) (A) is true, but (R) is false]

4. **Assertion (A) :** Double Entry System It maintains only personal and cash accounts.

Reason (R) : Personal accounts are not maintained.

- (a) Both (A) and (R) are true and (R) is the correct explanation (A).
(b) Both (A) and (R) are true and (R) is not the correct explanation of (A).
(c) (A) is true, but (R) is false.
(d) (A) is false, but (R) is true.

[Ans. (c) (A) is true, but (R) is false]

5. **Assertion (A) :** Single entry actually refers to incomplete double entry system or the double entry system.

Reason (R) : It is not based on Single aspect concept. Hence it is incomplete, inaccurate and unscientific.

- (a) Both (A) and (R) are true and (R) the correct explanation (A).
 (b) Both (A) and (R) are true and (R) is not the correct explanation of (A).
 (c) (A) is true, but (R) is false.
 (d) (A) is false, but (R) is true.

[Ans. (d) (A) is false, but (R) is true]

(vii) **Choose the Correct Statement.**

1. (i) Double Entry System is an incomplete, inaccurate, unscientific and unsystematic system of book keeping.
 (ii) The Double entry system is suitable only for sole traders and partnership firms.
 (iii) Single Entry System is an incomplete, inaccurate, unscientific and unsystematic system of book keeping.

- (a) (i) is correct
 (b) (ii) is correct
 (c) (iii) is correct
 (d) (i) and (ii) are correct

[Ans. (c) (iii) is correct]

2. (i) Incomplete records system makes use of Double Entry System partially. It maintains only personal and cash accounts.
 (ii) Thus, Double entry actually refers to incomplete Single entry system or the defective Single entry system.
 (iii) Single entry is Debit and credit aspects of all transactions are recorded.

- (a) (i) is correct
 (b) (ii) is correct
 (c) (iii) is correct
 (d) (i) and (ii) are correct

[Ans. (a) (i) is correct]

3. (i) Single entry is Debit and credit aspects of all transactions are recorded.
 (ii) Single Entry System is a system of book keeping in which as a rule, only records of cash and personal accounts are maintained.
 (iii) Double Entry System is an incomplete, inaccurate, unscientific and unsystematic system of book keeping.

- (a) (i) is correct
 (b) (ii) is correct
 (c) (iii) is correct
 (d) (i) and (ii) are correct

[Ans. (b) (ii) is correct]

4. (i) Companies cannot keep books on double entry system because of legal provisions.
 (ii) It is always incomplete Single entry varying with circumstances.
 (iii) Single entry actually refers to incomplete double entry system or the defective double entry system.

- (a) (i) is correct
 (b) (ii) is correct
 (c) (iii) is correct
 (d) (i) and (ii) are correct

[Ans. (c) (iii) is correct]

5. (i) Double entry actually refers to incomplete Single entry system or the defective Single entry system.
 (ii) Double Entry System is a system of book keeping in which as a rule, only records of cash and personal accounts are maintained.
 (iii) If it is desired to calculate profit by preparing Trading and Profit and Loss account under single entry then it is called conversion method.

- (a) (i) is correct
 (b) (ii) is correct
 (c) (iii) is correct
 (d) (i) and (ii) are correct

[Ans. (c) (iii) is correct]

II VERY SHORT ANSWER QUESTIONS.

1. Name the two main accounts maintained in "accounts from incomplete records".

Ans. The two main accounts maintained in accounts from incomplete records are

- (i) Personal account
 (ii) Cash account

ACCOUNTS FROM INCOMPLETE RECORDS

Sura's XII Std - Accountancy

III. PROBLEMS.

1. What shall be the profits of the concern if:

Particulars	₹
Opening capital	1,60,000
Closing capital	1,80,000
Drawings	36,000
Additional capital	10,000

Solution :

Statement of profit or loss

Particulars	₹
Closing capital	1,80,000
Add: Drawings	36,000
	2,16,000
Less: Additional capital	10,000
Adjusted closing capital	2,06,000
Less: Opening capital	1,06,000
Profit for the year	46,000

2. Calculate the missing information:

Particulars	₹
Closing capital	32,000
Drawings	4,800
Additional capital	8,000
Profit made during the year	9,600

Solution :

Statement of profit or loss

Particulars	₹
Closing capital	32,000
Add: Drawings	4,800
	36,800
Less: Additional capital	8,000
Adjusted closing capital	28,800
Less: Opening capital [B/F]	19,200
Profit made during the year	9,600

3. Mrs. Geetha started business with ₹1,20,000 as capital on 1.4.2018. During the year she has withdrawn at the rate of ₹1,000 per month. She introduced ₹20,000 as additional capital. Her position on 31.3.2019 was as follows.

Particulars	₹
Bank balance	8,000
Stock	80,000
Sundry debtors	50,000
Furniture	2,500
Cash in hand	2,000
Sundry creditors	25,000
Expenses outstanding	1,000

She keeps her books under single entry system, determine for profit or loss for the year 2003-04.

Solution : Statement of affairs as on 31st March 2019

Liabilities	₹	Assets	₹
Sundry creditors	25,000	Bank balance	8,000
Expenses outstanding	1,000	Stock	80,000
Closing capital (B/F)	1,16,500	Sundry debtors	50,000
		Furniture	2,500
		Cash in hand	2,000
	1,42,500		1,42,500

**Statement of profit or loss**

Particulars	₹
Closing capital	1,16,500
Add: Drawings (1000 × 12)	12,000
	1,28,500
Less: Additional capital	20,000
	1,08,500
Adjusted closing capital	1,08,500
Less: Opening capital	1,20,000
Loss for the year	11,500

4. From the following find out credit sales.

Particulars	₹
Opening sundry debtors	50,000
Cash received from sundry debtors	80,000
Discount allowed to sundry debtors	2,000
Sales returns	5,000
Closing sundry debtors	75,000

Solution :

Dr		Total Debtors account		Cr	
Particulars	₹	Particulars	₹		
To Balance b/d (opening debtors)	50,000	By Cash received	80,000		
To Credit sales (B/F)	1,12,000	By Discount allowed	2,000		
		By Sales returns	5,000		
		By Balance c/d	75,000		
	1,62,000		1,62,000		

5. From the following details, find out credit purchases :

Particulars	₹
Opening sundry creditors	75,000
Closing sundry creditors	90,000
Cash paid to sundry creditors	22,500
Discount received	15,000
Purchase returns	7,500

Solution :

Dr		Total Creditors account		Cr	
Particulars	₹	Particulars	₹		
To Cash paid	22,500	By Balance b/d	75,000		
To Discount received	15,000	By Credit purchase (B/F)	60,000		
To Purchase return	7,500				
To Balance c/d	90,000				
	1,35,000		1,35,000		

ACCOUNTS FROM INCOMPLETE RECORDS

Sura's XII Std - Accountancy

6. M/s Saniya sport equipment does not keep proper records. From the following information, find out profit or loss and also prepare balance sheet for the year ended 31st December 2017.

Particulars	31.12.2016 ₹	31.12.2017 ₹
Cash in hand	6,000	24,000
Bank overdraft	30,000	-
Stock	50,000	80,000
Sundry creditors	26,000	40,000
Sundry debtors	60,000	1,40,000
Bills payable	6,000	12,000
Furniture	40,000	60,000
Bills receivable	8,000	28,000
Machinery	50,000	1,00,000
Investment	30,000	80,000

Drawings ₹10,000 per month for personal use, additional capital introduced during the year ₹2,00,000. A bad debts ₹2,000 and a provision of 5% it to be made on debtors. Outstanding salary ₹2,400, prepaid insurance ₹700, depreciation charged on furniture @10% per annum.

Solution :

Statement of affairs as on 31st December 2016

Liabilities	₹	Assets	₹
Bank overdraft	30,000	Cash in hand	6,000
Sundry creditors	26,000	Stock	50,000
Bills payable	6,000	Sundry Debtors	60,000
Capital (Balancing figure)	1,82,000	Furniture	40,000
		Bills receivable	8,000
		Machinery	50,000
		Investment	30,000
	<u>2,44,000</u>		<u>2,44,000</u>

Statement of affairs as on 31st December 2017

Liabilities	₹	Assets	₹	₹
Sundry creditors	40,000	Cash in hand		24,000
Bills payable	12,000	Stock		80,000
Outstanding salary	2,400	Debtors	1,40,000	
Capital (Balancing figure)	4,33,400	Less : Bad debts	2,000	
			<u>1,38,000</u>	
		Less : Provision @5%	6,900	1,31,100
		Furniture	60,000	
		Less : Depreciation @10%	6,000	54,000
		Bills receivable		28,000
		Prepaid insurance		700
		Machinery	1,00,000	
		Less : Depreciation @10%	10,000	90,000
		Investment		80,000
	<u>4,87,800</u>			<u>4,87,800</u>

Statement showing profit or loss for the year ending 31st December 2017

Particulars	₹
Capital at the end of the year	4,33,400
Add: Drawings during the year (10,000 × 12)	1,20,000
	5,53,400
Less: Additional capital introduced in the year	2,00,000
Adjusted closing capital	3,53,400
Less: Capital in the beginning of the year	1,82,000
Profit for the year 2017	1,71,400

7. Compute the amount of total purchases and total sales of Mr. Amit from the following information for the year ending on March 31, 2018.

	₹
Total debtors as on April 01, 2017	40,000
Total creditors as on April 01, 2017	50,000
Bills receivable as on April 01, 2017	30,000
Bills payable as on April 01, 2017	45,000
Discount received	5,000
Bad debts	2,000
Return inwards	4,000
Discount allowed	3,000
Cash sales	10,000
Cash purchases	8,000
Total debtors as on March 31, 2018	80,000
Cash received from debtors	1,00,000
Cash paid to creditors	80,000
Cash received against bills receivable	25,000
Payment made against bills receivable	40,000
Total creditors as on March 31, 2018	40,000
Bills payable as on March 31, 2018	50,000
Bills receivable as on March 31, 2018	35,000

Solution :

Total Bills receivable account

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Balance b/d	30,000	By Cash	25,000
To Total Debtors	30,000	By Balance c/d	35,000
(Balancing figure)	60,000		60,000

Total Bills payable account

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Cash	40,000	By Balance b/d	45,000
To Balance c/d	50,000	By Total creditors (Balancing figure)	45,000
	<u>90,000</u>		<u>90,000</u>

Total Debtors account

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Balance b/d	40,000	By Bad debts	2,000
To Sales	1,79,000	By Return inwards	4,000
(balancing figure)		By Discount allowed	3,000
		By Cash	1,00,000
		By Bills receivable (Transfer from bills receivable account)	30,000
		By Balance c/d	80,000
	<u>2,19,000</u>		<u>2,19,000</u>

Total Creditors account

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Discount received	5,000	By Balance b/d	50,000
To Cash	80,000	By Purchases (credit)	1,20,000
To Bills payable (transfer from bills payable account)	45,000	(Balancing figure)	
To Balance c/d	40,000		
	<u>1,70,000</u>		<u>1,70,000</u>

8. From the following details of vijay who maintains incomplete records, prepare trading and profit and loss account for the year ended 31st March 2018 and a Balance sheet as on the date.

Particulars	As on	As on
	1.4.2017	31.3.2018
	₹	₹
Sundry Creditors	37,500	43,750
Furniture	2,500	2,500
Cash	6,250	10,000
Sundry debtors	62,500	87,500
Stock	25,000	12,500

Other details :

	₹
Drawings	10,000
Discount received	3,750
Discount allowed	2,500
Cash received from sundry debtors	1,35,000
Cash paid to creditors	1,12,500
Sales returns	3,750
Purchase returns	1,250
Sundry expenses paid	8,750

Charge depreciation on furniture @ 5%

Solution :

Calculation of opening capital:

Statement of affairs as on 1.4.2017

Liabilities	₹	Assets	₹
Sundry creditors	37,500	Furniture	2,500
Opening capital (B/F)	58,750	Cash	6,250
		Sundry Debtors	62,500
		Stock	25,000
	<u>96,250</u>		<u>96,250</u>

Calculation of Credit sales:

Total Debtors account

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Balance b/d	62,500	By Cash received	1,35,000
To Credit Sales (B/F)	1,66,250	By Discount allowed	2,500
		By Sales returns	3,750
		By Balance c/d	87,500
	<u>2,28,750</u>		<u>2,28,750</u>

Calculation of Credit Purchase :

Total Creditors account

Dr.		Cr.	
Particulars	₹	Particulars	₹
To Cash paid	1,12,500	By Balance b/d	37,500
To Discount received	3,750	By Credit purchases (B/F)	1,23,750
To Purchase returns	1,250		
To Balance c/d	43,750		
	<u>1,61,250</u>		<u>1,61,250</u>

Trading and Profit and loss account for the year ended 31.3.2018

Dr.			Cr.		
Particulars	₹	₹	Particulars	₹	₹
To Opening stock		25,000	By Sales	1,66,250	
To Purchases	1,23,750		Less : Sales returns	3,750	1,62,500
Less : Purchase returns	1,250	1,22,500			
To Gross profit c/d		27,500	By Closing stock		12,500
		1,75,000			1,75,000
To Discount allowed		2,500	By Gross profits b/d		27,500
To Sundry expenses		8,750	By Discount received		3,750
To Depreciation		125			
To Net profit		19,875			
(Transferred to capital a/c)		31,250			31,250

Balance sheet as on 31.3.2018

Liabilities	₹	₹	Assets	₹	₹
Capital	58,750		Furniture	2,500	
Add : Net profit	19,875		Less : Depreciation	125	2,375
	78,625		Cash		10,000
Less : Drawings	10,000	68,625	Sundry debtors		87,500
Sundry creditors		43,750	Closing stock		12,500
		1,12,375			1,12,375

HOTS QUESTIONS AND ANSWERS

1. Under single entry system is it possible to check the arithmetical accuracy of books of accounts?

Ans. No, as arithmetical accuracy is checked by preparing a trial balance and in case of single entry system a trial balance cannot be prepared as it does not record both aspects of a transaction.

2. Can a limited company maintain its accounts under single entry system?

Ans. No, due to legal restrictions, a company cannot maintain its accounts under single entry system.

3. Why is statement of affairs prepared under single entry system not referred to as balance sheet?

Ans. Statement of affairs prepared under single entry system is not called a balance sheet because statement of affairs is not prepared with the list of ledger balances kept on the basis of double entry system. Also value of assets and liabilities shown in statement of affairs are only the estimates and not the actual values.

4. What are the possible reasons for keeping incomplete records?

Ans. It is observed that many businessmen keep incomplete records because of the following reasons.

- Single entry system can be adopted by people who do not have the proper knowledge of accounting principles.
- As specialised accountants are not required, it is an inexpensive mode of maintaining records.
- As only a few books are maintained, time consumed in maintaining records is also less.
- It is suitable for organisations which have limited number of transactions and very few assets and liabilities.



VALUE BASED QUESTIONS AND ANSWERS

1. Radhika started a small bakery for providing healthy and good quality bakery product at reasonable prices on 1st January, 2019 with a capital of ₹1,80,000. She appointed a ten year old boy as a sweeper. She withdrew ₹60,000 for household expenses. She introduced ₹20,000 as fresh capital. Her position of assets and liabilities as at 31st December, 2019 stood as follows.

	₹
Cash in hand	70,000
Stock	80,000
Bills receivable	1,00,000
Debtors	1,50,000
Creditors	60,000
Bills payable	10,000

You are required to calculate profit or loss and also identify the values introduced in this question.

Solution :

Statement of affairs as on 31.12.2019

Liabilities	₹	Assets	₹
Creditors	60,000	Cash in hand	70,000
Bills payables	10,000	Stock	80,000
Capital	3,30,000	Bills receivables	1,00,000
(Balancing figure)		Debtors	1,50,000
	4,00,000		4,00,000

Calculation of Profit

Particulars	₹
Capital at the end	3,30,000
Add: Drawings	60,000
	3,90,000
Less: Additional capital	20,000
	3,70,000
Less: Opening capital	1,80,000
Profit for the year	1,90,000

Values involved are

- (i) Violating child labour act by employing 10 year old boy.
- (ii) By providing good quality product she is promoting the welfare and health of society
- (iii) By charging reasonable prices she is not indulged in profiteering.

2. Which values are affected, when accounts are maintained on single entry system basis.

Ans. Values being affected are

- (i) **Reliability :** Value of reliability is affected as accounts maintained on single entry system are less reliable as they are prepared from incomplete records.
- (ii) **Accuracy :** Value of arithmetical accuracy is affected, as in single entry system, trial balance cannot be prepared which proves arithmetical accuracy of accounts.



UNIT

2

ACCOUNTS OF NOT - FOR - PROFIT ORGANISATION

CHAPTER SNAPSHOT

- | | |
|---|---|
| <ul style="list-style-type: none">2.1 Introduction2.2 Features of not-for-profit organisations2.3 Receipts and Payments Account<ul style="list-style-type: none">2.3.1 Steps in preparation of receipts and payments account2.4 Items peculiar to not-for-profit organisations2.5 Income and Expenditure Account<ul style="list-style-type: none">2.5.1 Steps in preparation of income and expenditure account from receipts and payments account | <ul style="list-style-type: none">2.5.2 Format of Income and Expenditure Account2.5.3 Differences between receipts and payments account and income and expenditure account2.5.4 Treatment of revenue receipts2.6 Balance Sheet |
|---|---|



Important Points

- ❑ Not-for-profit entities exist to provide services to the members or to the society at large.
- ❑ The three principal accounting statements of a not-for-profit organisation include Receipts and Payments Account, Income and Expenditure Account and Balance Sheet.
- ❑ The Receipts and Payments Account is a summarised cash book which records all cash receipts and cash payments effected during an accounting year irrespective of the nature as to capital or revenue, irrespective of the period to which it belongs, that is, whether it relates to the previous or current year or subsequent year.
- ❑ Income and Expenditure Account is prepared to ascertain the excess of revenue income over revenue expenditure (surplus) or excess of revenue expenditure over revenue income (deficit) for a particular accounting year, which is the result of the entity's over all activities for the accounting year.
- ❑ Opening capital is found out by comparing the opening balances of assets and liabilities.
- ❑ The Balance sheet is prepared at the end of the accounting year to show the financial position on that date.
- ❑ It includes the capital fund or accumulated fund, special purpose funds, long term liabilities and current liabilities on the liabilities side and fixed assets and current assets on the assets side.

SELF-EXAMINATION QUESTIONS

I MULTIPLE CHOICE QUESTIONS

CHOOSE THE CORRECT ANSWER

1. Receipts and payments account is a

- (a) Nominal A/c
- (b) Real A/c
- (c) Personal A/c
- (d) Representative personal account

[Ans. (b) Real A/c]

2. Receipts and payments account records receipts and payments of

- (a) Revenue nature only
- (b) Capital nature only
- (c) Both revenue and capital nature
- (d) None of the above

[Ans. (c) Both revenue and capital nature]

3. Balance of receipts and payments account indicates the

- (a) Loss incurred during the period
- (b) Excess of income over expenditure of the period
- (c) Total cash payments during the period
- (d) Cash and bank balance as on the date

[Ans. (d) Cash and bank balance as on the date]

4. Income and expenditure account is a

- (a) Nominal A/c
- (b) Real A/c
- (c) Personal A/c
- (d) Representative personal account

[Ans. (a) Nominal A/c]

5. Income and Expenditure Account is prepared to find out

- (a) Profit or loss
- (b) Cash and bank balance
- (c) Surplus or deficit
- (d) Financial position

[Ans. (c) Surplus or deficit]

6. Which of the following should not be recorded in the income and expenditure account?

- (a) Sale of old news papers
- (b) Loss on sale of asset
- (c) Honorarium paid to the secretary
- (d) Sale proceeds of furniture

[Ans. (d) Sale proceeds of furniture]

7. Subscription due but not received for the current year is

- (a) An asset
- (b) A liability
- (c) An expense
- (d) An item to be ignored

[Ans. (a) An asset]

8. Legacy is a

- (a) Revenue expenditure
- (b) Capital expenditure
- (c) Revenue receipt
- (d) Capital receipt

[Ans. (d) Capital receipt]

9. Donations received for a specific purpose is

- (a) Revenue receipt
- (b) Capital receipt
- (c) Revenue expenditure
- (d) Capital expenditure

[Ans. (b) Capital receipt]

10. There are 500 members in a club each paying ₹ 100 as annual subscription. Subscription due but not received for the current year is ₹ 200; Subscription received in advance is ₹ 300. Find out the amount of subscription to be shown in the income and expenditure account.

- (a) ₹ 50,000
- (b) ₹ 50,200
- (c) ₹ 49,900
- (d) ₹ 49,800

[Ans. (a) ₹ 50,000]

II VERY SHORT ANSWER QUESTIONS**1. State the meaning of not-for-profit organisation.**

Ans. (i) Some organisations are established for the purpose of rendering services to the public without any profit motive.

(ii) They may be created for the promotion of art, culture, education, sports, etc. These organisations are called not-for-profit organisation.

(iii) Charitable institutions, educational institutions, cultural societies, sports and recreation clubs, hospitals, libraries and literary associations are some of the examples of not-for-profit organisations.

2. What is receipts and payments account?

Ans. (i) Receipts and Payments account is a summary of cash and bank transactions of not-for-profit organisations prepared at the end of each financial year.

(ii) It is a real account in nature. The receipts and payments account begins with the opening balances of cash and bank and ends with closing balances of cash and bank.

3. What is legacy?

Ans. A gift made to a not-for-profit organisation by a will, is called legacy. It is a capital receipt.

4. Write a short note on life membership fees.

Ans. Amount received towards life membership fee from members is a capital receipt as it is non-recurring in nature.

5. Give four examples for capital receipts of not-for-profit organisation.

- Ans. (i)** Life membership fee
(ii) Endowment fund
(iii) Sale of fixed assets
(iv) Specific donations.

6. Give four examples for revenue receipts of not-for-profit organisation.

- Ans. (i)** Interest on investment
(ii) Interest on fixed deposit
(iii) Sale of (old) sports materials
(iv) Sale of (old) news papers.

III SHORT ANSWER QUESTIONS**1. What is income and expenditure account?**

- Ans. (i)** Income and expenditure account is a summary of income and expenditure of a not-for-profit organisation prepared at the end of an accounting year.
- (ii)** It is prepared to find out the surplus or deficit pertaining to a particular year.

- (iii)** It is a nominal account in nature in which items of revenue receipts and revenue expenditure, relating to the current year alone are recorded.
- (iv)** It is just like preparing a profit and loss account. In this account, incomes are shown on the credit side and expenses are shown on the debit side.
- (v)** Apart from cash items, non-cash items such as income accrued but not received, loss or gain on sale of fixed assets, depreciation, etc. will also be recorded.

2. State the differences between Receipts and Payments Account and Income and Expenditure Account.**Ans.**

S.NO.	Basis	Receipts and Payments Account	Income and Expenditure Account
1.	Nature of account	It is a real account. Cash receipts are recorded on the debit side and cash payments are recorded on the credit side.	It is a nominal account. Expenses are recorded on the debit side and incomes are recorded on the credit side.
2.	Basis of accounting	It is based on cash system of accounting. Non-cash items are not recorded	It is based on accrual system of accounting. Non-cash items like outstanding expenses, depreciation, etc. are also recorded.
3.	Opening and closing balance	It commences with an opening balance of cash and bank and ends with closing balance of cash and bank.	There is no opening balance. It ends with surplus or deficit.
4.	Nature of items	It contains actual receipts and payments irrespective of revenue or capital items in nature.	It contains only revenue items, that is, only revenue expenses and revenue incomes.
5.	Period	All cash receipts and payments made during the year pertaining to the past period, current period and subsequent period are recorded.	It contains only the items relating to the current period.

3. How annual subscription is dealt with in the final accounts of not-for-profit organisation?**Ans. (a) Treatment in income and Expenditure account :**

When subscription received for the current year, previous years and subsequent period are given separately, subscription received for the current year will be shown on the credit side of Income and Expenditure Account after making the adjustments given below:

- (i)** Subscription outstanding for the current year is to be added.
- (ii)** Subscription received in advance in the previous year which is meant for the current year, is to be added.

When total subscription received during the current year is given, that total subscriptions received during the current year will be shown on the credit side of Income and Expenditure Account after making the following adjustments:

- (i) Subscription outstanding in the previous year which is received in the current year will be subtracted. Subscription outstanding for the current year is added.
- (ii) Subscriptions received in advance in the previous year which is meant for the current year, is added and subscriptions received in advance in the current year which is meant for the subsequent year must be subtracted.

(B) Treatment in Balance Sheet

- (i) Subscriptions outstanding for the current year and still outstanding for the previous year will be shown on the assets side of the balance sheet.
- (ii) Subscriptions received in advance in the current year will be shown on the liabilities side of the balance sheet.

4. How the following items are dealt with in the final accounts of not-for-profit organisation?

- a) Sale of sports materials
- b) Life membership fees
- c) Tournament fund

Ans. (a) Sale of sports materials :

- (i) Consumable items such as sports materials, stationery, medicines, etc., consumed during the year will appear on the debit side of income and expenditure account.
 - (ii) $\text{Consumption} = \text{Opening stock} + \text{Purchases during the current year} - \text{Closing stock}$
 - (iii) Closing stock will appear on the assets side of the balance sheet as at the end of the year.
 - (iv) If there is any sale of old sports materials, etc., that will be shown on the credit side of income and expenditure account or can be subtracted from the respective items consumed on the debit side of income and expenditure account.
- (b) Life membership fees :** Amount received towards life membership fee from members is a capital receipt as it is non-recurring in nature.
- (c) Tournament fund :** If there are any specific funds such as tournament fund, prize fund, etc., these funds should be shown on the liabilities side of the balance sheet separately.

IV EXERCISES

1. From the information given below, prepare Receipts and Payments account of Kurunji Sports Club for the year ended 31st December, 2018.

Particulars	₹	Particulars	₹
Cash in hand (1.1.2018)	4,000	Paid for printing charges	2,500
Salaries paid	3,000	Lockers rent received	1,000
Life membership fees received	10,000	Tournament receipts	14,000
Subscription received	15,000	Tournament expenses	10,500
Rent received	2,000	Investments purchased	25,000

Solution :**In the books of kurunji sports club****Receipts and Payments Account for the year ended 31st December 2018**

Dr.		Cr.	
Receipts	₹	Payments	₹
To Balance b/d		By Salaries paid	3,000
Cash in hand	4,000	By Printing charges paid	2,500
To Life membership fees received	10,000	By Tournament expenses	10,500
To Subscription received	15,000	By Investment purchased	25,000
To Rent received	2,000	By Balance c/d	
To Lockers rent received	1,000	Cash in hand	5,000
To Tournament receipts	14,000		
	<u>46,000</u>		<u>46,000</u>

2. From the information given below, prepare Receipts and Payments account of Coimbatore Cricket Club for the year ending 31st March, 2019.

Particulars	₹	₹	Particulars	₹
Bank overdraft (1.4.2018)		6,000	Honorarium paid	2,800
Cash in hand (1.4.2018)		1,000	Water and electricity charges	700
Wages paid for ground maintenance		2,000	Match expenses	2,600
Subscription received:			Sports material purchased	1,900
Previous year	500		Match fund receipts	5,200
Current year	9,600		Legacies received	2,000
Subsequent year	400	10,500	Cash balance (31.03.2019)	300
Wages yet to be paid		2,200	Donation received for pavilion	2,000
Interest on loan paid		2,000		

Solution :**In the books of Coimbatore Cricket Club****Receipts and Payments Account for the year ended 31st March 2019**

Dr.		Cr.		
Receipts	₹	₹	Payments	₹
To Balance b/d			By Balance b/d	
Cash in hand		1,000	Bank overdraft	6,000
To Subscription received:			By Wages paid	2,000
Previous year	500		By Interest on loan	2,000
Current year	9,600		By Honorarium paid	2,800
Subsequent year	400	10,500	By Water and electricity charges	700
			By Match expenses	2,600
To Match fund receipts		5,200	By Sports material purchased	1,900
To Legacies received		2,000	By Balance c/d	
To Donation received		2,000	Cash in hand	300
		<u>20,700</u>	Cash at bank	2,400
				<u>20,700</u>

[Hint : Wages yet to be paid is a non cash item. Hence it is excluded in receipts and payments account]



ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. An advance receipt of subscription from a member of the non - profit organization is considered as a/an

- (a) Expense (b) Liability
(c) Equity (d) Asset

[Ans: (b) Liability]

2. Income and Expenditure account is based on

- (a) Cash accounting
(b) Government accounting
(c) Management accounting
(d) Accrual accounting

[Ans: (d) Accrual accounting]

3. Which of the following is to be recorded in an income and expenditure account?

- (a) Purchase of a fixed asset.
(b) Capital expenditure incurred on a fixed asset
(c) Profit on the sale of a fixed asset
(d) Sale of a fixed asset.

[Ans: (c) Profit on the sale of a fixed asset]

4. Subscription received but not yet earned is considered as a / an

- (a) Asset (b) Liability
(c) Income (d) Expenditure

[Ans: (b) Liability]

5. ₹10,000 received as to annual membership subscription. Out of this ₹ 2,000 is pertaining to the previous accounting period whereas ₹1000 is receivable at the end of the current accounting period. Calculate the amount of subscription that will be shown in the income and expenditure account for this accounting.

- (a) ₹ 10,000 (b) ₹ 9,000
(c) ₹ 12,000 (d) ₹ 8,000

[Ans: (b) ₹ 9,000]

6. Income and Expenditure accounts show

- (a) cash available to an organization
(b) closing capital of an organization
(c) cash available in the bank account
(d) surplus or deficit for the current accounting period.

[Ans: (d) surplus or deficit for the current accounting period]

7. On what basis the receipts and payments account is prepared?

- (a) Cash basis (b) Credit basis
(c) Both (d) None of these

[Ans: (a) Cash basis]

8. The amount or property received by a non - profit organization as stated by the will of a deceased person is commonly referred to as

- (a) Donation (b) Honorarium
(c) Legacy (d) Endowment

[Ans: (c) Legacy]

9. In non - profit organization, the sale of old newspapers is generally considered as a/an

- (a) Revenue receipt (b) Expenditure
(c) Income (d) Capital receipt

[Ans: (c) Income]

10. Some organisations are established for the purpose of rendering services to the public without

- (a) any profit motive
(b) any service motive
(c) both

(d) none of these [Ans. (a) any profit motive]

11. Charitable institutions and educational institutions are the examples of

- (a) profit organisation
(b) not-for-profit organisation
(c) both
(d) none of these

[Ans. (b) not-for-profit organisation]

12. If the donation is received without any specific condition, then it is a

- (a) general donation
(b) specific donation
(c) legacy
(d) grants from government

[Ans. (a) general donation]

13. Capital fund also called as

- (a) accumulated fund
(b) special fund
(c) donation fund

(d) none of these [Ans. (a) accumulated fund]

(vii) Consider the Following Statement.

1. **Assertion (A) :** The receipts and payments account begins with the opening balances of cash and bank and ends with closing balances of cash and bank.

Reason (R) : Non-cash items such as depreciation, outstanding expenses and accrued income are shown in receipts and payments account.

- (a) Both (A) and (R) are true, and (R) is the correct explanation of (A)
 (b) Both (A) and (R) are true, and (R) is not the correct explanation of (A)
 (c) (A) is true but (R) is false
 (d) (A) is false but (R) is true.

[Ans : (c) (A) is true but (R) is false]

2. **Assertion (A) :** Life membership fee is non-recurring in nature.

Reason (R) : Admission fee is a fee collected from every member only once at the time of his or her Admission into the organization.

- (a) Both (A) and (R) are true and (R) is the correct explanation of (A)
 (b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
 (c) (A) is true but (R) is false.
 (d) (A) is false but (R) is true.

[Ans: (b) Both (A) and (R) are true and (R) is not the correct explanation of (A)]

(viii) Choose the Correct Statement.

1. (i) Specific fund is to be shown on the liabilities side and specific fund investments account is to be shown on the assets side of the balance sheet.
 (ii) Incomes and expenses relating to the specific fund account should not be recorded in income and expenditure account.
 (iii) Balance sheet is a statement showing the financial position of an organisation.
- (a) (i) is correct
 (b) (ii) is correct
 (c) (i) and (ii) are correct
 (d) (i), (ii) and (iii) are correct

[Ans. (d) (i), (ii) and (iii) are correct]

2. (i) Capital fund also called as general fund or accumulated fund is taken to the assets side.
 (ii) The total of debit balances will be equal to the total of credit balances.
 (iii) Revenues, gains and liabilities will have credit balance.
- (a) (i) is correct
 (b) (ii) and (iii) are correct
 (c) (ii) is correct
 (d) (i), (ii) and (iii) are correct

[Ans. (b) (ii) and (iii) are correct]

II. VERY SHORT ANSWER QUESTIONS**1. What is Balance sheet?**

Ans. A balance sheet is a statement showing the financial position of an organization. The preparation of balance sheet of a not-for-profit organization is more or less similar to that of a trading concern.

III. SHORT ANSWER QUESTIONS**1. What are the features of not-for-profit organizations?**

Ans. Following are the features of not-for-profit organizations.

- (i) Not-for-profit organizations are the organizations which function without any profit motive.
 (ii) Their main aim is to provide service to a specific group or the public at large.
 (iii) Generally, they do not undertake business or trading activities.
 (iv) Their main sources of income include subscription from members, donations, grant-in-aid and legacies.

2. Explain the steps in preparations of receipts and payments account.

Ans. Following are the steps involved in the preparation of receipts and payments accounts:

- (i) Record the opening balance of cash in hand and favourable bank balance on the debit side of receipts and payments account. If there is a bank overdraft, it must be recorded on the credit side.

- (ii) Actual cash receipts during the year are recorded on the debit side and actual cash payments during the year are recorded on the credit side.
- (iii) While recording cash receipts and payments, no distinction needs to be made between revenue and capital items.
- (iv) If the total of the debit side is more than the credit side, the balancing figure will appear on the credit side. It represents the closing balance of cash or bank.
- (v) If the total of the credit side is more than the debit side, the balancing figure will appear on the debit side. It represents bank overdraft.

3. Write a note on Donations.

- Ans.** (i) These are the amount received by not-for-profit organizations as a gift. It may be general donation or specific donation.
- (ii) **General donation:** If the donation is received without any specific condition, then it is a general donation. It is a revenue receipt.
- (iii) **Specific donation :** If the donation is received with a specific condition for particular purpose like donations for sports fund, prize fund etc., It is known as specific donation. It is a capital receipt.

IV. PROBLEMS:

1. From the Receipt and Payment Account given below, prepare the Income and Expenditure Account of clean Delhi club for the year ended March 31, 2017

Receipt and Payment Account for the year ending March 31st, 2017

Dr		Cr	
Receipts	₹	Payments	₹
To Balance b/d		By Salary	1,500
Cash in hand	3200	By Rent	800
To Subscriptions	22,500	By Electricity	3,500
To Entrance fees	1,250	By Taxes	1,700
To Donations	2,500	By Printing stationery	380
To Rent of hall	750	By Sundry expenses	920
To Sale of investment	3,000	By Books purchased	7,500
		By Govt. bonds purchased	10,000
		By Fixed deposit with bank (on 31-3-2014)	5,000
		By Balance c/d	
		Cash in hand	400
		Cash at bank	<u>1,500</u>
	<u>33,200</u>		<u>33,200</u>

Solution :

**In the books of clean Delhi club
Income and Expenditure Account for the year ending March 31st, 2017**

Dr		Cr
Expenditure	₹	Income
To Salary	1,500	By Subscriptions
To Rent	800	By Entrance fees
To Electricity	3,500	By Donation
To Taxes	1,700	By Rent of hall
To Printing & Stationery	380	
To Surplus (Excess of income over expenditure)	18,200	
	27,000	
		27,000

2. From the following Receipt and Payment Account for the year ending 31st March 2015 of crickets club. Prepare Income and Expenditure Account for the same period:

Receipt and Payment Account for the year ending March 31, 2015

Dr		Cr
Receipts	₹	Payments
To Balance c/d		By Purchase of furniture (1.7.14)
Bank	25,000	By Salaries
To Subscriptions		By Telephone expenses
2014 1,500		By Electricity charges
2015 10,000		By Postage and stationery
2016 500	12,000	By Purchase of books
To Donation	2,000	By Entertainment expenses
To Hall rent	300	By Purchase of 5% Government papers (1.7.14)
To Interest on bank deposits	450	By Miscellaneous expenses
To Entrance fees	1,000	By Balance c/d
		Cash
		Bank
	40,750	20,400
		40,750

The following additional information is available:

- (i) Salaries outstanding ₹1,500
- (ii) Entertainment expenses outstanding ₹500
- (iii) Bank interest receivable ₹150
- (iv) Subscription accrued ₹400
- (v) 50 percent of entrance fees is to capitalised
- (vi) Furniture is to be depreciated at 10 percent per annum.

Solution :

In the books of Cricket club
Income and Expenditure Account for the year ending 31.3.2015

Dr					Cr
Expenditure	₹	₹	Income	₹	₹
To Salaries	2,000		By Subscriptions		10,400
Add: Outstanding	1,500	3,500	By Donation		2,000
To Telephone charges		300	By Entrance fees (50% of 1000)		500
To Electricity charges		600	By Bank interest	450	
To Postage and stationery		150	Add: Outstanding interest	150	600
To Entertainment expenses	900		By Interest on investment		200
Add: Outstanding expenses	500	1,400	By Hall rent		300
To Miscellaneous expenses		600			
To Depreciation on furniture		375			
To Surplus (Excess of income over expenditure)		7,075			
		14,000			14,000

3. From the following extract of Receipt and Payment Account and the additional information given below, compute the amount of income from subscriptions and show as how they would appear in the Income and Expenditure Account for the year ending March 31st, 2015 and Balance sheet.

Receipt and Payment Account for the year ending March 31, 2015

Dr					Cr
Receipts	₹	Payments	₹		
Subscription:					
2013-14	7,000				
2014-15	30,000				
2015-16	<u>5,000</u>	42,000			

Additional Information:

- (i) Subscriptions outstanding March 31, 2014 ₹ 8,500
- (ii) Total subscriptions outstanding March 31, 2015 ₹ 18,500
- (iii) Subscriptions received in advance as ₹ 4,000 on March 31, 2014.

Solution :**Income and Expenditure Account for the year ending on March 31, 2015**

Dr		Cr		
Expenditure	₹	Income	₹	₹
		By Subscriptions received for 2014-15	30,000	
		Add: Outstanding for 2014-15	17,000	
		Add: Received in advance For 2014-15	4,000	
				<u>51,000</u>

Note:

- ☛ Total amount of subscription outstanding as on 31.3.2015 are ₹18,500. This include ₹1,500 (₹8,500 – ₹7000) for subscription still outstanding for 2013-14. Hence the subscriptions outstanding for 2014-15 are ₹17,000 (₹18,500 – ₹1,500).

Balance sheet as on March 31, 2015

Liabilities	₹	Assets	₹	₹
Subscription received in advance for 2014-15	5,000	Subscription outstanding 2013-14	1,500	
		2014-15	<u>17,000</u>	18,500

4. From the following balances prepare a balance sheet as on 31st March 2016.

	₹
Cash in hand	12,000
Cash at bank	8,000
Books	16,000
Billiard Table	24,000
Furniture	30,000
Investment	30,000
Prepaid expenses	20,000
Building	1,00,000
Outstanding expenses	40,000
Subscription received in advance	24,000
Subscription accrued	20,000
Surplus (Income over expenditure)	20,000

Solution :**Balance Sheet as on 31st March, 2016**

Liabilities	₹		Assets	₹
Subscription in advance		24,000	Cash in hand	12,000
Outstanding expenses		40,000	Cash at bank	8,000
Capital fund	1,76,000		Books	16,000
(balancing figure)			Billiard Table	24,000
Add: Surplus	20,000	1,96,000	Furniture	30,000
			Investment	30,000
			Prepaid expenses	20,000
			Building	1,00,000
			Subscription accrued	20,000
		<u>2,60,000</u>		<u>2,60,000</u>

5. Following is the receipts and payments accounts of Literacy club for the year ended 31st March 2016

Receipts	₹	₹	Payments	₹
To Balance c/d		19,550	By Salary	3,000
To Subscriptions			By News papers	2,050
2014-2015	1,200		By Electricity bill	1,000
2015-2016	26,500		By Fixed deposit	20,000
2016-2017	500		(on 1st July, 2015 @	
		28,200	9% per annum)	
To Sale of old newspaper		1,250	By Books	10,600
To Government grants		10,000	By Rent	6,800
To Sale of old furniture		5,700	By Furniture	10,500
(book value ₹.7,000)			By Balance dd	11,200
To Interest on fixed deposits		450		
		<u>65,150</u>		<u>65,150</u>

Additional information:

- Subscription outstanding as on 31st March, 2015 were ₹ 2000 and on 31st March, 2016 ₹2,500.
- On 31st March, 2016 Salary outstanding was ₹ 600 and rent outstanding was ₹ 1,200.
- The club owned furniture ₹ 15,000 and books ₹ 7,000 on 1st April, 2015.

Prepare income and expenditure account of the club for the year ended 31st March 2016 and as certain capital fund on 31st March, 2015. Also prepare a balance sheet as on 31st March, 2016.

Solution :**Balance sheet as on 31st March 2015**

Liabilities	₹	Assets	₹
Capital fund (balancing figure)	43,550	Cash in hand	19,550
		Subscription outstanding	2,000
		Furniture	15,000
		Books	7,000
	43,550		43,550

Income and Expenditure Account for the year ended 31st March 2016

Dr			Cr		
Expenditure	₹	₹	Income	₹	₹
To Salary	3,000		By Subscriptions	26,500	
Add: Outstanding	600	3,600	Add: Outstanding for 2015-16	1,700	28,200
To Newspapers		2,050	By Sale of old newspaper		1,250
To Electricity bill		1,000	By Government grants		10,000
To Rent	6,800		By Interest on fixed deposit	450	
Add: Outstanding	1,200	8,000	Add: Accrued interest	900	1,350
To Loss on sale of furniture (7000 – 5700)		1,300			
To Surplus (Excess of income over expenditure)		24,850			
		40,800			40,800

Note :

- ☞ Subscription outstanding on 31st March, 2016 is ₹ 2,500 which includes the subscription outstanding for the year 2014-15 ₹ 800 i.e. 2000 – 1200 received during 2015-2016. Hence the subscription outstanding for 2015-16 is ₹ 1700 (i.e. ₹ 2,500 – ₹ 800). It should be noted that there is difference between subscription outstanding on 31st March, 2016 and subscription outstanding for 2015-16. which indicates subscription outstanding on 31st March, 2016 and subscription outstanding for 2015-16 which indicates subscription outstanding only for 2015-16.

**HOTS QUESTIONS AND ANSWERS**

1. Can be balance in receipts and payments account be treated as income of the period?

Ans. No, as the balance in receipt and payments account is closing cash and bank balance.

2. Every receipt and Payments, whether capital or revenue and irrespective of the period is recorded in receipts and payments accounts why? Give reason.

Ans. It is so because receipts and payments account is prepared on cash basis of accounting.

3. Income and expenditure account of a not-for-profit organization is akin to profit and loss account of a business concern. Explain the statement.

Ans. Income and expenditure account is prepared by a non-profit organization and is a summary of income and expenditure of the accounting year.

Income and expenditure account is akin to profit and loss account because of the following similarities which are observed amongst these accounts.

(i) Both are nominal accounts.

(ii) Both are one prepared on accrual basis.

(iii) Both record revenue items related to current accounting year only.

(iv) In both the accounts, expenses and losses are recorded on the debit side and incomes and gains are recorded on the credit side.

4. Distinguish between income and expenditure account and profit and loss account.

Ans. The difference between income and expenditure account and profit and loss account are.

Basis	Income and Expenditure Account	Profit and Loss Account
Preparation	Income and Expenditure account is prepared by non-profit organisation.	Profit and loss account is prepared by organization whose main objective is to earn profit
Basis of preparation	It is prepared on the basis of receipts and payments account.	It is prepared on the basis of trial balance and additional information.
Objective	Its main objective is to ascertain surplus or deficit.	Its main objective is to ascertain net profit or loss.
Balance	The balance in this account is either surplus or deficit.	The balance in this account is either net profit or net loss.

VALUE BASED QUESTIONS AND ANSWERS

1. Yuvan foundation is formed to educate and to provide jobs to unemployed women. Identify the values involved.

Ans. The value involved are Respect for women and women empowerment.

2. Youth of India sports club decided to donate ₹ 50,000 and spread awareness among the people of nearby societies about cleanliness in the country under the programme "Bharat Abhiyan". Identify the values highlighted.

Ans. The values highlighted are

(i) Social responsibility towards society.

(ii) Sensitivity towards cleaner environment.



UNIT
3**ACCOUNTS OF PARTNERSHIP
FIRMS - FUNDAMENTALS****CHAPTER SNAPSHOT**

- 3.1** Introduction
- 3.2** Meaning, definition and features of partnership
 - 3.2.1** Meaning and definition of partnership
 - 3.2.2** Features of partnership
- 3.3** Partnership deed
 - 3.3.1** Contents of partnership deed
- 3.4** Application of the provisions of the Indian Partnership Act, 1932 in the absence of partnership deed
- 3.5** Final accounts of partnership firms
- 3.6** Methods of maintaining capital accounts of partners
 - 3.6.1** Fixed capital method
 - 3.6.2** Fluctuating capital method
 - 3.6.3** Differences between fixed capital method and fluctuating capital method
- 3.7** Interest on capital and interest on drawings of partners
 - 3.7.1** Interest on capital
 - 3.7.2** Calculation of interest on capital
 - 3.7.3** Interest on drawings
 - 3.7.4** Calculation of interest on drawings
- 3.8** Salary and commission to partners
- 3.9** Interest on loan from partners
- 3.10** Division of profits among partners
- 3.11** Profit and loss appropriation account
 - 3.11.1** Format of Profit and loss appropriation account



Important Points

- ❑ Profits and losses are shared among the partners of a firm in the profit sharing ratio. In the absence of agreed ratio, the profit and losses are to be shared by the partners equally.
- ❑ In the absence of agreement, no interest is allowed on capital, no interest is charged on drawings and no salary or other remuneration is given to the partners.
- ❑ Partners are entitled to interest on the loans advanced by them to the firm at a rate agreed by them. If the rate of interest on partner's loan is not agreed, the partners are entitled to interest on loan at 6% per annum.
- ❑ When fixed capital method is adopted by a firm, current accounts are opened for each partner apart from the capital account of each partner.
- ❑ When fluctuating capital method is followed, all the adjustments regarding additional capital introduced, share of profit, interest on capital, interest on drawings, etc. are done in the capital account.
- ❑ In profit and loss appropriation account adjustments are made for interest on capital, interest on drawings and partner's remuneration, the resultant profit is shared by the partners in their profit sharing ratio.

SELF-EXAMINATION QUESTIONS

I MULTIPLE CHOICE QUESTIONS

CHOOSE THE CORRECT ANSWER

1. In the absence of a partnership deed, profits of the firm will be shared by the partners in
 - (a) Equal ratio
 - (b) Capital ratio
 - (c) Both (a) and (b)
 - (d) None of these

[Ans. (a) Equal ratio]
2. In the absence of an agreement among the partners, interest on capital is
 - (a) Not allowed
 - (b) Allowed at bank rate
 - (c) Allowed @ 5% per annum
 - (d) Allowed @ 6% per annum

[Ans. (a) Not allowed]
3. As per the Indian Partnership Act, 1932, the rate of interest allowed on loans advanced by partners is
 - (a) 8% per annum
 - (b) 12% per annum
 - (c) 5% per annum
 - (d) 6% per annum

[Ans. (d) 6% per annum]
4. Which of the following is shown in Profit and loss appropriation account?
 - (a) Office expenses
 - (b) Salary of staff
 - (c) Partners' salary
 - (d) Interest on bank loan

[Ans. (c) Partners' salary]
5. When fixed capital method is adopted by a partnership firm, which of the following items will appear in capital account?
 - (a) Additional capital introduced
 - (b) Interest on capital
 - (c) Interest on drawings
 - (d) Share of profit

[Ans. (a) Additional capital introduced]
6. When a partner withdraws regularly a fixed sum of money at the middle of every month, period for which interest is to be calculated on the drawings on an average is
 - (a) 5.5 months
 - (b) 6 months
 - (c) 12 months
 - (d) 6.5 months

[Ans. (b) 6 months]

7. Which of the following is the incorrect pair?

(a)	Interest on drawings	-	Debited to capital account
(b)	Interest on capital	-	Credited to capital account
(c)	Interest on loan	-	Debited to capital account
(d)	Share of profit	-	Credited to capital account

[Ans. (c) Interest on loan - Debited to capital account]

8. In the absence of an agreement, partners are entitled to

- Salary
- Commission
- Interest on loan
- Interest on capital

[Ans. (c) Interest on loan]

9. Pick the odd one out

- Partners share profits and losses equally
- Interest on partners' capital is allowed at 7% per annum
- No salary or remuneration is allowed
- Interest on loan from partners is allowed at 6% per annum.

[Ans. (b) Interest on partners' capital is allowed at 7% per annum]

10. Profit after interest on drawings, interest on capital and remuneration is ₹10,500. Geetha, a partner, is entitled to receive commission @ 5% on profits after charging such commission.

Find out commission.

- ₹50
- ₹150
- ₹550
- ₹500

[Ans. (d) ₹500]

a. For providing interest on capital :

Date	Particulars	L.F	Debit ₹	Credit ₹
	Interest on capital A/c Dr To partner's capital / current A/c		XXXX	XXXX

Note:

- ☞ Interest on capital is due to the partners from the firm hence partner's capital/current account is credited and interest on capital account is debited.

Hint : Commission as a percentage of net profit after charging such commission
= Net profit before commission

$$\times \frac{\% \text{ of commission}}{100 + \% \text{ of commission}}$$

$$= ₹ 10,500 \times \frac{5}{100 + 5} = \frac{10,500 \times 5}{105}$$

$$= ₹ 500$$

II VERY SHORT ANSWER QUESTIONS**1. Define partnership.**

Ans. According to section 4 of the Indian partnership Act, 1932, partnership is defined as "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".

2. What is a partnership deed?

Ans. Partnership deed is a document in writing that contains the terms of the agreement among the partners. It is not compulsory for a partnership to have a partnership deed as per the Indian Partnership Act, 1932

3. What is meant by fixed capital method?

- Ans. (i)** Under this method, two accounts are maintained for each partner viz. a) Capital account and b) current account
- (ii)** The transactions relating to initial capital introduced, additional capital introduced and capital permanently withdrawn are entered in the capital account and all other transactions are recorded in the current account.

4. What is the journal entry to be passed for providing interest on capital to a partner?

Ans. Following are the journal entries to be made in the books of the partnership firm.

**b. For closing interest on capital account :**

Date	Particulars	L.F	Debit ₹	Credit ₹
	Profit and loss appropriation A/c Dr To Interest on Capital A/c		XXXX	XXXX

5. Why is Profit and loss appropriation account prepared?

Ans. (i) The profit and loss appropriation account is an extension of profit and loss account prepared for the purpose of adjusting the transactions relating to amounts due to and amount due from partners. It is a nominal account in nature

(ii) The balance being the profit or loss is transferred to the partner's capital or current account in the profit sharing ratio.

(2) There should be an agreement among the persons to share the profit or loss of the business.

(3) The agreement must be carry on a business and to share the profits of the business.

(4) The business may be carried on by all the partners or any of them acting for all.

2. State any six contents of a partnership deed.

Ans. (1) Name of the firm and nature and place of business.

(2) Date of commencement and duration of business

(3) Names and addresses of all partners

(4) Capital contributed by each partner

(5) Profit sharing ratio

(5) Rate of interest to be allowed on capital

III SHORT ANSWER QUESTIONS**1. State the features of partnership.**

Ans. Following are the essential features of partnership

(1) Partnership is an association of two or more persons. The maximum number of partners is limited to 50.

3. State the differences between fixed capital method and fluctuating capital method.

Ans.

Basis of destination	Fixed capital method	Fluctuating capitals method
1.Number of accounts	Two accounts are maintained for each partner, that is, capital account and current account.	Only one account, that is, capital account is maintained for each partner.
2.Change in capital	The amount of capital normally remains unchanged except when additional capital is introduced or capital is withdrawn permanently	The amount of capital changes from period to period.
3.Closing balance	Capital account always shows a credit balance	Capital account generally shows credit balance. It may also show a debit balance.
4.Adjustments	All adjustments relating to interest on capital, interest on drawings, salary or commission, share of profit or loss are done in current account	All adjustments relating to interest on capital, interest on drawings, salary or commission, share of profit or loss are done in the capital account

4. Write a brief note on the applications of the provisions of the Indian Partnership Act, 1932 in the absence of partnership deed.

Ans. If there is no partnership deed or when there is no express statement in the partnership deed, then the following provisions of the act will apply

(i) Remuneration to partners:

No salary or remuneration is allowed to any partner (Section 13(a))

(ii) Profit sharing ratio:

Profits and losses are to be shared by the partners equally [section 13(b)]

(iii) Interest on capital:

No interest is allowed on the capital, where a partner is entitled to interest on capital contributed as per partnership deed, such interest on capital will be payable only out of profits. [section 13(c)]

(iv) Interest on loans advanced by partners to the firm:

Interest on loan is to be allowed at the rate of 6 per cent annum. [section 13(d)]

(v) Interest on drawings:

No interest is charged on the drawings of the partners.

5. Jayaraman is a partner who withdrew ₹10,000 regularly in the middle of every month. Interest is charged on the drawings at 6% per annum. Calculate interest on drawings for the year ended 31st December, 2018.

Solution :

If Drawings are made in the middle of every month :

Average period = 6

Interest on drawings = Total amount of drawings

$$\times \text{Rate of interest} \times \frac{\text{Average Period}}{12}$$

$$= ₹10,000 \times \frac{6}{100} \times \frac{6}{12}$$

$$= ₹ 300$$

IV EXERCISES

1. Akash, Bala, Chandru and Daniel are partners in a firm. There is no partnership deed. How will you deal with the following?

(i) Akash has contributed maximum capital. He demands interest on capital at 10% per annum.

(ii) Bala has withdrawn ₹3,000 per month. Other partners ask Bala to pay interest on drawings @ 8% per annum to the firm. But, Bala did not agree to it.

(iii) Akash demands the profit to be shared in the capital ratio. But, others do not agree.

(iv) Daniel demands salary at the rate of ₹10,000 per month as he spends full time for the business.

(v) Loan advanced by Chandru to the firm is ₹50,000. He demands interest on loan @ 12% per annum.

Ans. Since there is no partnership deed, provisions of the Indian partnership Act, 1932 will apply.

(i) No interest on capital is payable to any partner. Therefore Akash is entitled to the interest in capital.

(ii) No interest is chargeable on drawings made by the partner. Therefore, Bala need not pay interest on drawings.

(iii) Profits should be distributed equally.

(iv) No remuneration is payable to any partner. Hence Daniel is not entitled to salary.

(v) Interest on loan is payable at 6% per annum of ₹ 50,000.



ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. The name under which the business of a firm is carried on is called the

- (a) Company name (b) Firm name
(c) Partnership firm (d) Partner's name

[Ans. (b) Firm name]

2. The profit or loss arising from the partnership business is shared by the partners in the

- (a) old ratio (b) new ratio
(c) agreed ratio (d) sacrifice ratio

[Ans. (c) agreed ratio]

3. In India, partnership firms are governed by the Indian partnership Act.

- (a) 1932 (b) 1930
(c) 1992 (d) 1986

[Ans. (a) 1932]

4. The maximum number of partners in a partnership firm is

- (a) 25 (b) 10
(c) 30 (d) 50

[Ans. (d) 50]

5. In sole proprietorship, the profit or loss in the profit and loss account is transferred directly to the sole proprietor's

- (a) drawings account (b) capital account
(c) loan account (d) salary account

[Ans. (b) capital account]

6. The balance in the appropriation account is transferred to the partner's capital account in the

- (a) agree ratio (b) sacrifice ratio
(c) profit sharing ratio (d) old ratio

[Ans. (c) profit sharing ratio]

7. Capital account balance of the sole proprietor alone as shown in the balance sheet of

- (a) Sole proprietorship (b) Partnership
(c) Joint Hindu family (d) Company

[Ans. (a) Sole proprietorship]

8. Amount invested by partners in the partnership business is called

- (a) Owner's capital
(b) Partner's capital
(c) Profit and loss appropriation
(d) None of these

[Ans. (b) Partner's capital]

9. Which of the following method, the capital of the partners is not altered and it remains generally fixed?

- (a) Fixed capital method
(b) Fluctuating capital method
(c) Both 'a' and 'b'
(d) None of these

[Ans. (a) Fixed capital method]

10. All the transactions between the partner and the firm are recorded in the

- (a) capital account
(b) drawings account
(c) profit and loss account
(d) revaluation account

[Ans. (a) capital account]

11. The rate of interest on capital is generally agreed by the partners and is mentioned in the

- (a) capital account
(b) profit and loss account
(c) partnership deed
(d) none of these

[Ans. (c) partnership deed]

12. Interest on capital is to be calculated on the capitals at the beginning for the

- (a) particular period
(b) relevant period
(c) average period
(d) all of these

[Ans. (b) relevant period]

13. Period of interest refers to the period from the date of drawings to the closing date of the

- (a) opening year
(b) closing year
(c) previous year
(d) accounting year

[Ans. (d) accounting year]

(vii) Choose the Correct Statement.

1. (i) The sole proprietorship has its limitations such as limited capital, limited managerial ability and limited risk - bearing capacity.
(ii) The sole proprietorship has its limitations such as Unlimited capital, Unlimited managerial ability and Unlimited risk - bearing capacity
(iii) The Partnership has its limitations such as Unlimited capital, Unlimited managerial ability and Unlimited risk - bearing capacity
(a) (i) is correct
(b) (i) and (ii) are correct
(c) (ii) and (iii) are correct
(d) (i), (ii) and (iii) are correct
[Ans. (a) (i) is correct]
2. (i) An incoming partner pays his share of good will in cash, and profit sharing ration of old partner is changed, Good - will be distributed among old partners According to new ration.
(ii) Any partner who investments in the business but does not take active part in the businesses Secret partner.
(iii) 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.
(a) (i) and (ii) are correct
(b) (iii) is correct
(c) (ii) and (iii) are correct
(d) (i), (ii) and (iii) are correct
[Ans. (b) (iii) is correct]
3. (i) Any partner who investments in the business but does not take active part in the business is Nominal partner.
(ii) The capital account will continue to show the same balance from year to year unless some amount of capital is introduced or withdrawn.
(iii) In the absence of an agreement, Interest on loan advanced by the partner to the firm is allowed at the rate of 7%.

- (a) (ii) and (iii) are correct
- (b) (i) and (ii) are correct
- (c) (ii) is correct
- (d) (i), (ii) and (iii) are correct

[Ans. (c) (ii) is correct]

4. (i) On the retirement of a partner any reserve being should be transferred to the capital account of Neither the retiring partner, nor the remaining partner
(ii) Amount due to outgoing partner is shown in the balance sheet as his Liability.
(iii) A partnership firm, the net profit as shown by the Profit and Loss Account need certain adjustments with regard to interest on capitals, interest on drawings, salary and commission to the partners.
(a) (ii) and (iii) are correct
(b) (i) and (ii) are correct
(c) (i), (ii) and (iii) are correct
(d) (iii) is correct [Ans. (d) (iii) is correct]
5. (i) Current accounts of the partners should be opened when the capitals are Either fixed or fluctuating.
(ii) Goodwill is the present value of a firm's anticipated excess earnings in future and the efforts had already made in the past.
(iii) Any partner who investments in the business but does not take active part in the business is Nominal partner'
(a) (ii) and (iii) are correct
(b) (i) and (ii) are correct
(c) (ii) is correct
(d) (i), (ii) and (iii) are correct

[Ans. (c) (ii) is correct]

II. VERY SHORT ANSWER QUESTIONS.**1. What is drawing?**

- Ans. (i)** Drawings is the amount withdrawn in each or in kind, for personal purposes.
- (ii)** A drawings account is opened in the name of each partner and the drawings are debited to this account.
- (iii)** At the end of every year, the drawings account is closely by a transfer to the respective partner's capital account or current account.

**2. What is partner's current Account?**

Ans. In the current account, the transactions relating to drawings, interest on capital, interest on drawings, salary, share of profit or loss etc, are recorded. Hence, the balance in the currents accounts change every year.

3. If the partner's capital accounts are fixed, where will you record the following items?

(a) Salary payable to a partner

(b) Drawings made by a partner

Ans. (a) Under fixed capital method, salary payable to a partner is recorded in the current account

(b) Under fixed capital method, drawings made by a partner is recorded in the current account.

III. SHORT ANSWER QUESTIONS.**1. Explain the procedure for preparation of final accounts of a partnership firm.**

Ans. (i) In sole proprietorship, the profit or loss in the profit and loss account is transferred directly to the sole proprietor's capital account. In partnership, profit and loss appropriation account is prepared to which net profit or loss from profit and

to which net profit or loss from profit and loss account is transferred.

(ii) In the profit and loss appropriation account, adjustments for interest on capital, interest on drawings, salary and other remuneration due to the partners are shown. Finally, the balance in the appropriation account is transferred to the partner's capital account in the profit sharing ratio.

(iii) Capital account balance of the sole proprietor alone is shown in the balance sheet of sole proprietorship. The balance sheet of a partnership concern shows the balances in the individual capital accounts (an current accounts) of the partners.

2. What is Fluctuating capital method?

Ans. (i) Under this method, only one capital account is maintained for each partner.

(ii) The capital is changing from period to period.

(iii) This capital account shows always a credit balance

(iv) All adjustment relating to partners are recorded directly in the capital account.

PROBLEMS:**1. Write up the capital and current accounts of the partners, Kannagi and vasugi from the following details.**

Particulars	Kannagi ₹	Vasugi ₹
Capital on 1.4.2018	1,00,000	60,000
Current A/c on 1.4.2018	3,000(Dr)	2,000(Cr)
Drawing during 2018-19	8,000	5,000
Interest on capital	5,000	3,000
Interest in drawings	240	150
Share of profit 2018-19	12,000	10,000
Partner's salary	4,000	-

Solution :

Dr				Capital Account				Cr	
Date	Particulars	Kannagi ₹	Vasugi ₹	Date	Particulars	Kannagi ₹	Vasugi ₹		
31.3.2019	To Balance c/d	1,00,000	60,000	1.4.2018	ToBalanceb/d	1,00,000	60,000		
		<u>1,00,000</u>	<u>60,000</u>			<u>1,00,000</u>	<u>60,000</u>		

Dr				Current Account				Cr	
Date	Particulars	Kannagi ₹	Vasugi ₹	Date	Particulars	Kannagi ₹	Vasugi ₹		
	To Balance b/d	3,000	-		BY Balance b/d	-	2,000		
	To Drawings	8,000	5,000		By Interest on capital	5,000	3,000		
	To Interest on drawings	240	150		By Share of profit	12,000	10,000		
	To Balance c/d (Balancing figure)	9,760	9,850		By Salary	4,000	-		
		<u>21,000</u>	<u>15,000</u>		By Balance c/d	9,760	9,850		

2. From the following information, prepare capital accounts of partners Manoj and Seran, when their capitals are fluctuating.

Particulars	Manoj ₹	Seran ₹
Capital on 1 st January 2018 (Cr. balance)	1,00,000	87,500
Drawings during 2018	20,000	17,500
Interest on drawings	500	250
Share of profit for 2018	10,500	8,250
Interest on capital	6,000	5,250
Salary	9,000	Nil
Commission	Nil	1250

Solution :

Dr		Partner's capital Account		Cr	
Particulars	Manoj ₹	Seran ₹	Particulars	Manoj ₹	Seran ₹
To Drawing A/c	20,000	17,500	By Balance b/d	1,00,000	87,500
To Interest on drawings A/c	500	250	By Profit and loss appropriation A/c	10,500	8,250
To Balance c/d (Balancing figure)	1,05,000	84,500	By Interest on capital A/c	6,000	5,250
			By Salary A/c	9,000	-
			By Commission A/c	-	1,250
	<u>1,25,500</u>	<u>1,02,250</u>		<u>1,25,500</u>	<u>1,02,250</u>
			By balance b/d	1,05,000	84,500

3. Mala and Ratna share profits and losses in the ratio of 2:1. The capital on 1st April 2017 was ₹90,000 for Mala and ₹60,000 for Ratna and their current accounts show a credit balance of ₹15,000 and ₹5,000 respectively. Calculate interest on capital at 5% p.a for the year ending 31st march 2018 and show the journal entries.

Solution :

Calculation of interest on capital:

Interest on capital = Amount of capital × Rate of interest

$$\text{Interest on Mala's capital} = ₹90,000 \times \frac{5}{100} = ₹4,500$$

$$\begin{aligned} \text{Interest on Ratna's capital} &= ₹60,000 \times \frac{5}{100} \\ &= ₹3,000 \end{aligned}$$

Note:

- ☞ Balance of current account will not be considered for calculation of interest on capital.

Date	Particulars	L.F	Debit ₹	Credit ₹
2018 March 31	Interest on capital A/c Dr To Mala's current A/c To Ratna's current A/c (Interest on capital provided)		7,500	4,500 3,000
2018 March 31	Profit and loss appropriation A/c Dr To Interest on capital A/c (Interest on capital closed)		7,500	7,500

4. From the following balance sheets of Subha and Sudha who share profits and losses equally. Calculate interest on capital at 6% p.a for the year ending 31st December 2017.

Balance sheet as on 31st December 2017

Liabilities	₹	Assets	₹
Capital accounts:		Fixed assets	60,000
Subha	30,000	Current assets	40,000
Sudha	40,000		
Current liabilities	30,000		
	<u>1,00,000</u>		<u>1,00,000</u>

Drawing of Subha and Sudha during the year were ₹5,000 and ₹7,000 respectively profit earned during the year was ₹30,000.

Solution :

Particulars	Subha ₹	Sudha ₹
Capital on 31 st December 2017	30,000	40,000
Add: Drawings	5,000	7,000
	<u>35,000</u>	<u>47,000</u>
Less: Profit already credited	15,000	15,000
	<u>20,000</u>	<u>32,000</u>
Capital on 1 st January 2017	20,000	32,000

Calculation of interest on capital:

Subha:

$$\text{On opening capital} = ₹20,000 \times \frac{6}{100} = ₹1,200$$

Sudha:

$$\text{On opening capital} = ₹32,000 \times \frac{6}{100} = ₹1,920$$

5. Anusha and Barathi contribute ₹2,00,000 and ₹1,00,000 respectively as capital. Their respective share of profit is 3:2 and the profit before interest on capital for the year is ₹ 27,000. Compute the amount of interest on capital in each of the following situations:

- If the partnership deed is silent as to the interest on capital
- If interest on capital @ 3% is allowed as per the partnership deed
- If the partnership deed allows interest on capital @ 5% p.a.

Solution :

- Interest on capital will not allowed as the partnership deed is silent as to the interest on capital.
- Profit before interest on capital is 27,000

Computation of interest on capital:

$$\text{Anusha: } ₹2,00,000 \times \frac{3}{100} = ₹6,000$$

$$\text{Barathi: } ₹ 1,00,000 \times \frac{3}{100} = ₹3,000$$

Computation of interest on capital:

$$\text{Anusha: } ₹2,00,000 \times \frac{5}{100} = ₹10,000$$

$$\text{Barathi: } ₹1,00,000 \times \frac{5}{100} = ₹5,000$$

Since the profit is insufficient interest on capital will not be provided. Profit of ₹27,000 will be distributed to the partners in the capital ratio of 3:2

6. Arul is a partner in a partnership firm. As per the partnership deed, interest on drawing is charged at 6% p.a. During the year ended on 31st December 2018 he drew as follows.

Date	₹
March 1	3,000
June 1	2,000
September 1	5,000
December 1	4,000

Calculate the amount of interest on drawings.**Solution :**

Interest on drawings = Amount of drawings × Rate of interest × Period of interest

$$\text{Withdrawal on March 1} = ₹3,000 \times \frac{6}{100} \times \frac{10}{12} = ₹ 150$$

$$\text{Withdrawal of June 1} = ₹2,000 \times \frac{6}{100} \times \frac{7}{12} = ₹ 70$$

$$\text{Withdrawal of September 1} = ₹5,000 \times \frac{6}{100} \times \frac{4}{12} = ₹ 100$$

$$\text{Withdrawal of December 1} = ₹4,000 \times \frac{6}{100} \times \frac{1}{12} = ₹ 20$$

$$\text{Total interest on drawings} = ₹ 340$$

7. Kala is a partner in a partnership firm. As per partnership deed, interest on drawings is charged at 12% p.a. During the year ended 31st December 2018. She drew as follows.

Date	₹
March 1	12,000
June 1	8,000
September 1	10,000
December 1	4,000

Calculate the amount of interest on drawings by using produce method**Solution :**

Date of drawings	Amount withdrawn	Period up to December 31 (months)	Product ₹
March 1	12,000	10	1,20,000
June 1	8,000	7	56,000
September 1	10,000	4	40,000
December 1	4,000	1	4,000
Sum of Product			2,20,000

$$\begin{aligned} \text{Interest on drawings} &= \text{Sum of product} \times \text{Rate of interest} \times \frac{1}{12} \\ &= 2,20,000 \times \frac{12}{100} \times \frac{1}{12} = ₹2,200 \end{aligned}$$

8. Durga and Preethi entered into a partnership agreement on 1st April 2018, Durga contributing ₹50,000 and Preethi ₹60,000 as capital. The agreement provided that:

- Profits and losses to be shared in the ratio 3:2 as between Durga and Preethi.
- Partners to be entitled to interest on capital @ 5% p.a.
- Interest on drawings to be charged Durga ₹600 and Preethi ₹900
- Durga to receive a salary of ₹10,000 for the year and
- Preethi to receive a commission of ₹4,000

During the year, the firm made a profit of ₹40,000 before adjustment of interest, salary and commission prepare the profit and loss appropriation account.

Solution :

Profit and loss appropriation accounts for the year ended 31st March 2019

Dr		Cr		
Particulars	₹	₹	Particulars	₹
To Interest on capital A/c			By Profit and loss A/c	40,000
Durga (50,000 × 5/100)		2,500	By Interest on	
Preethi (60,000 × 5/100)		3,000	drawings A/c	
To Salary Durga		10,000	Durga	600
To Commission to Preethi			Preethi	900
A/c		4,000		
To Partner's capital A/c				
(Profit transferred)				
Durga (22,000 × 3/5)	13,200	22,000		
Preethi (22,000 × 2/5)	8,800			
		41,500		41,500

HOTS QUESTIONS AND ANSWERS

1. Suresh and Ramesh are partners in a firm with capitals of ₹3,00,000 and ₹4,00,000 respectively. They do not have a partnership deed. Ramesh wants to share the profits in the ratio of capitals. State with reason whether the claim is valid

Ans. According to Indian partnership Act, 1932 in the absence of partnership deed, profits are shared equally among the partners. So, the claim of Ramesh to share the profits in the ratio of capitals is not valid.

2. A and B are partners in a firm without a partnership deed. A is an active partner and claims a salary of ₹ 18,000 per month. State with reasons whether the claim is valid or not

Ans. According to Indian partnership Act, 1932, no salary is allowed to partners in the absence of partnership deed so the claim of A for salary of ₹ 18,000 per month is not valid.

3. Interest on partner's capital and interest on drawings are recorded through profit and loss appropriation account instead of profit and loss account. Why?

Ans. Interest on partner's capital and interest on drawings are an appropriation of profit and not a charge on profit and hence is recorded through profit and loss appropriation account instead of profit and loss account

4. How is interest on drawings calculated, if the drawings are made at regular intervals as on the first day of each month?

Ans. If the drawings are made regularly on the first day of each month, the interest on drawings will be

calculated for $6\frac{1}{2}$ months i.e

Interest on drawings = Total drawings \times $\frac{\text{Rate} \times 6.5}{100 \times 12}$

5. Salary or commission paid to a partner is debited to profit and loss appropriation account and not to profit and loss account. Why?

Ans. It is so because salary or commission paid to a partner is not a charge on profit but an appropriation of profit.

6. An accountant of the firm has debited interest on partner's loan to the profit and loss appropriation account and credited to the partner's capital account. Is he correct?

Ans. No, the accountant is not correct. He has not recorded the interest on loan currently because the interest on loan is a charge against profits and not an appropriation of profits.

7. State where the following items shall appear in case the capital contributed by partners remain fixed.

- Interest on capital
- Withdrawal of capital
- Fresh capital introduced
- Drawings
- Share of profit by a partner

Ans. (i) Credit side of partner's current account.
(ii) Debit side of partner's capital account
(iii) Credit of partner's capital account
(iv) Debit side of partner's current account
(v) Credit side of partner's current account

VALUE BASED QUESTIONS AND ANSWERS

1. The firm of A and B earned a profit of ₹2,75,000 during the year ending on 31st March, 2015. They have decided to donate 10% of this profit to an NGO working for senior citizens. Pass necessary journal entry for the distribution of profits. Identify the values shown by the firm in donating a part of profit of NGO.

Solution :

Journal entry

Date	Particulars	L.f	Debit ₹	Credit ₹
	Profit and loss appropriation A/c	Dr	2,47,500	
	To A's capital A/c			1,23,750
	To B's capital A/c			1,23,750
	(Being profit transferred to capital account)			

Values shown by the firm are

i. **Responsibility :**

Firm has shown responsibility towards senior citizens by giving them their dues.

ii. **Compassion :**

Partners have shown compassion towards senior citizens by fulfilling their duties towards senior citizens.



UNIT
4**GOODWILL IN PARTNERSHIP
ACCOUNTS****CHAPTER SNAPSHOT**

- | | |
|--|---|
| 4.1 Introduction | 4.5 Classification of goodwill |
| 4.2 Nature of good will | 4.6 Methods of valuation of goodwill |
| 4.3 Factors determining the value of god will of a partnership firm | 4.6.1 Average profit method |
| 4.4 Need for valuation of goodwill of partnership firms | 4.6.2 Super profit methods |
| | 4.6.3 Capitalisation method |



Important Points

- Goodwill is the good name or reputation of the business which brings benefit to the business
- Goodwill is an intangible fixed asset. It is intangible because it has no physical existence. It cannot be seen or touched.
- In case of partnership firms, whenever there is a change in the mutual rights of partners, the need for valuation of goodwill arises.
- Goodwill may be classified into acquired goodwill and self-generated goodwill.
- Annuity refers to series of uniform cash flows at regular intervals
- Only acquired goodwill can be shown in the books of accounts. Self-generated goodwill should not be shown in the books of accounts.
- Before calculating the average profit for the purpose of valuation of goodwill, all adjustments such as adjustments for non-operating expenses and incomes, non-recurring expenses and incomes and over or under-valuation of stocks must be made.
- Normal rate of return refers to the rate at which profit is earned by similar business entities in the industry under

SELF-EXAMINATION QUESTIONS

I MULTIPLE CHOICE QUESTIONS

CHOOSE THE CORRECT ANSWER

1. Which of the following statements is true?

- (a) Goodwill is an intangible asset
- (b) Goodwill is a current asset
- (c) Goodwill is a fictitious asset
- (d) Goodwill cannot be acquired

[Ans. (a) Goodwill is an intangible asset]

2. Super profit is the difference between

- (a) Capital employed and average profit
- (b) Assets and liabilities
- (c) Average profit and normal profit
- (d) Current year's profit and average profit

[Ans. (c) Average profit and normal profit]

3. The average rate of return of similar concerns is considered as

- (a) Average profit
- (b) Normal rate of return
- (c) Expected rate of return
- (d) None of these

[Ans. (b) Normal rate of return]

4. Which of the following is true?

- (a) Super profit = Total profit / number of years
- (b) Super profit = Weighted profit / number of years
- (c) Super profit = Average profit - Normal profit
- (d) Super profit = Average profit × Years of purchase

[Ans. (c) Super profit = Average profit - Normal profit]

5. Identify the incorrect pair

(a)	Goodwill under Average profit method	-	Average profit × Number of years of purchase
(b)	Goodwill under Super profit method	-	Super profit × Number of years of purchase
(c)	Goodwill under Annuity method	-	Average profit × Present value annuity factor
(c)	Goodwill under Weighted average profit method	-	Weighted average profit × Number of years of purchase

[Ans. (c) Goodwill under Annuity method - Average profit × Present value annuity factor]

GOODWILL IN PARTNERSHIP ACCOUNTS

6. When the average profit is ₹25,000 and the normal profit is ₹15,000, super profit is

- (a) ₹25,000 (b) ₹5,000
(c) ₹10,000 (d) ₹15,000

[Ans. (c) ₹10,000]

Hint : Super profit = Average profit – Normal profit
= ₹ 25,000 – ₹15,000
= ₹10,000

7. Book profit of 2017 is ₹35,000; non-recurring income included in the profit is ₹1,000 and abnormal loss charged in the year 2017 was ₹2,000, then the adjusted profit is

- (a) ₹36,000 (b) ₹35,000
(c) ₹38,000 (d) ₹34,000

[Ans. (a) ₹36,000]

Hint : Calculation of adjusted profit :

Particulars	2017 ₹
Book profit	35,000
<u>Less</u> : Non-recurring income	1,000
	34,000
<u>Add</u> : Abnormal loss	2,000
Adjusted profit	36,000

8. The total capitalised value of a business is ₹1,00,000; assets are ₹1,50,000 and liabilities are ₹80,000. The value of goodwill as per the capitalisation method will be

- (a) ₹40,000 (b) ₹70,000
(c) ₹1,00,000 (d) ₹30,000

[Ans. (d) ₹30,000]

Hint : Goodwill = Total capitalised value of the average profit – Capital employed

Capital employed = Current assets – Current liabilities
= ₹ 1,50,000 – ₹ 80,000
= ₹ 70,000

Goodwill = ₹ 1,00,000 – ₹ 70,000
= ₹ 30,000

II VERY SHORT ANSWER QUESTIONS

1. What is goodwill?

Ans. Goodwill is the good name or reputation of the business which brings benefit to the business. It enables the business to earn more profit. It is the present value of a firm's future excess earnings. It is an intangible asset as it has no physical existence.

2. What is acquired goodwill?

Ans. Goodwill acquired by making payment in cash or kind is called acquired or purchased goodwill. The excess of purchase consideration over the value of net assets acquired is treated as acquired goodwill.

3. What is super profit?

Ans. The excess of average profit over normal profit is called super profit. The goodwill under the super profits method is calculated by multiplying the super profits by certain number of years purchase. Super profit = Average profit – Normal profit

4. What is normal rate of return?

Ans. Normal rate of return refers to the rate at which profit is earned by similar business entities in the industry under normal circumstances.

5. State any two circumstances under which goodwill of a partnership firm is valued.

- Ans. (i)** When there is a change in the profit sharing ratio
(ii) When a new partner is admitted into a firm

III SHORT ANSWER QUESTIONS

1. State any six factors determining goodwill.

Ans. Generally, the following factors determine the value of goodwill of a partnership firm:

(i) Profitability of the firm:

A firm earning higher profits and having potential to generate higher profits in future will have higher value of good will.

(ii) Good quality of goods or services offered:

If a firm enjoys good reputation among the customers and general public for the good quality of its products or services, the value of goodwill for the firm will be high.

(iii) Tenure of the business enterprise:

A firm which has carried on business for several years will have higher reputation among its customers as it is better known to the customers.

(iv) Efficiency of management:

A firm having efficient management will earn more profits and the value of its goodwill will be higher compared to a firm with less efficient managerial personnel .

**(v) Degree of competition :**

In the case of business enterprises having no competition or negligible competition, the value of goodwill will be high

(vi) Other factors:

There are other factors which add to the value of goodwill of a business such as popularity of the proprietor, impressive advertisements and publicity, good relations with customers, etc.

2. How is goodwill calculated under the super profits method?

Ans. (i) Under these methods, super profit is the base for calculation of the value of goodwill. Super profit is the excess of average profit over the normal profit of a business.

Super profit = Average profit - Normal profit

(ii) Average profit is calculated by dividing the total of adjusted actual profits of certain number of years by the total number of such years. Normal profit is the profit earned by the similar business firms under normal conditions.

(iii) Normal profit = $\frac{\text{Capital employed} \times \text{Normal rate of return}}{\text{Normal rate of return}}$

(iv) Capital employed = Fixed assets + current assets - Current liabilities

(v) Normal rate of return = It is the rate at which profit is earned by similar business entities in the industry under normal circumstances.

3. How is the value of goodwill calculated under the capitalisation method?

Ans. (i) Under this method, goodwill is the excess of capitalised value of average profit of the business over the actual capital employed in the business.

Goodwill = Total capitalised value of the business - Actual capital employed

(ii) The total capitalised value of the business is calculated by capitalising the average profits on the basis of the normal rate of return.

Capitalised value of the business

$$= \frac{\text{Average profit}}{\text{Normal rate of return}} \times 100$$

(iii) Actual capital employed = Fixed assets (excluding goodwill) + Current assets - Current liabilities

4. Compute average profit from the following information.

2016: ₹8,000; 2017: ₹10,000; 2018: ₹9,000

Solution :

$$\text{Average profit} = \frac{\text{Total profit}}{\text{Number of years}}$$

$$\text{Average profit} = \frac{8,000 + 10,000 + 9,000}{3}$$

$$\text{Average profit} = ₹ 9,000$$

5. Calculate the value of goodwill at 2 years purchase of average profit when average profit is ₹15,000.

Solution :

$$\text{Goodwill} = \text{Average profit} \times \text{Number of years of purchase}$$

$$= 15,000 \times 2$$

$$= 30,000$$

$$\text{Goodwill} = ₹30,000$$

IV EXERCISES:**1. Simple average profit method**

The following are the profits of a firm in the last five years:

2014 : ₹10,000; 2015 : ₹11,000; 2016 : ₹12,000; 2017 : ₹13,000 and 2018 : ₹14,000

Calculate the value of goodwill at 2 years purchase of average profit of five years.

Solution :

$$\text{Goodwill} = \text{Average profit} \times \text{Number of years of purchase}$$

$$\text{Average profit} = \frac{\text{Total profit}}{\text{Number of years}}$$

$$= \frac{10,000 + 11,000 + 12,000 + 13,000 + 14,000}{5}$$

$$= \frac{60,000}{5} = ₹ 12,000$$

$$\text{Average profit} = ₹12,000$$

$$\text{Goodwill} = \text{Average profit} \times \text{Number of years of purchase}$$

$$= 12,000 \times 2 = 24,000$$

$$\text{Goodwill} = ₹ 24,000$$



ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. Which is the present value of a firm's future excess earnings?

- (a) Fixed asset (b) Current assets
(c) Goodwill (d) None of these

[Ans. (c) Goodwill]

2. Goodwill is shown under fixed assets in the

- (a) Trial balance
(b) Balance sheet
(c) Trading account
(d) Profit and loss account

[Ans. (b) Balance sheet]

3. The monetary value of such advantage is termed as

- (a) Goodwill (b) Bank overdraft
(c) Capital (d) Cash

[Ans. (a) Goodwill]

4. Goodwill helps in earning more profit and attracts more

- (a) customers (b) producers
(c) competitors (d) suppliers

[Ans. (a) customers]

5. The profit earning capacity of the firm determines the value of its

- (a) balance sheet
(b) goodwill
(c) profit and loss account
(d) all of these

[Ans. (b) goodwill]

6. Goodwill acquired by making payment in cash or kind is called

- (a) Purchased goodwill
(b) Self-generated goodwill
(c) Average goodwill
(d) 'a' and 'b'

[Ans. (a) Purchased goodwill]

7. Which of the following method, goodwill is calculated by multiplying the weighted average profit?

- (a) Super profit method
(b) Annuity
(c) Weighted average profit method
(d) All of these

[Ans. (c) Weighted average profit method]

8. Self-generated goodwill should not be shown in the

- (a) journal
(b) ledger
(c) balance sheet
(d) books of accounts

[Ans. (d) books of accounts]

9. The total capitalised value of the business is calculated by capitalising the average profits on the basis of

- (a) average profit
(b) normal rate of return
(c) actual capital employed
(d) none of these

[Ans. (b) normal rate of return]

10. Goodwill is to be valued when

- (a) amalgamation takes place
(b) a partner is admitted
(c) one company takes over another company
(d) all of the above

[Ans. (d) all of the above]

11. Goodwill is paid for obtaining

- (a) future profit
(b) present benefit
(c) past benefit
(d) none of the above

[Ans. (a) future profit]

12. Super profit is

- (a) excess of average profit over normal profit
(b) extra profit earned
(c) average profit earned by similar companies
(d) none of the above

[Ans. (a) excess of average profit over normal profit]

13. Normal profit is

- (a) average profit earned
(b) profit earned by similar companies in the same industry
(c) both 'a' and 'b'
(d) none of the above

[Ans. (b) profit earned by similar companies in the same industry]

(vii) Choose the Correct Statement.

- Goodwill is shown under fixed assets in the balance sheet.
 - Goodwill is an intangible asset.
 - Goodwill helps in earning more profit and attracts more customers.
 - (i) is correct
 - (ii) is correct
 - (i) and (ii) are correct
 - (i), (ii) and (iii) are correct

[Ans. (d) (i), (ii) and (iii) are correct]

- Goodwill acquired by making payment in cash or kind is called acquired or purchased goodwill.
 - Weighted average profit method, goodwill is calculated by multiplying the weighed average profit by a certain number of years of purchase.
 - Normal profit = Capital employed × Fixed assets
 - (i) is correct
 - (i) and (ii) are correct
 - (ii) and (iii) are correct
 - (i), (ii) and (iii) are correct

[Ans. (b) (i) and (ii) are correct]

II. VERY SHORT ANSWER QUESTIONS.**1. What is Annuity?**

Ans. Annuity refers to series of uniform cash flow at regular intervals. The table value gives the present value of annuity of rupee one received at the end of every year for a specified number of years.

$$\text{Annuity factor} = \frac{i(1+i)^n}{(1+i)^n - 1}$$

Where, i = interest rate

n = estimated number of years

III. SHORT ANSWER QUESTIONS.**1. What is the nature of goodwill?**

Ans. The nature of goodwill can be described as follows:

- Goodwill is an intangible fixed asset. It cannot be seen or touched.
- It has a definite value depending on the profitability of the business enterprise

- It cannot be separated from the business
- It helps in earning more profit and attracts more customers
- It can be purchased or sold only when the business is purchased or sold in full or in part

2. What is the need for valuation of goodwill?

Ans. Following are the circumstances that require valuation of goodwill of partnership firms in order to protect the rights of the partners

- When there is a change in the profit sharing ratio
- When a new partner is admitted into a firm
- When an existing partner retires from the firm or when a partner dies.
- When a partnership firm is dissolved

3. Explain the classification of goodwill.

Ans. Goodwill may be classified into acquired goodwill or self-generated goodwill.

(i) Acquired or purchased goodwill:

- Goodwill acquired by making payment in cash or kind is called acquired or purchased goodwill.
- The excess of purchase consideration over the value of net assets acquired is treated as acquired goodwill.

(ii) Self-generated goodwill:

It is the goodwill which is self generated by a firm based on features of the business such as favourable location, local customers, etc. Such self-generated goodwill cannot be recorded in the books of accounts.

4. How is goodwill calculated under the weighted average profit method?

Ans. (i) Under this method, goodwill is calculated by multiplying the weighted average profit by a certain number of years of purchase.

(ii) Goodwill = Weighted average profit × Number of years of purchase

(iii) In this method, weights are assigned to each year's profit. Weighted profit is ascertained by multiplying the weights assigned with the respective year's profit.

GOODWILL IN PARTNERSHIP ACCOUNTS

Sura's XII Std - Accountancy

- (iv) The sum of the weighted profits is divided by the sum of weights assigned to determine the weighted average profit.

$$\text{Weighted average profit} = \frac{\text{Total of weighted Profits}}{\text{Total of weights}}$$

IV. PROBLEMS.

1. The profit and losses of a firm for the last four years were as follows:

2015 : ₹20,000; 2016 ; ₹25,000;
2017; ₹3,000 (loss) 2018; ₹18,000

You are required to calculate the amount of goodwill on the basis of 5 years purchase of average profit of the last 4 years.

Solution :

$$\text{Goodwill} = \text{Average profit} \times \text{Number of years purchase}$$

$$\begin{aligned} \text{Average profit} &= \frac{\text{Total profit}}{\text{Number of years}} \\ &= \frac{20,000 + 25,000 - 3,000 + 18,000}{4} \\ &= \frac{60,000}{4} \\ &= ₹15,000 \end{aligned}$$

$$\begin{aligned} \text{Goodwill} &= \text{Average profit} \times \text{Number of years of purchase} \\ &= 15,000 \times 5 = ₹75,000 \end{aligned}$$

$$\text{Goodwill} = ₹75,000$$

3. From the following information relating to Arul enterprises, calculate the value of goodwill on the basis of 2 years purchase of the average profits of 3 years.

- (a) Profits for the years ending 31st December 2016, 2017 and 2018 were ₹ 23,000 ₹22,000 and ₹ 25,000 respectively.
(b) A non-recurring income of ₹ 2,500 is included in the profits of the year 2016.
(c) The closing stock of the year 2017 was overvalued by ₹ 5,000.

Solution : Calculation of adjusted profit

Particulars	2016 ₹	2017 ₹	2018 ₹
Profit	23,000	22,000	25,000
Less: Non – recurring income	2,500	–	–
	20,500	22,000	25,000
Less: Less over valuation of closing stock	–	5,000	–
	20,500	17,000	25,000
Add: Over valuation of opening stock	–	–	5,000
Profit after adjustments	20,500	17,000	30,000

2. A partnership firm has decided to value its goodwill for the purpose of setting a retiring Partner. The profit of that firm for the last four years were as follows:

2015 : ₹20,000; 2016 : ₹25,000; 2017; ₹24,000 and 2018: ₹23,000

The business was looked after by a partner. No remuneration was paid to him. The fair remuneration of the partner valued at comes to ₹ 3,000 per annum.

Find out the value of goodwill, if it is valued on the basis of three years purchase of the average profit of the last four years.

Solution :

$$\begin{aligned} \text{Average profit} &= \frac{\text{Total profit}}{\text{Number of years}} \\ &= \frac{20,000 + 25,000 + 24,000 + 23,000}{4} \\ &= \frac{92,000}{4} = ₹23,000 \end{aligned}$$

$$\text{Average profit} = ₹23,000$$

$$\begin{aligned} \text{Average profit before adjusting fair remuneration of the partner} &= ₹23,000 \end{aligned}$$

Less :

$$\begin{aligned} \text{Fair remuneration of partners} &= \frac{3,000}{4} \end{aligned}$$

$$\text{Average profit} = \frac{20,000}{4}$$

$$\begin{aligned} \text{Goodwill} &= \text{Average profit} \times \text{Number of years of purchase} \\ &= 20,000 \times 3 = ₹60,000 \end{aligned}$$

$$\begin{aligned} \text{Average profit} &= \frac{\text{Total profit}}{\text{Number of years}} \\ &= \frac{20,500 + 17,000 + 30,000}{3} \\ &= \frac{67,500}{3} \end{aligned}$$

$$\begin{aligned} \text{Average profit} &= ₹22,500 \\ \text{Goodwill} &= \text{Average profit} \times \text{Number of years of purchase} \\ &= 22,500 \times 2 = 45,000 \end{aligned}$$

[**Note** : Over valuation of closing stock in 2017 will result in over valuation of opening stock in 2018]

4. For the purpose of admitting a new partner, a firm has decided to value its good will at 3 years purchase of the average profit of the last 4 years using weighted average method profits of the past 4 years and the respective weights are as follows.

Year	2015	2016	2017	2018
Profit	40,000	44,000	48,000	56,000
Weight	1	2	3	4

Compute the value of goodwill

Solution :

Calculating of weighted average profit

Year	Profit (a) ₹	Weights (b) ₹	Weighted profit (a × b) ₹
2015	40,000	1	40,000
2016	44,000	2	88,000
2017	48,000	3	1,44,000
2018	56,000	4	2,24,000
Total		10	4,96,000

Weighted average profit

$$\begin{aligned} &= \frac{\text{Total of weighted profits}}{\text{Total of weights}} \\ &= \frac{4,96,000}{10} = ₹49,600 \end{aligned}$$

$$\begin{aligned} \text{Goodwill} &= \text{Weighted average profit} \times \text{Number of years of purchase} \\ &= 49,600 \times 3 = ₹1,48,800 \end{aligned}$$

5. From the following information, calculate the value of goodwill based on 3 years purchase of Super profit

- (i) Capital employed: 1,00,000
(ii) Normal rate of return: 10%
(iii) Average profit of the business : 42,000

Solution :

$$\text{Normal profit} = \text{Capital employed} \times \text{Normal rate of return}$$

$$= 1,00,000 \times 10\% = ₹10,000$$

$$\text{Super profit} = \text{Average profit} - \text{Normal profit}$$

$$= 42,000 - 10,000 = ₹32,000$$

$$\text{Goodwill} = \text{Super profit} \times \text{Number of years of purchase}$$

$$= 32,000 \times 3$$

$$= ₹96,000$$

6. Calculate the value of goodwill at 5 years purchase of super profit from the following information

(a) Capital employed : ₹ 60,000

(b) Normal rate of profit : 20%

(c) Net profit for 5 years

2014: ₹1,00,000; 2015: ₹50,000 2016: ₹70,000;
2017: ₹54,000 and 2018: ₹10,000

(d) Fair remuneration to the partners 3,600 per annum

Solution :

$$\text{Average profit} = \frac{\text{Total profit}}{\text{Number of years}}$$

$$= \frac{1,00,000 + 50,000 + 70,000}{5}$$

$$\text{Average profit} = \frac{+54,000 + 10,000}{5}$$

$$\text{Average profit} = \frac{2,84,000}{5} = ₹56,800$$

	₹
Average profit before fair remuneration to the partners	56,800
Less : Fair remuneration to the partners	3,600
Average profit	53,200

GOODWILL IN PARTNERSHIP ACCOUNTS

Sura's XII Std - Accountancy

Normal profit = Capital employed × Normal rate of returns

$$= 60,000 \times 20\% \\ = ₹12,000$$

Super profit = Average profit – Normal profit
= 53,200 – 12,000
= ₹41,200

Goodwill = Super profit × Number of years of purchase
= 41,200 × 5
= ₹2,06,000

7. From the following information, compute the value of goodwill as per annuity method:

- (a) Capital employed : ₹1,00,000
(b) Normal rate of return : 15%
(c) Profit of the years 2016, 2017 and 2018 were ₹16,000, ₹18,000 and ₹20,000 respectively
(d) The present value of annuity of ₹1 for 3 years at 10 % is 2.4868

Solution :

$$\text{Average profit} = \frac{\text{Total profit}}{\text{Number of years}} \\ = \frac{16,000 + 18,000 + 20,000}{3} \\ = \frac{54,000}{3} = ₹18,000$$

Normal profit = Capital employed × Normal rate of return

$$= 1,00,000 \times 15\% \\ = ₹15,000$$

Super profit = Average profit – Normal profit
= 18,000 – 15,000
= ₹3,000

Goodwill = Super profit × Value of annuity
= 3,000 × 2.4868
= ₹7,460.40

8. From the following information, find out the value of goodwill by capitalisation method:

- (a) Average profit = ₹60,000
(b) Normal rate of return = 10%
(c) Capital employed = ₹5,60,000

Solution :

Total capitalised value of the average profit

$$= \frac{\text{Average profit}}{\text{Normal rate of return}} \times 100 \\ = \frac{60,000}{10} \times 100 \\ = ₹6,00,000$$

Goodwill = Total capitalised value of the average profit – Capital employed
= 6,00,000 – 5,60,000
= ₹40,000

HOTS QUESTIONS AND ANSWERS

1. What is meant by number of years purchase at the time of valuation of goodwill?

Ans. Number of years purchase means for how many specific years the business will earn same amount of profits because of its past efforts.

2. Why is goodwill considered as an intangible asset but not a fictitious assets?

Ans. Goodwill is considered as an intangible asset because it has a realised value whereas fictitious assets do not have a realisable value.

3. How does the factor's 'quality of product' affect the goodwill of a firm?

Ans. If the firm enjoys good reputations for its product's quality, there will be higher sales and the value of its goodwill will increase.

4. How does the 'market situation' affect the value of goodwill of a firm?

Ans. The monopoly condition or limited competition enables the concern to earn high profits which leads to higher value of goodwill

**VALUE BASED QUESTIONS AND ANSWERS**

1. Venu and Somu are carrying on a business of repairing electronic items. There are no other technicians for repairing electronic items in the locality. As the electric supply has a lot of fluctuations, the equipments get damaged. Therefore, both the partners themselves do the repairing work to the satisfaction of the customers. The firm donates 10% of its profits to a Charitable Hospital of the locality for the medical treatment of persons below poverty line. State the two factors affecting the goodwill of the firm discussed in the above para. Also identify any two values which the firm is trying to propagate.

Ans. The factors affecting the goodwill of the firm are

- (i) Location
- (ii) Market situation

The values which the firm is trying to propagate are

- (i) Sensitivity towards people belonging to lower income group.
- (ii) Working towards customer satisfaction

2. Kalyan and Dilip are partners in a firm dealing in stationery items. The firm is well managed and enjoys the advantage of being cost effective. It buys stationery items at reasonable cost from Dilip's relative who is manufacture of stationery items. The firm's sale outlet is situated near a school. As a result, the firm is donating 10% of its profits to the nearby school for the education of the students of below poverty line. State any two factors affecting the value of goodwill of the firm. Also identify any two values which the firm is trying to propagate.

Ans. The factors affecting the value of goodwill of the firm are

- (i) Nature of business
- (ii) Efficiently of management

The values which the firm is trying to propagate are

- (i) Promoting education among the students of below poverty line.
- (ii) Providing quality services to customers resulting in customer satisfaction.



UNIT

5

ADMISSION OF A PARTNER

CHAPTER SNAPSHOT

- 5.1 Introduction
- 5.2 Adjustments required at the time of admission of a partner
- 5.3 Distribution of accumulated profits, reserves and losses
- 5.4 Revaluation of assets and liabilities
- 5.5 New profit sharing ratio and Sacrificing ratio
 - 5.5.1 New profit sharing ratio
 - 5.5.2 Sacrificing ratio
- 5.6 Adjustment for goodwill
 - 5.6.1 Accounting treatment for goodwill
- 5.7 Adjustment of capital on the basis of new profit sharing ratio



Important Points

- ❑ On admission of a new partner, the firm is reconstituted with a new agreement and the existing agreement comes to an end
- ❑ On admission of a new partner, generally there is a change in the mutual rights of the partners.
- ❑ The new partner acquires the right to share the future profits and share the assets of the firm.
- ❑ The new partner becomes liable for all the acts which are carried out by the firm from the date of his/her admission into the firm.
- ❑ On admission of a partner, the accumulated profits, accumulated losses and reserves before admission are to be distributed to the existing partners in the old ratio.
- ❑ When a partner is admitted into the firm, assets and liabilities are to be revalued and the profit or loss on revaluation is to be distributed to the existing partners in the old ratio.
- ❑ At the time of admission of a partner it is necessary to determine the new profit sharing ratio because the new partner is entitled to share the future profits of the firm.
- ❑ If the new profit sharing ratio is not agreed, the partners will share the profits and losses equally.
- ❑ The existing partners sacrifice part of their share of profit in favour of the new partner. To compensate the sacrifice made by the existing partners, goodwill brought by the new partner is distributed in the sacrificing ratio to the old partners who sacrifice.
- ❑ Sacrificing ratio is the proportion of the profit which is sacrificed or foregone by the old partners in favour of the new partner.

SELF-EXAMINATION QUESTIONS

I. MULTIPLE CHOICE QUESTIONS.

CHOOSE THE CORRECT ANSWER :

1. Revaluation A/c is a

- (a) Real A/c (b) Nominal A/c
(c) Personal A/c (d) Impersonal A/c

[Ans. (b) Nominal A/c]

2. On revaluation, the increase in the value of assets leads to

- (a) Gain (b) Loss
(c) Expense (d) None of these

[Ans. (a) Gain]

3. The profit or loss on revaluation of assets and liabilities is transferred to the capital account of

- (a) The old partners
(b) The new partner
(c) All the partners
(d) The Sacrificing partners

[Ans. (a) The old partners]

4. If the old profit sharing ratio is more than the new profit sharing ratio of a partner, the difference is called

- (a) Capital ratio (b) Sacrificing ratio
(c) Gaining ratio (d) None of these

[Ans. (b) Sacrificing ratio]

5. At the time of admission, the goodwill brought by the new partner may be credited to the capital accounts of

- (a) all the partners
(b) the old partners
(c) the new partner
(d) the sacrificing partners

[Ans. (d) the sacrificing partners]

6. Which of the following statements is not true in relation to admission of a partner

- (a) Generally mutual rights of the partners change
(b) The profits and losses of the previous years are distributed to the old partners

ADMISSION OF A PARTNER

- (c) The firm is reconstituted under a new agreement
 (d) The existing agreement does not come to an end

[Ans. (d) The existing agreement does not come to an end]

7. Match List I with List II and select the correct answer using the codes given below:

List I		List II	
(i)	Sacrificing ratio	1.	Investment fluctuation fund
(ii)	Old profit sharing ratio	2.	Accumulated profit
(iii)	Revaluation Account	3.	Goodwill
(iv)	Capital Account	4.	Unrecorded liability

Codes :

- | | | | | |
|-----|-----|------|-------|------|
| | (i) | (ii) | (iii) | (iv) |
| (a) | 1 | 2 | 3 | 4 |
| (b) | 3 | 2 | 4 | 1 |
| (c) | 4 | 3 | 2 | 1 |
| (d) | 3 | 1 | 4 | 2 |

[Ans. (b) (i) - 3 (ii) - 2 (iii) - 4 (iv) - 1]

8. Select the odd one out

- (a) Revaluation profit
 (b) Accumulated loss
 (c) Goodwill brought by new partner
 (d) Investment fluctuation fund

[Ans. (c) Goodwill brought by new partner]

9. James and Kamal are sharing profits and losses in the ratio of 5:3. They admit Sunil as a partner giving him 1/5 share of profits. Find out the sacrificing ratio.

- (a) 1:3 (b) 3:1 (c) 5:3 (d) 3:5

[Ans. (c) 5:3]

10. Balaji and Kamalesh are partners sharing profits and losses in the ratio of 2:1. They admit Yogesh into partnership. The new profit sharing ratio between Balaji, Kamalesh and Yogesh is agreed to 3:1:1. Find the sacrificing ratio between Balaji and Kamalesh.

- (a) 1:3 (b) 3:1 (c) 2:1 (d) 1:2

[Ans. (d) 1:2]

II. VERY SHORT ANSWER QUESTIONS.

1. What is meant by revaluation of assets and liabilities?

Ans. When a partner is admitted into the partnership, the assets and liabilities are revalued as the current value may differ from the book value. Determination of current values of assets and liabilities is called revaluation of assets and liabilities.

2. How are accumulated profits and losses distributed among the partners at the time of admission of a new partner?

Ans. Profits and losses of previous years which are not distributed to the partners are called accumulated profit and losses. Any reserve and accumulated profits and losses belong to the old partners and hence these should be distributed to the old partners in the old profit sharing ratio.

3. What is sacrificing ratio?

Ans. Sacrificing ratio is the proportion of the profit which is sacrificed or foregone by the old partners in favour of the new partner. The purpose of finding the sacrificing ratio is to share the goodwill brought in by the new partner.

$$\text{Share sacrificed} = \text{Old share} - \text{New share}$$

$$\text{Sacrificing ratio} = \text{Ratio of share sacrificed by the old partners}$$

4. Give the journal entry for writing off existing goodwill at the time of admission of a new partner.

Ans. Journal Entry

Date	Particular	L.F	Debit ₹	Credit ₹
	Old partner's capital/current A/c (in old ratio) Dr To goodwill A/c (Existing goodwill written off)		XXX	XXX

5. State whether the following will be debited or credited in the revaluation account.

- (a) Depreciation on assets
 (b) Unrecorded liability
 (c) Provision for outstanding expenses
 (d) Appreciation of assets

Ans. (a) Debit account
 (b) Debit account
 (c) Debit account
 (d) Credit account

III. SHORT ANSWER QUESTIONS.**1. What are the adjustments required at the time of admission of a partner?**

Ans. The following adjustment are necessary at the time of admission of a partner

- (i) Distribution of accumulated profits, reserves and losses.
- (ii) Revaluation of assets and liabilities
- (iii) Determination of new profit sharing ratio and sacrificing ratio
- (iv) Adjustment for goodwill
- (v) Adjustment of capital on the basis of new profit sharing ratio (if so agreed).

2. What are the journal entries to be passed on revaluation of assets and liabilities?

Solution :

Following are the journal entries to be passed to record the revaluation of assets and liabilities

Date	Particulars	L.F	Debit ₹	Credit ₹
	1. For increase in the value of asset Concerned asset A/c To Revaluation A/c	Dr	XXX	XXX
	2. For decrease in the value of asset Revaluation A/c To Concerned asset A/c	Dr	XXX	XXX
	3. For increase in the amount of liabilities Revaluation A/c To Concerned liabilities A/c	Dr	XXX	XXX
	4. For decrease in the amount of liability Concerned liability Dr To Revaluation A/c		XXX	XXX
	5. For recording an unrecorded asset Concerned asset A/c To Revaluation A/c	Dr	XXX	XXX
	6. For recording an unrecorded liability Revaluation A/c To Concerned liability A/c	Dr	XXX	XXX
	7. For transferring the balance in revaluation A/c (a) If there is profit on revaluation Revaluation A/c To Old partner's capital A/c (individually in old ratio)	Dr	XXX	XXX
	(b) If there is loss on revaluation Old partner's capital A/c (individually in old ratio) To Revaluation A/c		XXX	XXX

ADMISSION OF A PARTNER

3. Write a short note on accounting treatment of goodwill.

Ans. According treatment for goodwill on admission of a partner is discussed below:

(i) When new partner brings cash on wards goodwill

When the new partner brings cash towards goodwill in addition to the amount of capital it is distributed to the existing partners in the sacrificing ratio.

(ii) When the new partner does not bring goodwill in cash or in kind

If the new partner does not bring goodwill in cash or in kind, his share of goodwill must be adjusted through the capital accounts of the partners.

(iii) When the new partner brings only a part of the goodwill in cash or in kind

Sometimes the new partner may bring only a part of the goodwill in cash or assets. In such a case, for the cash or the assets brought the respective account is debited and for the amount not brought in cash or kind, the new partner's capital account is debited

(iv) Existing goodwill

If goodwill already appears in the books of accounts at the time of admission if the partners decide, it can be written off by transferring it to the existing partner's capital account/current account in the old profit sharing ratio.

IV. EXERCISES.

Distribution of accumulated profits, reserves and losses

1. Arul and Anitha are partners sharing profits and losses in the ratio of 4:3. On 31.3.2018, Ajay was admitted as a partner. On the date of admission, the book of the firm showed a general reserve of ₹42,000. Pass the journal entry to distribute the general reserve.

Solution :

Journal Entry

Date	Particulars	L.F	Debit ₹	Credit ₹
2018 March 31	General reserve A/c Dr		42,000	
	To Arul's capital A/c $(42,000 \times \frac{4}{7})$			24,000
	To Anita's capital A/c $(42,000 \times \frac{3}{7})$			18,000
	(General reserve transferred to old partner's capital account in the old profit sharing ratio)			

25. Sundar and Suresh are partners sharing profits in the ratio of 3:2. Their balance sheet as on 1st January, 2017 was as follows:

Liabilities	₹	₹	Assets	₹
Capital accounts:			Buildings	40,000
Sundar	30,000		Furniture	13,000
Suresh	20,000	50,000	Stock	25,000
Creditors		50,000	Debtors	15,000
General reserve		10,000	Bills receivable	14,000
Workmen compensation fund		15,000	Bank	18,000
		1,25,000		1,25,000

They decided to admit Sugumar into partnership for 1/4 share in the profits on the following terms:

- (a) Sugumar has to bring in ₹30,000 as capital. His share of goodwill is valued at ₹5,000. He could not bring cash towards goodwill.
 (b) That the stock be valued at ₹20,000.
 (c) That the furniture be depreciated by ₹2,000.
 (d) That the value of building be depreciated by 20%.

Prepare necessary ledger accounts and the balance sheet after admission.

Solution :

Revaluation Account

Dr		Cr	
Particulars	₹	Particulars	₹
To Stock A/c	5,000	By Loss on revaluation transferred to Sundar's capital A/c (3/5)	9,000
To Furniture A/c	2,000	Suresh's capital A/c (2/5)	6,000
To Building A/c	8,000		15,000
	15,000		15,000

Capital Account

Dr				Cr			
Particulars	Sundar ₹	Suresh ₹	Sugumar ₹	Particulars	Sundar ₹	Suresh ₹	Sugumar ₹
To Revaluation A/c	9,000	6,000	–	By Balance b/d	30,000	20,000	–
To Sundar's capital A/c (Share of goodwill)	–	–	5,000	By Bank A/c	–	–	30,000
To Balance c/d	41,000	24,000	25,000	By General reserve A/c	6,000	4,000	–
				By Workmen Compensation fund A/c	9,000	6,000	–
				By Sugumar's capital A/c (Share of goodwill)	5,000	–	–
	50,000	30,000	25,000		50,000	30,000	30,000
				By Balance b/d	41,000	24,000	25,000

ADMISSION OF A PARTNER

Balance sheet as on 1st January 2017

Liabilities	₹	₹	Assets	₹	₹
Capital Account :			Building	40,000	
Sundar	41,000		Add: Depreciation 20%	8,000	32,000
Suresh	24,000		Furniture	13,000	
Sugumar	25,000	90,000	Less: Depreciation	2,000	11,000
Creditors		50,000	Stock	25,000	
			Less: Depreciation	5,000	20,000
			Debtors		15,000
			Bills receivable		14,000
			Bank (18,000 + 30,000)		48,000
		1,40,000			1,40,000

26. The following is the balance sheet of James and Justina as on 1.1.2017. They share the profits and losses equally.

Liabilities	₹	₹	Assets	₹
Capital accounts:			Building	70,000
James	40,000		Stock	30,000
Justina	50,000	90,000	Debtors	20,000
Creditors		35,000	Bank	15,000
Reserve fund		15,000	Prepaid insurance	5,000
		1,40,000		1,40,000

On the above date, Balan is admitted as a partner with 1/5 share in future profits. Following are the terms for his admission:

- Balan brings ₹25,000 as capital.
- His share of goodwill is ₹10,000 and he brings cash for it.
- The assets are to be valued as under:
Building ₹80,000; Debtors ₹18,000; Stock ₹33,000

Prepare necessary ledger accounts and the balance sheet after admission.

Solution :

Revaluation Account

Dr	₹	₹	Cr	₹
To Debtors A/c		2,000	By Building A/c	10,000
To Profit on revaluation transferred to			By Stock A/c	3,000
James's capital A/c	5,500			
Justina's capital A/c	5,500	11,000		
		13,000		13,000

Capital Account

Dr				Cr			
Particulars	James ₹	Justina ₹	Balan ₹	Particulars	James ₹	Justina ₹	Balan ₹
To Balance c/d	58,000	68,000	25,000	By Balance b/d	40,000	50,000	-
				By Reserve fund A/c	7,500	7,500	-
				By Bank A/c	-	-	25,000
				By Revaluation A/c	5,500	5,500	-
				By Bank A/c (Share of goodwill)	5,000	5,000	-
	58,000	68,000	25,000		58,000	68,000	25,000
				By Balance b/d	58,000	68,000	25,000

Cash at Bank Account

Dr		Cr	
Particulars	₹	Particulars	₹
To Balance b/d	15,000	By Balance c/d	50,000
To Balan's capital A/c	25,000		
To Jame's capital A/c	5,000		
To Justina's capital A/c	5,000		
	50,000		50,000

Balance sheet as on 1st January 2017

Liabilities	₹	₹	Assets	₹	₹
Capital Account :			Building	70,000	
James's A/c	58,000		Add: Appreciation	10,000	80,000
Justina A/c	68,000		Stock	30,000	
Balan A/c	25,000	1,51,000	Less: Appreciation	3,000	33,000
Creditors		35,000	Debtors	20,000	
			Less: Undervalued	2,000	18,000
			Bank		50,000
			Prepaid insurance		5,000
		1,86,000			1,86,000

27. Anbu and Shankar are partners in a business sharing profits and losses in the ratio of 3:2. The balance sheet of the partners on 31.03.2018 is as follows:

Liabilities	₹	₹	Assets	₹
Capital accounts:			Computer	40,000
Anbu	4,00,000		Motor car	1,60,000
Shankar	3,00,000	7,00,000	Stock	4,00,000
Profit and loss		1,20,000	Debtors	3,60,000
Creditors		1,20,000	Bank	40,000
Workmen compensation fund		60,000		
		10,00,000		10,00,000

ADMISSION OF A PARTNER

Rajesh is admitted for 1/5 share on the following terms:

- Goodwill of the firm is valued at ₹75,000 and Rajesh brought cash for his share of goodwill.
- Rajesh is to bring ₹1,50,000 as his capital.
- Motor car is valued at ₹2,00,000; Stock at ₹3,80,000 and debtors at ₹3,50,000.
- Anticipated claim on workmen compensation fund is ₹10,000
- Unrecorded investment of ₹5,000 has to be brought into account.

Prepare revaluation account, capital accounts and balance sheet after Rajesh's admission.

Solution :

Revaluation Account

Dr			Cr	
Particulars	₹		Particulars	₹
To Stock A/c		20,000	By Motor car	40,000
To Debtors A/c		10,000	By Investment A/c	5,000
To Profit on revaluation transferred to Anbu's capital A/c	9,000			
Shankar's capital A/c	6,000	15,000		
		45,000		45,000

Dr				Cr			
Particulars	Anbu ₹	Shankar ₹	Rajesh ₹	Particulars	Anbu ₹	Shankar ₹	Rajesh ₹
To Balance c/d	5,20,000	3,80,000	1,50,000	By Balance b/d	4,00,000	3,00,000	-
				By Bank A/c	-	-	1,50,000
				By Profit and loss A/c	72,000	48,000	-
				By Workmen compensation fund (60,000 - 10,000)	30,000	20,000	-
				By Revaluation A/c	9,000	6,000	-
				By Goodwill A/c	9,000	6,000	-
	5,20,000	3,80,000	1,50,000		5,20,000	3,80,000	1,50,000
				By Balance b/d	5,20,000	3,80,000	1,50,000

Good will of the firm is = ₹75,000

Rajesh share of goodwill = $75,000 \times \frac{1}{5}$

= ₹ 15,000

It is to be distributed to Anbu and Shankar in their old ratio of 3:2

Dr			Cr	
Particulars	₹	Particulars	₹	
To Balance b/d	40,000			
To Rajesh capital A/c	1,50,000			
To Anbu's capital A/c	9,000			
To Shankar's capital A/c	6,000	By Balance c/d	2,05,000	
	2,05,000		2,05,000	

Balance Sheet

Liabilities	₹	₹	Assets	₹	₹
Capital accounts:			Computer		40,000
Anbu	5,20,000		Motor Car	1,60,000	
Shankar	3,80,000		Add: Appreciation	40,000	2,00,000
Rajesh	1,50,000	10,50,000	Stock	4,00,000	
Creditors		1,20,000	Less: Depreciation	20,000	3,80,000
Workmen compensation fund (60,000 – 50,000)		10,000	Debtors	3,60,000	
			Less: Under valued	10,000	3,50,000
			Bank		2,05,000
			Unrecorded investment		5,000
		11,80,000			11,80,000

ADDITIONAL QUESTIONS AND ANSWERS

Unit - 5

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer :

1. A person may join as a new partner in an existing

- (a) Partnership firm
(b) Sole proprietorship
(c) Hindu undivided Family
(d) None of these

[Ans. (a) Partnership firm]

2. Revaluation account is also called

- (a) Accumulation profit and loss account
(b) Profit and loss adjustment account
(c) Profit and loss appropriation account
(d) None of these

[Ans. (b) Profit and loss adjustment account]

3. When the value of an asset increases, it results in

- (a) profit (b) loss
(c) income (d) expense

[Ans. (a) profit]

4. When an unrecorded liabilities is brought into books, is results in

- (a) profit (b) loss
(c) income (d) expense

[Ans. (b) loss]

5. The revaluation profit or loss is transferred to the old partner's capital accounts, in their

- (a) Old ratio (b) New ratio
(c) Sacrifice ratio (d) Gain ratio

[Ans. (a) Old ratio]

6. When A and B sharing profits and losses in the ratio of 3:2, they admit C as a partner giving him 1/3 share of profits. This will be given by A and B.

- (a) Equality
(b) In the ratio of their capitals
(c) In the ratio of their profits
(d) None of these

[Ans. (c) In the ratio of their profits]

7. In order to maintain fair dealings, at the time of admission, it is necessary to revalue assets and liabilities of the firm to their

- (a) Cost price (b) True value
(c) Selling price (d) None of these

[Ans. (b) True value]

8. On admission of a partner if goodwill account is to be raised this should be debited to

- (a) Partner's capital account
(b) Goodwill account
(c) Revaluation account
(d) None of these

[Ans. (b) Goodwill account]

ADMISSION OF A PARTNER

4. (i) Current accounts of the partners should be opened when the capitals are Either fixed.
- (ii) This necessitates the calculation of new profit sharing ratio of the remaining partners.
- (iii) The ratio in which the old partners have agreed to sacrifice their shares in profit in favour of a new partner is called the sacrificing ratio.
- (a) (i) is correct
 (b) (i), (ii) and (iii) are correct
 (c) (iii) is correct
 (d) (i) and (ii) are correct

[Ans. (c) (iii) is correct]

II. VERY SHORT ANSWER QUESTIONS.

1. What is meant by admission of a partner?

Ans. A person may join as a new partner in an existing partnership firm. This is called admission of a partner.

Solution :

Journal entries

Date	Particulars	L.F	Debit ₹	Credit ₹
	Investment A/c Dr To Revaluation A/c (Profit item credited to Revaluation A/(c))		18,000	18,000
	Revaluation A/c Dr To Stock A/c To Furniture A/c To Machinery A/c To Workmen's compensation A/c (Loss items debited to revaluation A/c)		78,000	18,000 6,000 30,000 24,000
	Sridevi's Capital A/c Dr Santhiya's Capital A/c Dr To Revaluation A/c (Loss on revaluation transferred to old partners capital accounts in the old ratio)		36,000 24,000	60,000

2. Who is an incoming partner?

Ans. According to section 31(1) of the Indian partnership Act 1932, a person can be admitted only with the consent of all the existing partners. A person who is admitted to the firm is known as an incoming or a new partner.

III. PROBLEMS.

1. Sridevi and Santhiya were partners sharing profit and loss in the ratio of 3:2. They decided to admit Fathima into the partnership and revalue their assets and liabilities as indicated here under:

- (a) To bring into record investment of ₹18,000 which had not so far been recorded in the books of the firm.
- (b) To depreciate stock, furniture and machinery by, ₹18,000, ₹6,000 and ₹30,000 respectively.
- (c) To provide for workmen's compensation of ₹24,000.

Pass the necessary journal entries and show the revaluation account.



Revaluation Account

Dr		Cr		
Particulars	₹	Particulars	₹	₹
To Stock A/c	18,000	By Investments A/c		18,000
To Furniture A/c	6,000	By Loss on revaluation transferred to :		
To Machinery A/c	30,000	Sridevi's capital A/c	36,000	
To Workmen's compensation A/c	24,000	Santhiya's capital A/c	24,000	60,000
	78,000			78,000

2. Sheela and Neela were sharing profits in the ratio of 4:3. Kamala was admitted with 1/5th share in profits of business. Calculated the New profit Ratio and the sacrificing ratio.

Solution :

(i) **New partner sharing ratio:**

Let the total profit be 1

$$\text{New partner Kamala's share} = \frac{1}{5}$$

$$\text{Remaining share of Sheela and Neela} = 1 - \frac{1}{5} = \frac{5-1}{5} = \frac{4}{5}$$

$$\text{New share of Sheela} = \text{Remaining share} \times \text{Sheela's old share}$$

$$\text{Sheela} = \frac{4}{5} \times \frac{4}{7} = \frac{16}{35}$$

$$\text{Neela} = \frac{4}{5} \times \frac{3}{7} = \frac{12}{35}$$

Share of new partner:

$$\text{Kamala} = \frac{1}{5}$$

In order to equalize the denominator, multiply and divide Kamala's share by 7.

$$\text{Kamala's share} = \frac{1}{5} \times \frac{7}{7} = \frac{7}{35}$$

$$\text{New profit sharing ratio of Sheela, Neela and Kamala} = \frac{16}{35} : \frac{12}{35} : \frac{7}{35} \text{ that } 16:12:7$$

ii. Sacrificing ratio:

$$\text{Sacrifice} = \text{Old share} - \text{New share}$$

$$\text{Sheela's sacrifice} = \frac{4}{7} - \frac{16}{35} = \frac{15-12}{35} = \frac{3}{35}$$

$$\text{Neela's sacrifice} = \frac{3}{7} - \frac{12}{35} = \frac{15-12}{35} = \frac{3}{35}$$

$$\text{Sacrificing ratio} = \frac{3}{35} : \frac{3}{35} = 1:1$$

7. Valluvan and Kamban were partners sharing profits and losses as 60% to Valluvan and 40% Kamban. Their balance sheet as at 1st January, 2019 stood as under:

Liabilities	₹	₹	Assets	₹
Sundry creditors		96,000	Cash in hand	4,000
Bills payable		34,000	Sundry debtors	56,000
Capital Accounts:			Stock	40,000
Valluvan	90,000		Plant and machinery	80,000
Kamban	80,000	1,70,000	Land and Buildings	1,20,000
		3,00,000		3,00,000

The partners agreed to admit Elangovan into the firm subject to revaluation of the following items:

- Stock was to be reduced by ₹ 4,000
 - Land and Buildings were to be valued at ₹ 1,60,000
 - A provision of $2\frac{1}{2}\%$ was to be created for doubtful debtors.
 - A liability of ₹ 2,600 for outstanding expenses had been omitted to be recorded in the books
- Prepare the Revaluation account, capital accounts and the Balance sheet after the above adjustment.

Revaluation Account

Dr				Cr	
Particulars	₹	₹	Particulars	₹	
To Stock A/c		4,000	By Land and Buildings A/c	40,000	
To Provision for doubtful debts A/c		1,400			
To Outstanding expenses A/c		2,600			
To Profit on revaluation transferred to :					
Valluvan's capital A/c	19,200				
Kamban's capital A/c	12,800	32,000			
		40,000		40,000	

Capital Account

Dr			Cr		
Particulars	Valluvan ₹	Kamban ₹	Particulars	Valluvan ₹	Kamban ₹
To Balance c/d	1,09,200	92,800	By Balance b/d	90,000	80,000
			By Revaluation A/c	19,200	12,800
	1,09,200	92,800		1,09,200	92,800
			By Balance b/d	1,09,200	92,800

ADMISSION OF A PARTNER

Balance sheet of Valluvan and Kamban as on 1st January, 2019

Liabilities	₹	₹	Assets	₹	₹
Outstanding expenses		2,600	Cash in hand		4,000
Sundry creditors		96,000	Sundry Debtors	56,000	
Bills payable		34,000	<u>Less:</u> Provision for doubtful debts	1,400	54,600
Capital Accounts:			Stock	40,000	
Valluvan	1,09,200		<u>Loss:</u> Reduction	4,000	36,000
Kamban	92,800	2,02,000	Plant & Machinery		80,000
			Land and buildings	1,20,000	
			<u>Add:</u> Appreciation	40,000	1,60,000
		3,34,600			3,34,600

8. Lakshmi and Saraswathi are partners of a firm sharing profits and losses in proportion to capital. Trial Balance sheet as on 31st March 2019 is as under

Liabilities	₹	₹	Assets	₹
Sundry creditors		60,000	Bank	12,000
Bills payable		40,000	Sundry debtors A/c	40,000
Capital accounts:			Stock	40,000
Lakshmi	60,000		Plant	90,000
Saraswathi	40,000	1,00,000	Furniture	18,000
		2,00,000		2,00,000

They decided to admit Sulochana into the partnership with effect from 1st April, 2005 on the following terms.

- Sulochana shall bring in a capital of ₹ 50,000 for $\frac{1}{5}$ th share of profits.
- Goodwill is to be valued at ₹ 40,000
- Plant and furniture was to be depreciated by 5%
- Provision for doubtful debts be created at $1\frac{1}{2}$ % on sundry debtors.

Show revaluation account, capital accounts, bank account and Balance sheet of the reconstituted partnership.

Solution :

Revaluation Account

Dr		Cr		
Particulars	₹	Particulars	₹	₹
To Plant A/c	4,500	By Loss on revaluation:		
To Furniture A/c	900	Lakshmi's capital A/c	3,600	
To Provision for doubtful debts	600	Saraswathi's capital A/c	2,400	6000
	6,000			6,000

Dr				Capital Account				Cr			
Particulars	Lakshmi ₹	Saraswathi ₹	Sulochana ₹	Particulars	Lakshmi ₹	Saraswathi ₹	Sulochana ₹	Particulars	Lakshmi ₹	Saraswathi ₹	Sulochana ₹
To Revaluation A/c	3,600	2,400	-	By Balance c/d	60,000	40,000	-	By Balance c/d	-	-	-
To Balance c/d	80,400	53,600	50,000	By Bank A/c	-	-	50,000	By Goodwill A/c	24,000	16,000	-
	84,000	56,000	50,000		84,000	56,000	50,000	By Balance b/d	80,400	53,600	50,000

Dr		Bank A/c		Cr	
Particulars	₹	Particulars	₹	Particulars	₹
To Balance b/d	12,000	By Balance c/d	62,000		
To Sulochana's capital A/c	50,000				
	62,000				62,000

Balance sheet of Lakshmi, Saraswathi and Sulochana as on 31.3.2005

Liabilities	₹	₹	Assets	₹	₹
Sundry creditors		60,000	Bank		62,000
Bills payable		40,000	Sundry Debtors	40,000	
Capital A/c:			Less: Provision for doubtful debts	600	39,400
Lakshmi	80,400		Stock		40,000
Saraswathi	53,600		Plant	90,000	
Sulochana	50,000	1,84,000	Less: Depreciation	4,500	85,500
			Furniture	18,000	
			Less: Depreciation	900	17,100
			Goodwill		40,000
		2,84,000			2,84,000

HOTS QUESTIONS AND ANSWER

1. Durga and Naresh were partnership in a firm. They wanted to admit five more members in the firm. List any two categories of individuals other than minors who cannot be admitted by them.

Ans. The individual other than minors who cannot be admitted by them are

- Person of unsound mind
- Person of disqualified by law

2. The amount of bills payable appearing in the balance sheet is understated by ₹10,000. State whether the revaluation account will be debited or credited to restore the amount of bills payable to its actual value. Also give reason for your answer.

Ans. Revaluation account will be debited. Increase in bills payable is a loss for the firm. Being a nominal account, to record this loss, revaluation account will have to be debited.

3. On the admission of C, A and B decide to record an unrecorded asset worth ₹ 10,000. State whether the revaluation account will be debited or credited.

Ans. Revaluation account will be credited.

4. The value of Plant and machinery increased by 10%. State whether revaluation account will be debited or credited.

Ans. Revaluation account will be credited.



UNIT
6**RETIREMENT AND DEATH
OF A PARTNER****CHAPTER SNAPSHOT**

- 6.1** Introduction
- 6.2** Adjustments required on retirement of a partner
- 6.3** Distribution of accumulated profits, reserves and losses
- 6.4** Revaluation of assets and liabilities
- 6.5** Determination of new profit sharing ratio and gaining ratio
 - 6.5.1** New profit sharing ratio
 - 6.5.2** Gaining ratio
 - 6.5.3** Differences between the sacrificing ratio and the gaining ratio
- 6.6** Adjustment for goodwill
 - 6.6.1** Existing goodwill
- 6.7** Adjustment for current year's profit or loss upto the date retirement
- 6.8** Settlement of the amount due to the retiring partner, Death of a partner
- 6.9** Adjustments required on the death of a partner

Important Points

- ❑ When a partner leaves from a partnership firm, it is known as retirement.
- ❑ The retiring partner is liable for all the acts of the firm upto the date of his retirement.
- ❑ Assets and liabilities have to be revalued and the profit or loss on revaluation is to be distributed to all the partners.
- ❑ Profits and losses of previous years which are not distributed to the partners are known as accumulated profits and losses.
- ❑ A revaluation account is opened to record the increase or decrease in the value of assets and liabilities.
- ❑ Revaluation account which is otherwise called profit and loss adjustment account is a nominal account.
- ❑ A memorandum revaluation account which is a temporary account is opened when the revised values are not to be shown in the books of accounts.
- ❑ New profit sharing ratio is the agreed proportion in which future profit will be distributed to the continuing partners.
- ❑ Gaining ratio is the proportion of the profit which is gained by the continuing partners.
- ❑ Life policies may be taken on the life of the partners in a partnership firm.

SELF-EXAMINATION QUESTIONS

I MULTIPLE CHOICE QUESTIONS

CHOOSE THE CORRECT ANSWER

1. A partner retires from the partnership firm on 30th June. He is liable for all the acts of the firm up to the

- (a) End of the current accounting period
- (b) End of the previous accounting period
- (c) Date of his retirement
- (d) Date of his final settlement

[Ans. (c) Date of his retirement]

2. On retirement of a partner from a partnership firm, accumulated profits and losses are distributed to the partners in the

- (a) New profit sharing ratio
- (b) Old profit sharing ratio
- (c) Gaining ratio
- (d) Sacrificing ratio

[Ans. (b) Old profit sharing ratio]

3. On retirement of a partner, general reserve is transferred to the

- (a) Capital account of all the partners
- (b) Revaluation account
- (c) Capital account of the continuing partners
- (d) Memorandum revaluation account

[Ans. (a) Capital account of all the partners]

4. On revaluation, the increase in liabilities leads to

- (a) Gain
- (b) Loss
- (c) Profit
- (d) None of these

[Ans. (b) Loss]

5. At the time of retirement of a partner, determination of gaining ratio is required

- (a) To transfer revaluation profit or loss
- (b) To distribute accumulated profits and losses
- (c) To adjust goodwill
- (d) None of these

[Ans. (c) To adjust goodwill]

RETIREMENT AND DEATH OF A PARTNER

Sura's XII Std - Accountancy

6. If the final amount due to a retiring partner is not paid immediately, it is transferred to

- Bank A/c
- Retiring partner's capital A/c
- Retiring partner's loan A/c
- Other partners' capital A/c

[Ans. (c) Retiring partner's loan A/c]

7. 'A' was a partner in a partnership firm. He died on 31st March 2019. The final amount due to him is ₹ 25,000 which is not paid immediately. It will be transferred to

- A's capital account
- A's current account
- A's Executor account
- A's Executor loan account

[Ans. (d) A's Executor loan account]

8. A, B and C are partners sharing profits in the ratio of 2:2:1. On retirement of B, goodwill of the firm was valued as ₹ 30,000. Find the contribution of A and C to compensate B:

- ₹ 20,000 and ₹ 10,000
- ₹ 8,000 and ₹ 4,000
- ₹ 10,000 and ₹ 20,000
- ₹ 15,000 and ₹ 15,000

Hint :

$$\begin{aligned} \text{B's share of goodwill} &= 30,000 \times \frac{2}{5} \\ &= ₹12,000 \end{aligned}$$

$$\text{A's capital A/c } (12,000 \times \frac{2}{3}) = ₹8,000$$

$$\text{C's capital A/c } (12,000 \times \frac{1}{3}) = ₹4,000$$

[Ans. (b) ₹ 8,000 and ₹ 4,000]

9. A, B and C are partners sharing profits in the ratio of 4:2:3. C retires. The new profit sharing ratio between A and B will be

- 4:3
- 3:4
- 2:1
- 1:2 [Ans. (c) 2:1]

Hint :

A, B, C's sharing ratio = 4 : 2 : 3

C's retired, so A and B's share ratio = 4 : 2 = 2 : 1

10. X, Y and Z were partners sharing profits and losses equally. X died on 1st April 2019. Find out the share of X in the profit of 2019 based on the profit of 2018 which showed ₹ 36,000.

- ₹ 1,000
- ₹ 3,000
- ₹ 12,000
- ₹ 36,000

[Ans. (b) ₹ 3,000]

II. VERY SHORT ANSWER QUESTIONS:

1. What is meant by retirement of partners?

Ans. When a partner leaves from a partnership firm, it is known as retirement. The reasons for the retirement of a partner may be illness, old age, better opportunity elsewhere, disagreement with other partners, etc.

2. What is gaining ratio?

Ans. The continuing partners may again a portion of the share of profit of the retiring partner. The gain may be shared by all the partners or some of the partners. Gaining ratio is the proportion of the profit which is gained by the continuing partners.

3. What is the purpose of calculating gaining ratio?

Ans. The purpose of finding the gaining ratio is to bear the goodwill to be paid to the retiring partner. The share gained is calculated as follows:

$$\text{Share gained} = \text{New share} - \text{Old share}$$

$$\text{Gaining ratio} = \text{Ratio of share gained by the continuing partners.}$$

4. What is the journal entry to be passed to transfer the amount due to the deceased partner to the executor of the deceased partner?

Ans. To transfer the amount due to the deceased partner to the executor or legal representative of the deceased partner.

Date	Particulars	L.F	Debit ₹	Credit ₹
	Deceased partner's capital A/c Dr. To Deceased partner's executor's A/c		XXX	XXX

III. SHORT ANSWER QUESTIONS:

1. List out the adjustments made at the time of retirement of a partner in a partnership firm.

Ans. The following adjustments are necessary at the time of retirement of a partner.

- (i) Distribution of accumulated profits, reserves and losses.
- (ii) Revaluation of assets and liabilities.
- (iii) Determination of new profit sharing ratio and gaining ratio.
- (iv) Adjustment for goodwill.
- (v) Adjustment for current year's profit or loss upto the date of retirement.
- (vi) Settlement of the amount due to the retiring partner.

2. Distinguish between sacrificing ratio and gaining ratio.

Basic		Sacrificing ratio	Gaining ratio
1.	Meaning	It is the proportion of the profit which is sacrificed by the old partners in favour of a new partner.	It is the proportion of the profit which is gained by the continuing partners from the retiring partner.
2.	Purpose	It is calculated to determine the amount to be adjusted towards goodwill for the sacrificing partners.	It is calculated to determine the amount to be adjusted towards goodwill for the gaining partners.
3.	Time of calculation	It is calculated at the time of admission of a new partner.	It is calculated at the time of retirement of a partner.
4.	Method of Calculation	It is the difference between the old ratio and the new ratio. Sacrificing ratio = Old profit sharing ratio – New profit sharing ratio.	It is the difference between the new ratio and the old ratio. Gaining ratio = New profit sharing ratio – Old profit sharing ratio.

3. What are the ways in which the final amount due to an outgoing partner can be settled?

Ans. The amount due to the retiring partner may be settled in one of the following ways.

- (i) Paying the entire amount due immediately in cash.
- (ii) Transfer the entire amount due to the loan account of the partner.
- (iii) Paying part of the amount immediately in cash and transferring the balance to the loan account of the partner.

The journal entries to be made are as follows:

(a) When the amount due is paid in cash immediately.

Date	Particulars	L.F	Debit ₹	Credit ₹
	Retiring partner's capital A/c Dr. To Cash / Bank A/c		XXX	XXX

(b) When the amount due is not paid immediately in cash.

Date	Particulars	L.F	Debit ₹	Credit ₹
	Retiring partner's capital A/c Dr. To Retiring partner's loan A/c		XXX	XXX

RETIREMENT AND DEATH OF A PARTNER**Sura's XII Std - Accountancy**

- (c) When the amount due is partly paid in cash immediately.

Date	Particulars	L.F	Debit ₹	Credit ₹
	Retiring partner's capital A/c Dr. To Cash / Bank A/c (amount paid) To Retiring partner's loan A/c		XXX	XXX XXX

Retiring partner's loan account will appear on the liabilities side of the balance sheet prepared after retirement till it is completely settled.

IV. EXERCISE:**RETIREMENT OF A PARTNER**

Distribution of accumulated profits, reserves and losses:

- Dheena, Surya and Janaki are partners sharing profits and losses in the ratio of 5:3:2. On 31.3.2018, Dheena retired. On the date of retirement, the books of the firm showed a reserve fund of ₹ 50,000. Pass journal entry to transfer the reserve fund.

Solution :

Journal entry

Date	Particulars	L.F	Debit ₹	Credit ₹
2018 March 31	General reserve A/c Dr. To Dheena A/c (50,000 × 5/10) To Surya A/c (50,000 × 3/10) To Janaki A/c (50,000 × 2/10) (General reserve transferred to all partner's capital account in the profit sharing ratio)		50,000	25,000 15,000 10,000

- Rosi, Rathi and Rani are partners of a firm sharing profits and losses equally. Rathi retired from the partnership on 1.1.2018. On that date, their balance sheet showed accumulated loss of ₹ 45,000 on the asset side of the balance sheet. Give the journal entry to distribute the accumulated loss.

Solution :

Journal entry

Date	Particulars	L.F	Debit ₹	Credit ₹
2018 January 1	Rosi A/c (45,000) Dr. Rathi A/c Dr. Rani A/c Dr. To Profit and loss A/c (Accumulated loss transferred to all partner's capital account in the old profit sharing ratio)		15,000 15,000 15,000	45,000

ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. When a partner leaves from a partnership firm, it is known as

- (a) Admission (b) Retirement
(c) dissolution (d) death

[Ans. (b) Retirement]

2. The firm is reconstituted and other partners continue the partnership firm with a new

- (a) Contract (b) agreement
(c) start business (d) none of these

[Ans. (b) agreement]

3. A partner who retires from the firm is called an

- (a) Outgoing partner (b) admitted partner
(c) death of a partner (d) none of these

[Ans. (a) Outgoing partner]

4. Profits and losses of previous years which are not distributed to the partners are known as

- (a) Accumulated profit and losses
(b) general reserve
(c) Reserve fund
(d) workmen compensation fund

[Ans. (a) Accumulated profit and losses]

5. The profit or loss arising therefrom is transferred to the capital accounts of all the partners in the

- (a) New profit sharing ratio
(b) Old profit sharing ratio
(c) Gaining ratio
(d) Sacrificing ratio

[Ans. (b) Old profit sharing ratio]

6. The settlement is to be done in the manner prescribed in the

- (a) Partnership-at-will
(b) Partnership deed
(c) Both 'a' and 'b'
(d) None of the above

[Ans. (b) Partnership deed]

7. In both types of policies, the insurance premium is paid by the

- (a) Sole tradership
(b) Partnership firm
(c) Hindu undivided family
(d) None of these

[Ans. (b) Partnership firm]

8. The policy amount received from the insurance company is used to settle the amount due to the

- (a) Increased partner
(b) Deceased partner
(c) Partnership at will
(d) Partnership deed

[Ans. (b) Deceased partner]

9. At the time of retirement of partners, the existing partners stand to

- (a) Gain (b) Loss
(c) Income (d) None of these

[Ans. (a) Gain]

10. At the time of retirement of a partner, calculation of new profit ratio is

- (a) Compulsory (b) Optional
(c) Necessary (d) Not necessary

[Ans. (c) Necessary]

11. At the time to retirement Balance Sheet items like profit and loss account and General reserve must be transferred to

- (a) Revaluation A/c
(b) Partners capital A/c
(c) Both 'a' and 'b'
(d) None of the above

[Ans. (b) Partners capital A/c]

12. If the goodwill account is raised for 50,000, the amount is debited to:

- (a) The capital accounts of partners
(b) Goodwill account
(c) Cash account
(d) Loan account

[Ans. (b) Goodwill account]

RETIREMENT AND DEATH OF A PARTNER

2. (a) It is calculated to determine the amount of compensation to be paid by each of the continuing partners to the Incoming partner.
 (b) The old partnership comes to an end and a new one comes into existence with the remaining partners.
 (c) This ratio is calculated by taking out the difference between new profit sharing ratio and Gaining ratio.
 (d) It is calculated at the time of retirement of a New partner.
- (a) (i) is correct
 (b) (ii) is correct
 (c) (i) and (ii) are correct
 (d) (i), (ii) and (iii) are correct

[Ans: (b) (ii) is correct]

3. (a) At the time of retirement of a partner, the remaining partners acquire some portion of the retiring partner's share of profit.
 (b) This necessitates the calculation of new profit sharing ratio of the remaining New partners
 (c) where the partnership at will by giving notice in writing to all the old partners of his intention to retire in company.
 (d) Certain adjustments have to be made in the books to ascertain the amount due to him from the Company.
- (a) (i) is correct
 (b) (ii) is correct
 (c) (i) and (ii) are correct
 (d) (i), (ii) and (iii) are correct

[Ans: (a) (i) is correct]

II. VERY SHORT ANSWER QUESTIONS :

1. What is New profit sharing ratio?

Ans. New profit sharing ratio is the agreed proportion in which future profit will be distributed to the continuing partners.

2. Who is an outgoing partner?

Ans. A person who is retired from the firm is known as an outgoing partners or retiring partners.

3. How can a partner retire from the firm? (Any two)

A partner may retire from the firm:

- (i) With the consent of all the partners.
 (i) In accordance with an express agreement by the partners.

III. PROBLEMS:

1. Karan, Vinoth and Vinay are Partners sharing profits in the ratio of 3:2:1. Karan retires and the new profit sharing ratio between Vinoth and vinay is 2:3. Calculate the gaining ratio?

Solution :

Share gained = New share – Old share

$$\text{Vinoth} = \frac{2}{5} - \frac{2}{6} = \frac{12-10}{30} = \frac{2}{30}$$

$$\text{Vinay} = \frac{3}{5} - \frac{1}{6} = \frac{18-5}{30} = \frac{13}{30}$$

Therefore, the gaining ratio of Vinoth and Vinay is 2 : 13.

2. Sun, Moon and Jupiter are partners sharing profits and losses in the ratio of 5:3:2. Jupiter retires and the share is taken by Sun and Moon in the ratio of 3:2. Find out the new profit sharing ratio and gaining ratio.

Solution :

$$\text{Jupiter's share} = \frac{2}{10}$$

Share gained = Retiring partner's share × Proportion of share gained

$$\text{Sun} = \frac{2}{10} \times \frac{3}{5} = \frac{6}{50}$$

$$\text{Moon} = \frac{2}{10} \times \frac{2}{5} = \frac{4}{50}$$

$$\text{Gaining ratio} = \frac{6}{50} : \frac{4}{50} \text{ that is, } 3 : 2.$$

New share of continuing partner
 = Old share + share gained

$$\text{Sun} = \frac{5}{10} + \frac{6}{50} = \frac{25+6}{50} = \frac{31}{50}$$

$$\text{Moon} = \frac{3}{10} + \frac{4}{50} = \frac{15+4}{50} = \frac{19}{50}$$

The new ratio of Sun and Moon is $\frac{31}{50} : \frac{19}{50}$
 that is 31 : 19.

RETIREMENT AND DEATH OF A PARTNER

Sura's XII Std - Accountancy

11. On 1.1.2019, Pandiyan died and on his death the following arrangements are made:

- (i) Stock to be depreciated by 10 %
- (ii) Land is to be appreciated by ₹ 11,000
- (iii) To provide 3,000 for bad debts
- (iv) The final amount due to Pandiyan was not paid

Prepare revaluation account, partner's capital account and the balance sheet of the firm after death.

Solution :

Revaluation Account

Dr			Cr
Particulars	₹	₹	Particulars
To Stock A/c		2,000	By Land A/c
To Debtors A/c		3,000	
To Profit on revaluation transferred to			
Sankar's capital A/c ($6,000 \times 3/6$)	3,000		
Saleem's capital A/c ($6,000 \times 2/6$)	2,000		
Pandian's capital A/c ($6,000 \times 1/6$)	1,000	6,000	
		11,000	
			11,000

Capital Account

Dr				Cr			
Particulars	Sankar ₹	Saleem ₹	Pandiyam ₹	Particulars	Sankar ₹	Saleem ₹	Pandiyam ₹
To profit and loss A/c	3,000	2,000	1,000	By Balance b/d	50,000	40,000	10,000
To Pandian's Executor's A/c			16,000	By General reserve	18,000	12,000	6,000
To Balance c/d	68,000	52,000	-	By Revaluation A/c (profit)	3,000	2,000	1,000
	71,000	54,000	17,000		71,000	54,000	17,000
				By Balanced b/d	68,000	52,000	

RETIREMENT AND DEATH OF A PARTNER

Balance sheet as on 31st December 2018

Liabilities	₹	₹	Assets	₹	₹
Capital account:			Land	80,000	
Sankar	68,000		<u>Add:</u> Appreciation	11,000	91,000
Saleem	52,000	1,20,000	Stock	20,000	
Pandian's Executor's A/c		16,000	<u>Less:</u> Depreciation	2,000	18,000
Sundry creditors		14,000	Debtors	30,000	
			<u>Less:</u> Bad debts	3,000	27,000
		1,50,000	Cash at bank		14,000
					1,50,000

HOTS QUESTIONS AND ANSWER

1. If the retiring partner is not paid the full amount due to him immediately on retirement, how should his capital account be shown in subsequent balance sheet?

Ans. If the retiring partner is not paid fully immediately on retirement, then the remaining balance of his capital account will be transferred to his loan account and will be shown as his loan on the liabilities side of the balance sheet of the firm.

2. Name the account which is opened to credit the share of profit of the deceased partner, till the time of death to his capital account.

Ans. Profit and loss suspense account is opened to credit the share of profit of the deceased partner

3. For which share of goodwill, a partner is entitled at the time of his retirement?

Ans. At the time of retirement a partner is entitled to get an amount equal to his share in profits out of firm's goodwill.

4. Raji, Mohana, Sonu were partners in a firm sharing profits in the ration of 4;3;2 Mohana retired. Her share was taken over equally by Raji and Sonu. In which ratio will be profit or loss on revaluation of assets and liabilities on the retirement of Mohana be transferred to the capital accounts of the partners.

Ans. The profit or loss on revaluation of assets and liabilities on the retirement of Mohana will be transferred to the capital accounts of the partners in their old ratio i.e. 4:3:2.



UNIT
7**COMPANY ACCOUNTS****CHAPTER SNAPSHOT**

- 7.1** Introduction
- 7.2** Meaning and definition of a company
- 7.3** Characteristics of a company
- 7.4** Meaning and types of shares
- 7.5** Divisions of share capital
- 7.6** Issue of equity shares
- 7.7** Process of issue of equity shares
- 7.8** Issue of shares for cash in instalments
 - 7.8.1** Under subscription
 - 7.8.2** Over subscription
 - 7.8.3** Calls in advance
 - 7.8.4** Calls in arrear
 - 7.8.5** Forfeiture of shares
 - 7.8.6** Re-issue of forfeited shares
 - 7.8.7** Shares issued at premium
- 7.9** Issue of shares for cash in lumpsum
- 7.10** Issue of shares for consideration other than cash



Important Points

- ❑ Authorised capital is the maximum amount that can be raised as capital as is authorised by the memorandum of association.
- ❑ Reserve capital is part of subscribed capital to be called up at the time of winding up of the company.
- ❑ Issue of equity shares to public through prospectus by a public company is called public issue
- ❑ When the share capital is received through instalments, first instalment is called application money.
- ❑ The application money must be at least 5 percent of the nominal value of the shares.
- ❑ When the number of shares subscribed is less than the number of shares offered, it is known as under subscription
- ❑ When the minimum subscription stated in the prospectus has been subscribed for by the public, a company can allot shares.
- ❑ When applications are allotted in proportion of shares applied for it is called pro-rata allotment.
- ❑ The excess amount paid over the called up value of a share is known as calls in advance.
- ❑ When a shareholder fails to pay the amount due on allotment or on calls, the amount remaining unpaid is known as calls in arrears.
- ❑ When a company issues shares at a price more than the face value (nominal value), the shares are said to be issued at premium.

SELF-EXAMINATION QUESTIONS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer :

1. A preference share is one

- (i) which carries preferential right with respect to payment of dividend at fixed rate
 - (ii) which carries preferential right with respect to repayment of capital on winding up
- (a) Only (i) is correct
 (b) Only (ii) is correct
 (c) Both (i) and (ii) are correct
 (d) Both (i) and (ii) are incorrect

[Ans. (c) Both (i) and (ii) are correct]

2. That part of share capital which can be called up only on the winding up of a company is called:

- (a) Authorised capital (b) Called up capital
 (c) Capital reserve (d) Reserve capital

[Ans. (d) Reserve capital]

3. At the time of forfeiture, share capital account is debited with

- (a) Face value
 (b) Nominal value
 (c) Paid up amount
 (d) Called up amount

[Ans. (d) Called up amount]

4. After the forfeited shares are reissued, the balance in the forfeited shares account should be transferred to

- (a) General reserve account
 (b) Capital reserve account
 (c) Securities premium account
 (d) Surplus account

[Ans. (b) Capital reserve account]

5. The amount received over and above the par value is credited to

- (a) Securities premium account
 (b) Calls in advance account
 (c) Share capital account
 (d) Forfeited shares account

[Ans. (a) Securities premium account]

COMPANY ACCOUNTS

Sura's XII Std - Accountancy

6. Which of the following statement is false?

- Issued capital can never be more than the authorised capital
- In case of under subscription, issued capital will be less than the subscribed capital
- Reserve capital can be called at the time of winding up
- Paid up capital is part of called up capital

[Ans. (b) In case of under subscription, issued capital will be less than the subscribed capital]

7. When shares are issued for purchase of assets, the amount should be credited to

- Vendor's A/c
- Sundry assets A/c
- Share capital A/c
- Bank A/c

[Ans. (c) Share capital A/c]

8. Match the pair and identify the correct option

(1)	Under subscription	(i)	Amount prepaid for calls
(2)	Over subscription	(ii)	Subscription above the offered shares
(3)	Calls in arrear	(iii)	Subscription below the offered shares
(4)	Calls in advance	(iv)	Amount unpaid on calls

- | | | | | |
|-----|-------|-------|-------|------|
| | (1) | (2) | (3) | (4) |
| (a) | (i) | (ii) | (iii) | (iv) |
| (b) | (iv) | (iii) | (ii) | (i) |
| (c) | (iii) | (ii) | (iv) | (i) |
| (d) | (iii) | (iv) | (i) | (ii) |

[Ans. (c) 1 - (iii), 2 - (ii), 3 - (iv), 4 - (i)]

9. If a share of ₹10 on which ₹8 has been paid up is forfeited. Minimum reissue price is

- ₹10 per share
- ₹8 per share
- ₹5 per share
- ₹2 per share

[Ans. (d) ₹2 per share]

Hint :

$$\begin{aligned} \text{Minimum reissue price} &= ₹10 - ₹8 \\ &= ₹2 \end{aligned}$$

10. Supreme Ltd. forfeited 100 shares of ₹10 each for non-payment of final call of ₹2 per share. All these shares were re-issued at ₹9 per share. What amount will be transferred to capital reserve account?

- ₹700
- ₹800
- ₹900
- ₹1,000

[Ans. (a) ₹700]

Hint :

$$\begin{aligned} \text{Forfeited amount for 100 shares} &= 900 \\ \text{Final call amount (100} \times \text{2)} &= 200 \\ \text{Capital reserve} &= \underline{700} \end{aligned}$$

II. VERY SHORT ANSWER QUESTIONS.

1. What is a share?

Ans. The capital of a company is divided into small units of fixed amount. These units are called shares.

2. What is over-subscription?

Ans. When the number of shares applied for is more than the number of shares offered for subscription, it is said to be over subscription.

3. What is meant by calls in arrear?

Ans. When a shareholder fails to pay the amount due on allotment or on calls, the amount remaining unpaid is known as calls in arrears. In other words, the amount called up but not paid is calls in arrear.

4. Write a short note on securities premium account.

Ans. When a company issues shares at a price more than the face value (nominal value), the shares are said to be issued at premium. The excess is called as premium amount and is transferred to securities premium account. Securities premium account is shown under reserves and surplus as a separate head in the Note to Accounts to the balance sheet.

5. Why are the shares forfeited?

Ans. When a shareholder defaults in making payment of allotment and/or call money, the shares may be forfeited. On forfeiture, the share allotment is cancelled and to that extent paid up share capital is reduced. The person ceases to be a shareholder of the company after the shares are forfeited.

III. SHORT ANSWER QUESTIONS.

1. State the differences between preference shares and equity shares.

Ans.

Basis		Equity shares	Preference shares
1.	Meaning	Equity shares are the ordinary shares of the company representing the part ownership of the shareholder in the company	Preference shares are the shares that carry preferential rights on the matters of payment of dividend and repayment of capital.
2.	Payment of dividend	The dividend is paid after the payment of all liabilities	Priority in payment of dividend over equity shareholders
3.	Rate of dividend	Fluctuating	Fixed
4.	Voting rights	Equity shares carry voting rights	Normally, preference shares do not carry voting rights
5.	Convertibility	Equity shares can never be converted	Preference shares can be converted into equity shares.

2. Write a brief note on calls in advance.

- Ans. (i) The excess amount paid over the called up value of a share is known as calls in advance.
- (ii) It is the excess money paid on application or allotment or calls. Such excess amount can be returned or adjusted towards future payment.
- (iii) If the company decides to adjust such amount towards future payment, the excess amount may also be transferred to a separate account called call in advance.
- (iv) Calls in advance does not form part of the company's share capital and no dividend is payable on such amount.
- (v) In the balance sheet, it should be shown under current liabilities.

3. What is reissue of forfeited shares?

- Ans. (i) Shares forfeited can be reissued by the company.
- (ii) The shares can be reissued at any price. But, the reissue price cannot be less than the amount unpaid on forfeited shares.
- (iii) **Example:** If a share of ₹10 on which ₹4 already been paid as application money is forfeited and reissued as fully paid up, then a maximum of ₹6 must be fixed as the new price ($10 - 4 = 6$)

- (iv) When forfeited shares are reissued at a premium, the amount of such premium will be credited to securities premium account.

4. Write a short note on

- (a) Authorised capital
(b) Reserve capital

Ans. (a) **Authorised capital :**

It means such capital as is authorised by the memorandum of association. It is the maximum amount which can be raised as capital. It is also known as registered capital or nominal capital.

(b) **Reserve capital :**

The company can reserve a part of its subscribed capital to be called up only at the time of winding up. It is called reserve capital.

5. What is meant by issue of shares for consideration other than cash?

Ans. A company may issue shares for consideration other than cash when the company acquires fixed assets such as land and buildings, machinery, etc under such situation, the following journal entries are to be passed.

Date	Particulars	L.F	Debit ₹	Credit ₹
	(i) For Purchase of asset : Respective asset A/c Dr To Vendor A/c		xxx	xxx
	(ii) For issue of shares : Vendor A/c Dr To Equity share capital A/c To Securities premium A/c (if issued at premium)		xxx	xxx xxx

A company may also issue shares a consideration for the purchase of business, to promoters for their services and to brokers and underwriters for commission.

IV. EXERCISES.

1. Progress Ltd. issued 50,000 ordinary shares of ₹10 each, payable ₹2 on application, ₹4 on allotment, ₹2 on first call and ₹2 on final call. All the shares are subscribed and amount was duly received. Pass journal entries.

Solution :

In the books of progress Ltd Journal entries

Date	Particulars	L.F	Debit ₹	Credit ₹
	Bank A/c (50,000 × 2) Dr To Share application A/c (Application money received)		1,00,000	1,00,000
	Share application A/c Dr To Share capital A/c (Transfer of share application money to share capital)		1,00,000	1,00,000
	Share allotment A/c Dr To Share capital A/c (Share allotment money due)		2,00,000	2,00,000
	Bank A/c Dr To Share allotment A/c (Allotment money received)		2,00,000	2,00,000
	Equity share first call A/c Dr To Share capital A/c (Share first call money due)		1,00,000	1,00,000
	Bank A/c Dr To Share first call A/c (Share first call money received)		1,00,000	1,00,000
	Share second and final call A/c Dr To Share capital A/c (Share second and final call money due)		1,00,000	1,00,000
	Bank A/c Dr To Share second and final call A/c (Share second and final call money received)		1,00,000	1,00,000



ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. In order to meet their production must be carried on a

- (a) small scale (b) large scale
(c) medium scale (d) none of these

[Ans. (b) large scale]

2. The capital of companies is divided into small units called

- (a) shares (b) debentures
(c) dividend (d) none of these

[Ans. (a) shares]

3. The money raised by issuing shares is called

- (a) Share capital (b) Dividend
(c) Equity capital (d) Share application

[Ans. (a) Share capital]

4. Profits are distributed among the shareholders in the form of

- (a) shares (b) dividends
(c) both (d) none of these

[Ans. (b) dividends]

5. Company is a voluntary association of persons which has separate

- (a) legal entity
(b) voluntary association
(c) common seal
(d) limited liability

[Ans. (a) legal entity]

6. The liability of the shareholders of the company is limited to the extent of face value of the shares held by the

- (a) shareholders (b) cardholders
(c) debenture holders (d) none of these

[Ans. (a) shareholders]

7. The capital of a company is divided into small units of

- (a) current amount (b) fixed amount
(c) capital amount (d) none of these

[Ans. (b) fixed amount]

8. Equity shares do not enjoy any

- (a) Equity rights (b) Preference rights
(c) Dividend of rights (d) Ordinary shares

[Ans. (b) Preference rights]

9. Equity shares are also known as

- (a) authorised capital (b) issued capital
(c) subscribed capital (d) ordinary shares

[Ans. (d) ordinary shares]

10. Authorised capital is also known as

- (a) paid up capital
(b) called up capital
(c) nominal capital
(d) subscribed capital

[Ans. (c) nominal capital]

11. Paid up capital is that part of called up capital which has been actually paid by the

- (a) shareholders (b) members
(c) cardholders (d) directors

[Ans. (a) shareholders]

12. Issue of equity shares to the public through prospectus by a public company is called

- (a) Public issue
(b) Private placement
(c) Rights issue
(d) Bonus issue

[Ans. (a) Public issue]

13. Issue of equity shares to the existing shareholders of the company through a letter of offer is known as

- (a) public issue
(b) rights issue
(c) bonus issue
(d) private placement

[Ans. (b) rights issue]

14. Issue of equity shares to the existing shareholders of the company free of cost out of an accumulated profit is known as

- (a) private placement (b) public issue
(c) rights issue (d) bonus issue

[Ans. (d) bonus issue]

15. First installment called

- (a) application money (b) allotment money
(c) first call money (d) final call money

[Ans. (a) application money]

16. Second installment called

- (a) first call money (b) allotment money
(c) final call money
(d) application money

[Ans. (b) allotment money]

COMPANY ACCOUNTS

Sura's XII Std - Accountancy

II. VERY SHORT ANSWER QUESTIONS.

1. Definition of a Company.

Ans. According to Lord Justice Lindley, "A company is an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profit and loss arising there from. The common stock so contributed is denoted in money and is the capital of the company. The persons who contributed in it or form it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share".

2. What is allotment?

Ans. (i) Allotment means acceptance by a company of the offer made by an applicant to take shares.

(ii) It is done by Board of Directors.

(iii) On allotment, the applicant becomes the shareholder or member of the company.

3. What is prorata allotment?

Ans. (i) In the case of over subscription, the shares are allotted to the public with certain number lesser than the number of shares they applied for, in certain basis.

(ii) It is called pro-rata allotment.

4. What are the differences between over subscription and under subscription?

Ans.

	Under subscription	Over subscription
1.	In under subscription, all the shares offered may not be taken up by the public.	In over subscription all the shares offered are taken up by the public
2.	The shares cannot be allotted, if the minimum subscription is not received	Here all shares are subscribed, so there is no question of minimum subscription
3.	Under subscription does not require any special treatment in journal entries	In over subscription additional journal entries are required for rejection and adjustment of application money

III. SHORT ANSWER QUESTIONS.

1. What are the characteristics of a company?

Ans. Following are the characteristics of a company:

- Voluntary association:** A company is a voluntary association of persons. No law can compel persons to form a company
- Separate legal entity:** Company is an artificial person. It has a separate legal entity which is separate and distinct from its members.
- Common seal:** A company may have a common seal which can be affixed on the documents.
- Perpetual succession:** A company continues for ever. Its continuity is not affected by the changes in its members. It can be wound up only by law.
- Limited liability:** The liability of the shareholders of the company is limited to the extent of face value of the shares held by the shareholders.
- Transferability of shares:** The shares of a company are freely transferable except in case of a private company.

2. Explains the divisions of share capital.

Ans. The share capital of a company is divided into the following categories:

(i) Authorised capital

It means such capital as is authorised by the memorandum of association. It is the maximum amount which can be raised as capital. It is also known as registered capital or nominal capital.

(ii) Issued capital

This represents that part of authorised capital which is offered for subscription.

(iii) Subscribed capital

It refers to that part of issued capital which has been applied for and also allotted by the company.

(iv) Called up capital

It refers to that part of subscribed capital which has been called up by the company for payment.

**(v) Paid up capital**

It is that part of called up capital which has been actually paid by the shareholders.

(vi) Reserve capital

The company can reserve a part of its subscribed capital to be called up only at the time of winding up. It is called reserve capital.

3. Write a short note on**(i) Public issue****(ii) Private placement****(i) Public issue**

Issue of equity shares to the public through prospectus by a public company is called public issue. It includes initial public offer and further public offer.

(ii) Private placement

Private placement means any offer of equity shares or invitation to subscribe equity shares to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in Section 42 of the Indian Companies Act, 2013.

4. Write a short note on**(i) Rights issue****(ii) Bonus issue****Ans. (i) Rights issue**

Issue of equity shares to the existing shareholders of the company through a letter of offer is known as rights issue.

(ii) Bonus issue

Issue of equity shares to the existing shareholders of the company free of cost out of accumulated profit is known as bonus issue.

IV. PROBLEMS

1. Preeti Ltd. invited applications for 5,000 shares of ₹ 10 each payable as follows
 ₹ 3 on Application,
 ₹ 2 on Allotment,
 ₹ 2 on First call and
 ₹ 3 on Final call.

All these shares were subscribed and paid for. Pass journal entries.

Solution :

Journal Entries in the Books of Preeti Ltd.

Date	Particulars	L.F	Debit ₹	Credit ₹
	Bank A/c Dr. To Share Application A/c (money received on 5,000 shares @ ₹3 per share)		15,000	15,000
	Share Application A/c Dr. To Share Capital A/c (Transfer of application money on 5,000 shares @ ₹3 each)		15,000	15,000
	Share Allotment A/c Dr. To Share Capital A/c (amount due on the allotment of 5,000 shares @ ₹2 per share)		10,000	10,000
	Bank A/c Dr. To Share Allotment A/c (Allotment money received on 5,000 shares @ ₹2 per share)		10,000	10,000
	Share First call A/c Dr. To Share Capital A/c (First call money due on 5,000 shares @ ₹2 per share)		10,000	10,000
	Bank A/c Dr. To Share First call A/c (First call money received for 5,000 shares @ ₹2 per share)		10,000	10,000
	Share Final call A/c Dr. To Share Capital A/c (Final call money due on 5,000 shares @ ₹3 per share)		15,000	15,000
	Bank A/c Dr. To Share Final call A/c (Final call money received for 5,000 shares @ ₹3 per share)		15,000	15,000

UNIT

8

FINANCIAL STATEMENT ANALYSIS

CHAPTER SNAPSHOT

- 8.1 Introduction
- 8.2 Financial statements
 - 8.2.1 Meaning of financial statements
 - 8.2.2 Features of financial statements
 - 8.2.3 Significance of financial statements
 - 8.2.4 Limitations of financial statements
- 8.3 Financial statements of companies
- 8.4 Financial statement analysis
 - 8.4.1 Meaning of financial statement analysis
 - 8.4.2 Objectives of financial statement analysis
 - 8.4.3 Limitations of financial statement analysis
- 8.5 Tools of financial statement analysis
- 8.6 Preparation of comparative statements
- 8.7 Preparation of common - size statements
- 8.8 Trend analysis



Important Points

- ❑ The term financial statements generally refer to two basic statement income statement and balance sheet.
- ❑ Notes and schedules also form part of financial statements.
- ❑ The tools of financial statement analysis include comparative statement, common size statement, Trend analysis, Funds flow analysis and cash flow analysis.
- ❑ A statement giving comparison of net increase or decrease in the individual items of financial statements of two or more years of a business concern is called comparative statement.
- ❑ The common-size statements show the relationship of various items with some common base expressed as percentage of the common base.
- ❑ Trend analysis refers to the study of movement of figures over a period.

SELF-EXAMINATION QUESTIONS

I MULTIPLE CHOICE QUESTIONS

CHOOSE THE CORRECT ANSWER

1. Which of the following statements is not true?

- (a) Notes and schedules also form part of financial statements.
- (b) The tools of financial statement analysis include common-size statement
- (c) Trend analysis refers to the study of movement of figures for one year
- (d) The common-size statements show the relationship of various items with some common base, expressed as percentage of the common base

[Ans. (c) Trend analysis refers to the study of movement of figures for one year]

2. Balance sheet provides information about the financial position of a business concern

- (a) Over a period of time
- (b) As on a particular date
- (c) For a period of time
- (d) For the accounting period

[Ans. (b) As on a particular date]

3. Which of the following tools of financial statement analysis is suitable when data relating to several years are to be analysed?

- (a) Cash flow statement
- (b) Common size statement
- (c) Comparative statement
- (d) Trend analysis **[Ans. (d) Trend analysis]**

4. The financial statements do not exhibit

- (a) Non-monetary data
- (b) Past data
- (c) Short term data
- (d) Long term data

[Ans. (a) Non-monetary data]

5. Which of the following is not a tool of financial statement analysis?

- (a) Trend analysis
- (b) Common size statement
- (c) Comparative statement
- (d) Standard costing

[Ans. (d) Standard costing]

FINANCIAL STATEMENT ANALYSIS

Sura's XII Std - Accountancy

6. The term 'fund' refers to
 (a) Current liabilities (b) Working capital
 (c) Fixed assets
 (d) Non-current assets
[Ans. (b) Working capital]
7. Which of the following statements is not true?
 (a) All the limitations of financial statements are applicable to financial statement analysis also.
 (b) Financial statement analysis is only the means and not an end.
 (c) Expert knowledge is not required in analysing the financial statements.
 (d) Interpretation of the analysed data involves personal judgement.
[Ans. (c) Expert knowledge is not required in analysing the financial statements.]
8. A limited company's sales has increased from ₹ 1,25,000 to ₹ 1,50,000. How does this appear in comparative income statement?
 (a) + 20 % (b) + 120 %
 (c) - 120 % (d) - 20 %
[Ans. (a) + 20 %]

Hint :

$$\begin{aligned} \text{Comparative income statement} \\ &= 1,25,000 - 1,50,000 = +25,000 \\ &= \frac{+25,000}{1,25,000} \times 100 = +20\% \end{aligned}$$

9. In a common-size balance sheet, if the percentage of non-current assets is 75, what would be the percentage of current assets?
 (a) 175 (b) 125
 (c) 25 (d) 100 **[Ans. (c) 25]**

Hint :

$$\begin{aligned} \text{Total assets} &= \text{Current assets} - \text{Non-current assets} \\ 100 &= x - 75 \\ \therefore x &= 100 - 75 = 25 \\ \therefore \text{Current assets} &= 25. \end{aligned}$$

10. Expenses for a business for the first year were ₹ 80,000. In the second year, it was increased to ₹ 88,000. What is the trend percentage in the second year?
 (a) 10 % (b) 110 %
 (c) 90 % (d) 11 %
[Ans. (b) 110%]

Hint :

$$\text{Trend percentage} = \frac{88,000}{80,000} \times 100 = 110\%$$

II VERY SHORT ANSWER QUESTIONS

1. What are financial statements?

Ans. Financial statements are the statements prepared by the business concern at the end of the accounting period to ascertain the operating results and the financial position. The basic financial statements prepared by business concerns are income statement and balance sheet.

2. List the tools of financial statement analysis.

Ans. Following are the commonly used tools of financial statement analysis

- (i) Comparative statement
- (ii) Common-size statement
- (iii) Trend analysis
- (iv) Funds flow analysis
- (v) Cash flow analysis

3. What is working capital?

Ans. The term 'fund' refers to working capital. Working capital refers to the excess of current assets over current liabilities.

4. When is trend analysis preferred to other tools?

Ans. Trend analysis refers to the study of movement of figures over a period. The trend may be increasing trend or decreasing trend or irregular. When data for more than two years are to be analysed, it may be difficult to use comparative statement.

III SHORT ANSWER QUESTIONS:

1. 'Financial statements are prepared based on the past data'. Explain how this is a limitation.

Ans. Following are the limitations of financial statements.

(i) Lack of qualitative information :

Qualitative information that is non-monetary information is also important for business decisions.

(ii) Record of historical data :

Financial statements are prepared based on historical data. They may not reflect the current position.

2. Write a short note on cash flow analysis.

Ans. (i) Cash flow analysis is concerned with preparation of cash flow statement which shows the inflow and outflow of cash and cash equivalents in a given period of time.

- (ii) Cash includes cash in hand and demand deposits with banks.
- (iii) Cash equivalents denote short term investments which can be realised easily within a short period of time, without much loss in value.
- (iv) Cash flow analysis helps in assessing the liquidity and solvency of a business concern.

3. Briefly explain any three limitations of financial statements.

Ans. (i) Give only interim reports:

Financial statements are prepared at the end of every accounting period. But the actual position of the business can be known only when the business is closed.

(ii) Limited access to external users:

The external users do not have detailed and frequent information of financial results as they have limited access.

(iii) Influenced by personal judgement:

Preparation of financial statements may be influenced by personal judgements and therefore these are not free from bias.

4. Explain the steps involved in preparing comparative statement.

Ans. A comparative statement has five columns. Following are the steps to be followed in preparation of the comparative statement.

- (i) **Column 1:** In this column, particulars of items of income statement or balance sheet are written.
- (ii) **Column 2:** Enter absolute amount of year 1
- (iii) **Column 3:** Enter absolute amount of year 2
- (iv) **Column 4:** Show the difference in amounts between year 1 and year 2. If there is an increase in year 2, put plus sign and if there is decrease put minus sign.
- (v) **Column 5:** Show percentage increase or decrease of the difference amount shown in column 4 by dividing the amount shown in column 4 (absolute amount of increase or decrease) by column 2 (year 1 amount). That is,

$$\text{Percentage increase or decrease} = \frac{\text{Absolute amount of increase or decrease}}{\text{Year 1 amount}} \times 100$$

Format of comparative statement:

Particular	Year 1	Year 2	Absolute amount of increase (+) or Decrease (-)	Percentage increase (+) or decrease (-)
	₹	₹		
(1)	(2)	(3)	(4)	(5)

5. Explain the procedure for preparing common-size statement.

Ans. Common-size statement can be prepared with three columns. Following are the steps to be followed in preparation of common-size statement:

- (i) **Column 1:** In this column, particulars of items of income statement or balance sheet are written.
- (ii) **Column 2:** Enter absolute amount.
- (iii) **Column 3:** Choose a common base as 100. For example, revenue from operations can be taken as the base for income statement and total of balance sheet can be taken as the base for balance sheet. Work out the percentage for all the items of column 2 in terms of the common base and enter them in column 3.

Format of common-size statement:

Particulars	Absolute amount	Percentage

IV. EXERCISES:

COMPARATIVE STATEMENT ANALYSIS

1. From the following particulars, prepare comparative income statement of Arul Ltd.

Particulars	2015-16 ₹	2016-17 ₹
Revenue from operations	50,000	60,000
Other income	10,000	30,000
Expenses	40,000	50,000

Solution : Comparative income statement of Arul Ltd for the years ended 31st March 2016 and 31st March 2017

Particulars	2015-16	2016-17	Absolute amount of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
Revenue from Operations	50,000	60,000	+ 10,000	+ 20
Add : Other income	10,000	30,000	+ 20,000	+ 200
Total revenue	60,000	90,000	+ 30,000	+ 50
Less : Expenses	40,000	50,000	+ 10,000	+ 25
Profit before tax	20,000	40,000	+ 20,000	100

Note:

Computation of percentage increase for revenue form operations = $\frac{10,000}{50,000} \times 100 = 20\%$

Percentage increase for other incomes = $\frac{20,000}{10,000} \times 100 = 200\%$

Percentage increase for expenses = $\frac{10,000}{40,000} \times 100 = 25\%$

2. From the following particulars, prepare comparative income statement of Barani Ltd.

Particulars	2016-17 ₹	2017-18 ₹
Revenue from operations	30,000	45,000
Other income	4,000	6,000
Expenses	10,000	15,000
Income tax	30%	30%

Solution : Comparative income statement of Barani Ltd. for the years ended 2017 and 2018

Particulars	2016-17 ₹	2017-18 ₹	Absolute amount of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
Revenue from Operations	30,000	45,000	+ 15,000	+ 50
Add : Other income	4,000	6,000	+ 2,000	+ 50
Total revenue	34,000	51,000	+ 17,000	+ 50
Less : Expenses	10,000	15,000	+ 5,000	+ 50
Profit before tax	24,000	36,000	+ 12,000	+ 50
Less : Tax (30%)	7,200	10,800	+ 3,600	+ 50
Profit after tax	16,800	25,200	+ 8,400	+ 50

Note:

$$\text{Percentage increase for revenue from operations} = \frac{15,000}{30,000} \times 100 = 50\%$$

$$\text{Percentage increase for other incomes} = \frac{2000}{4000} \times 100 = 50\%$$

$$\text{Percentage increase for expenses} = \frac{5,000}{10,000} \times 100 = 50\%$$

$$\text{Percentage increase for Tax} = \frac{3,600}{7,200} \times 100 = 50\%$$

3. From the following particulars, prepare comparative income statement of Daniel Ltd.

Particulars	2015-16 ₹	2016-17 ₹
Revenue from operations	40,000	50,000
Operating expenses	25,000	27,500
Income tax (% of the profit before tax)	30	30

Solution :**Comparative income statement of Daniel Ltd for the year ended 2016 and 2017**

Particulars	2015-16 ₹	2016-17 ₹	Absolute amount of increase (+) or decrease (-) ₹	Percentage increase (+) or decrease (-)
Revenue from Operations	40,000	50,000	+ 10,000	+ 25
Less : Operating expenses	25,000	27,500	+ 2,500	+ 10
Profit before tax	15,000	22,500	+ 7,500	+ 50
Less : Income tax	4,500	6750	+ 2,250	+ 50
Profit after tax	10,500	15,750	+ 5,250	+ 50

Note:

$$\text{Percentage increase for revenue from operations} = \frac{10,000}{40,000} \times 100 = 25\%$$

$$\text{Percentage increase for operating expenses} = \frac{2,500}{25,000} \times 100 = 10\%$$

$$\text{Percentage increase for profit before tax} = \frac{7,500}{15,000} \times 100 = 50\%$$

$$\text{Percentage increase for income for Income tax} = \frac{2250}{4500} \times 100 = 50\%$$

$$\text{Percentage increase for profit after tax} = \frac{5250}{10,500} \times 100 = 50\%$$

10. Prepare common-size statement of financial position for the following particulars of Rani Ltd.

Particulars	31 st March, 2016 ₹	31 st March, 2016 ₹
I EQUITY AND LIABILITIES		
Shareholders' Fund	5,40,000	6,40,000
Non-current liabilities	2,70,000	2,50,000
Current liabilities	90,000	1,50,000
Total	4,00,000	10,00,000
II ASSETS		
Non-current assets	7,20,000	8,00,000
Current assets	1,80,000	2,00,000
Total	9,00,000	10,00,000

Solution :

**Common-size balance sheet of Rani Ltd for the year ended
31st March, 2016 and 31st March, 2017**

Particulars	Absolute amount 2015-16	Percentage of total assets	Absolute amount 2016-17	Percentage of total assets
	₹	₹	₹	
I Equity and Liabilities				
Share holder's funds	5,40,000	60	6,00,000	60
Non-current liabilities	2,70,000	30	2,50,000	25
Current liabilities	90,000	10	1,50,000	15
Total	9,00,000	100	10,00,000	100
II Assets				
Non-current assets	7,20,000	80	8,00,000	80
Current assets	1,80,000	20	2,00,000	20
Total	9,00,000	100	10,00,000	100

Note: In 2015-16

$$\text{Percentage of shareholders fund} = \frac{5,40,000}{9,00,000} \times 100 = 60\%$$

$$\text{Percentage of Non-current liabilities} = \frac{2,70,000}{9,00,000} \times 100 = 30\%$$

$$\text{Percentage of current liabilities} = \frac{90,000}{9,00,000} \times 100 = 10\%$$

$$\text{Percentage of non-current assets} = \frac{7,20,000}{9,00,000} \times 100 = 80\%$$

$$\text{Percentage of current assets} = \frac{1,80,000}{9,00,000} \times 100 = 20\%$$

In 2016-17

$$\text{Percentage of share holders fund} = \frac{6,00,000}{10,00,000} \times 100 = 60\%$$

FINANCIAL STATEMENT ANALYSIS

Sura's XII Std - Accountancy

$$\begin{aligned} \text{Percentage of Non-current liabilities} &= \frac{2,50,000}{10,00,000} \times 100 = 25\% \\ \text{Percentage of current liabilities} &= \frac{1,50,000}{10,00,000} \times 100 = 15\% \\ \text{Percentage of Non-current assets} &= \frac{8,00,000}{10,00,000} \times 100 = 80\% \\ \text{Percentage of current assets} &= \frac{2,00,000}{10,00,000} \times 100 = 20\% \end{aligned}$$

11. Prepare common-size statement of financial position for the following particulars of Yasmin Ltd. and Sakthi Ltd.

Particulars	Yasmin Ltd. ₹	Sakthi Ltd. ₹
I EQUITY AND LIABILITIES		
1. Shareholders' Fund		
a) Share capital	2,00,000	3,00,000
b) Reserves and surplus	50,000	60,000
2. Non-current liabilities		
Long-term borrowings	1,50,000	1,80,000
3. Current liabilities		
Trade payables	1,00,000	60,000
Total	5,00,000	6,00,000
II ASSETS		
1. Non-current assets		
a) Fixed assets	2,00,000	3,00,000
b) Non - current investments	50,000	1,20,000
2. Current assets		
Inventories	2,00,000	90,000
Cash and cash equivalents	50,000	90,000
Total	5,00,000	6,00,000

Solution :

Common-size balance sheet of Yasmin Ltd and Sakthi Ltd

Particulars	Yasmin Ltd		Sakthi Ltd	
	Absolute amount ₹	Percentage of total assets	Absolute Amount ₹	Percentage of total assets
I Equity and liabilities				
1. Shares holder's fund				
a. Share capital	2,00,000	40	3,00,000	50
b. Reserve and surplus	50,000	10	60,000	10
2. Non-current liabilities				
Long-term borrowings	1,50,000	30	1,80,000	30
3. Current liabilities				
Trade payables	1,00,000	20	60,000	10
Total	5,00,000	100	6,00,000	100
II. Assets				
1. Non-current assets				
a. Fixed assets	2,00,000	40	3,00,000	50
b. Non - current investments	50,000	10	1,20,000	20
2. Current assets				
Inventories	2,00,000	40	90,000	15
Cash and cash equivalents	50,000	10	90,000	15
Total	5,00,000	100	6,00,000	100

Note: Yasmin Ltd.

$$\text{Percentage of Share capital} = \frac{2,00,000}{5,00,000} \times 100 = 40\%$$

$$\text{Percentage of Reserves and surplus} = \frac{50,000}{5,00,000} \times 100 = 10\%$$

$$\text{Percentage of Long-term borrowing} = \frac{1,50,000}{5,00,000} \times 100 = 30\%$$

$$\text{Percentage of Trade payables} = \frac{1,00,000}{5,00,000} \times 100 = 20\%$$

$$\text{Percentage of fixed assets} = \frac{2,00,000}{5,00,000} \times 100 = 40\%$$

$$\text{Percentage of Non-current investment} = \frac{50,000}{5,00,000} \times 100 = 10\%$$

$$\text{Percentage of inventories} = \frac{2,00,000}{50,000} \times 100 = 40\%$$

$$\text{Percentage of cash and cash equivalents} = \frac{50,000}{5,00,000} \times 100 = 10\%$$

Note: Sakthi Ltd.

Percentage of Share capital	=	$\frac{3,00,000}{6,00,000} \times 100 = 50\%$
Percentage of Reserves and surplus	=	$\frac{60,000}{6,00,000} \times 100 = 10\%$
Percentage of Long-term borrowing	=	$\frac{1,80,000}{6,00,000} \times 100 = 30\%$
Percentage of Trade payables	=	$\frac{60,000}{6,00,000} \times 100 = 10\%$
Percentage of fixed assets	=	$\frac{3,00,000}{6,00,000} \times 100 = 50\%$
Percentage of Non-current investment	=	$\frac{1,20,000}{6,00,000} \times 100 = 20\%$
Percentage of Inventories	=	$\frac{90,000}{6,00,000} \times 100 = 15\%$
Percentage of cash and cash equivalents	=	$\frac{90,000}{6,00,000} \times 100 = 15\%$

Trend analysis :

12. From the following particulars, calculate the trend percentages of Kala Ltd.

Particulars	₹ in thousands		
	2015-16	2016-17	2017-18
Revenue from operations	400	500	600
Other income	100	150	200
Expenses	200	290	350

Solution :

Trend analysis for kala ltd

Particulars	₹ in thousands			Trends percentage		
	2015-16	2016-17	2017-18	2015-16	2016-17	2017-18
Revenue from operations	400	500	600	100	125	150
Add: Other income	100	150	200	100	150	200
Total revenue	500	650	800	100	130	160
Less: Expenses	200	290	350	100	145	175
Profit after tax	300	360	450	100	120	150

Note: 2016 - 17.

Percentage for Revenue from operations	=	$\frac{500}{400} \times 100 = 125\%$
Percentage of other income	=	$\frac{150}{100} \times 100 = 150\%$
Percentage of total revenue	=	$\frac{650}{500} \times 100 = 130\%$

$$\text{Percentage for expenses} = \frac{290}{500} \times 100 = 145\%$$

$$\text{Percentage for profit before tax} = \frac{360}{300} \times 100 = 120\%$$

In 2017 - 18.

$$\text{Percentage for revenue from operations} = \frac{600}{400} \times 100 = 150\%$$

$$\text{Percentage for other income} = \frac{200}{100} \times 100 = 200\%$$

$$\text{Percentage of total revenue} = \frac{800}{500} \times 100 = 160\%$$

$$\text{Percentage for expenses} = \frac{350}{200} \times 100 = 175\%$$

$$\text{Percentage for profit before tax} = \frac{450}{300} \times 100 = 150\%$$

13. From the following particulars, calculate the Trend percentages of Kavitha Ltd.

Particulars	₹ in thousands		
	2015-16	2016-17	2017-18
Revenue from operations	100	125	150
Other income	20	25	30
Expenses	100	120	80
Income Tax	30%	30%	30%

Solution :

Trend analysis for Kavitha Ltd.

Particular	₹ in thousands			Trends percentage		
	2015-16	2016-17	2017-18	2015-16	2016-17	2017-18
Revenue from operations	100	125	150	100	125	150
Add : Other income	20	25	30	100	125	150
Total revenue	120	150	180	100	125	150
Less : Expenses	100	120	80	100	120	80
Project before tax	20	30	100	100	150	500
Less Income tax (30%)	6	9	30	100	150	500
Profit after tax	14	21	70	100	150	500

Note: 2016 - 17.

$$\text{Percentage for Revenue from operations} = \frac{125}{100} \times 100 = 125\%$$

$$\text{Percentage of other income} = \frac{25}{20} \times 100 = 125\%$$

FINANCIAL STATEMENT ANALYSIS

Sura's XII Std - Accountancy

$$\begin{aligned} \text{Percentage of total revenue} &= \frac{150}{120} \times 100 = 125\% \\ \text{Percentage for expenses} &= \frac{120}{100} \times 100 = 120\% \\ \text{Percentage for before tax} &= \frac{30}{20} \times 100 = 150\% \\ \text{Percentage for profit before tax} &= \frac{21}{14} \times 100 = 150\% \end{aligned}$$

In 2017 - 18.

$$\begin{aligned} \text{Percentage for revenue from operations} &= \frac{150}{100} \times 100 = 150\% \\ \text{Percentage for other income} &= \frac{25}{20} \times 100 = 125\% \\ \text{Percentage of total revenue} &= \frac{180}{120} \times 100 = 150\% \\ \text{Percentage for expenses} &= \frac{80}{100} \times 100 = 80\% \\ \text{Percentage for profit before tax} &= \frac{100}{20} \times 100 = 500\% \\ \text{Percentage for profit after tax} &= \frac{70}{14} \times 100 = 500\% \end{aligned}$$

14. From the following particulars, calculate the trend percentages of Kumar Ltd.

Particulars	₹ in thousands		
	2015-16	2016-17	2017-18
Revenue from operations	300	270	150
Other income	50	80	60
Expenses	250	200	125
Income Tax	40	40	40

Solution :**Trend analysis for Kumar Ltd**

Particulars	₹ in thousands			Trends percentage		
	2015-16	2016-17	2017-18	2015-16	2016-17	2017-18
Revenue from operations	300	270	150	100	90	50
Add : Other income	50	80	60	100	160	120
	350	350	210	100	100	60
Less : Expenses	250	200	125	100	80	50
Profit before tax	100	150	85	100	150	85
Less Income tax (40%)	40	60	34	100	150	85
Profit after tax	60	90	51	100	150	85

Note: 2016 - 17.

$$\text{Percentage for Revenue from operation} = \frac{270}{300} \times 100 = 90\%$$

$$\text{Percentage of other income} = \frac{80}{50} \times 100 = 160\%$$

$$\text{Percentage for expenses} = \frac{200}{250} \times 100 = 80\%$$

$$\text{Percentage for before tax} = \frac{150}{100} \times 100 = 150\%$$

$$\text{Percentage for profit after tax} = \frac{90}{60} \times 100 = 150\%$$

In 2017 - 18.

$$\text{Percentage for revenue from operations} = \frac{150}{300} \times 100 = 50\%$$

$$\text{Percentage for other income} = \frac{60}{50} \times 100 = 120\%$$

$$\text{Percentage for expenses} = \frac{125}{250} \times 100 = 85\%$$

$$\text{Percentage for profit before tax} = \frac{85}{100} \times 100 = 85\%$$

$$\text{Percentage for income tax 40\%} = \frac{34}{40} \times 100 = 85\%$$

15. From the following particulars, calculate the trend percentages of Anu Ltd.

Particulars	₹ in thousands		
	Year 1	Year 2	Year 3
I EQUITY AND LIABILITIES			
Shareholders' Fund	500	550	600
Non-current liabilities	200	250	240
Current liabilities	100	80	120
Total	800	880	960
II ASSETS			
Non-current assets	600	720	780
Current assets	200	160	180
Total	800	880	960

Solution :

Trend analysis for Anu Ltd

Particulars	₹ in thousands			Trends percentage		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
I. Equity and liabilities						
Shares holder's fund	500	550	600	100	110	120
Non-current liabilities	200	250	240	100	125	120
Current liabilities	100	80	120	100	80	120
Total	800	880	960	100	110	120
II. Assets						
Non-current assets	600	720	780	100	120	130
Current assets	200	100	180	100	80	90
Total	800	880	960	100	110	120

16. From the following particulars, calculate the trend percentages of Babu Ltd.

Particulars	₹ in thousands		
	Year 1	Year 2	Year 3
I EQUITY AND LIABILITIES			
1. Shareholders' Fund			
a) Share capital	100	127	106
b) Reserves and surplus	30	30	45
2. Non-current liabilities			
Long-term borrowings	70	77	84
3. Current liabilities			
Trade payables	20	30	40
Total	220	264	275
II ASSETS			
1. Non-current assets			
a) Fixed assets	100	118	103
b) Non-current investments	40	50	60
2. Current assets			
Inventories	60	66	72
Cash and cash equivalents	20	30	40
Total	220	264	274

Solution :

Trends analysis for Babu Ltd

Particular	₹ in thousands			Trends percentage		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
I Equity and liabilities						
1. Shareholder's fund						
a. Share capital	100	127	106	100	127	106
b. Reserve and surplus	30	30	45	100	100	150
2. Non-current liabilities						
Long-term borrowings	70	77	84	100	110	120
3. Current liabilities						
Trade payables	20	30	40	100	150	200
Total	220	264	275	100	120	125
II. Assets						
1. Non-current assets						
a. Fixed assets	100	118	103	100	118	103
b. Non -investment	40	50	60	100	125	150
2. Current assets						
Inventories	60	66	72	100	110	120
Cash and cash equivalents	20	30	40	100	150	200
Total	220	264	275	100	120	125

ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. Which statement are prepared by the business concerns at the end of the accounting period to ascertain the operating results and the financial position?

- (a) Trend analysis
 (b) Income statement
 (c) Financial statement (d) Balance sheet

[Ans. (c) Financial statement]

2. Financial statements are prepared based on

- (a) past data (b) future cost
 (c) terminal cost (d) historical cost

[Ans. (d) historical cost]

3. which statements are involve personal judgment in certain cases?

- (a) Financial statements
 (b) Income statement
 (c) Profit and loss account statement
 (d) None of these

[Ans. (a) Financial statements]

4. Different tools are used for analysing the

- (a) balance sheet
 (b) financial statement
 (c) income statement (d) none of these

[Ans. (b) financial statement]

5. The term fund refers to

- (a) Working capital (b) Opening capital
 (c) Closing capital (d) None of these

[Ans. (a) Working capital]

6. When figure relating to several years are considered for the purpose of analysis, the analysis is called

- (a) Horizontal analysis
 (b) Vertical analysis
 (c) Trend analysis
 (d) Cash flow analysis

[Ans. (a) Horizontal analysis]

II. VERY SHORT ANSWER QUESTIONS :

1. Write a short note on i) Intra-firm comparison
ii) Inter-firm comparison

Ans. (i) Intra-firm comparison is comparison within the organisation among different departments, division etc.

(ii) Inter-firm comparison is comparison of one firm with other firm or firms in the industry.

2. What is trend analysis?

Ans. Trend refers to the tendency of movement. Trend analysis refers to the study of movement of figures over a period. The trend may be increasing trend or decreasing trend or irregular.

3. What is funds flow analysis?

Ans. Funds flow analysis is concerned with preparation of funds flow statement which shows the inflow and outflow of funds in a given period of time. Funds flow analysis is useful in judging the credit worthiness, financial planning and preparation of budgets.

4. What do you mean by financial statement analysis?

Ans. Financial statement analysis is comparison of the various items in the financial statements by establishing and evaluating relationship among them. So that, it gives a better understanding of the performance and financial status of the business concern.

III. SHORT ANSWER QUESTIONS :

1. What are the features of financial statements?

Ans. Following are the features of financial statements.

(i) Financial statements are generally prepared at the end of an accounting period based on transactions recorded in the books of accounts.

(ii) These statements are prepared for the organisation as a whole

(iii) Information is presented in a meaningful way by grouping items of similar nature such as fixed assets and current assets.

(iv) Financial statements involve personal judgement in certain cases.

(v) Financial statements are prepared based on historical cost.

2. What are the significance of financial statements?

Ans. The significance of financial statements to various stakeholders is as follows.

- (i) To management:**

Financial statements provide information to the management to take decision and to have control over business activities in various areas.

- (ii) To shareholders:**

Financial statements help the shareholders to know whether the business has potential for growth and to decide to continue their shareholding.

- (iii) To creditors:**

Creditors can get information about the ability of the business to repay the debts from financial statements.

- (iv) To bankers:**

Information given in the financial statements is significant to the bankers to assess whether there is adequate security to cover the amount of the loan or overdraft.

- (v) To government:**

Financial statements are significant to government to assess the tax liability of business concerns and to frame and amend industrial policies.

3. What are the objectives of financial statement analysis?

Ans. Financial statement analysis may be done with any of the following objectives.

(i) To analyse the profitability and earning capacity.

(ii) To study the long term and short term solvency of the business.

(iii) To determine the efficiency in operations and use of assets.

(iv) To determine the trend in sales, production etc.

(v) To forecast for future and prepare budgets.

(vi) To make inter-firm and intra-firm comparisons.

4. Briefly explain any three limitations of financial statement analysis. S. A

Ans. Following are the limitations of financial statement analysis.

(i) All the limitations of financial statements such as ignoring non-monetary information, ignoring price level changes, etc., are applicable to financial statement analysis also.

FINANCIAL STATEMENT ANALYSIS

Sura's XII Std - Accountancy

- (ii) Expert knowledge is required in analysing the financial statements.
- (iii) Interpretation of the analysed data involves personal judgement as different experts may give different views.

5. Write a short note on a) Comparative statement b) Common-size statement

Ans. (a) Comparative statement

- (i) A statement giving comparison of the net increase or decrease in the individual items of financial statements of two or more years of a business concern is called comparative statement.
- (ii) It shows the actual figures at different periods of time, the increase or decrease in these figures in absolute terms and the percentages of such increase or decrease.

(b) Common-size statement:

- (i) The common-size statements show the relationship of various items with some common base, expressed as percentage of the common base.

- (ii) The common size statements include common-size income statement and common-size balance sheet.

6. Write a note on i) Horizontal analysis ii) Vertical analysis

Ans. (i) Horizontal analysis

- (1) When figures relating to several years are considered for the purpose of analysis, the analysis is called horizontal analysis.
- (2) Comparative statements and trend percentages are examples of horizontal analysis.

(ii) Vertical analysis :

- (1) When figures relating to one accounting year alone are considered for the purpose of analysis, the analysis is called vertical analysis.
- (2) Preparation of common size statements and computation of ratios are examples of vertical analysis.

IV. Problems

1. From the following particulars, prepare comparative income statement of Sivakami co Ltd

Particulars	2016-17 ₹	2017-2018 ₹
Revenue from operations	4,00,000	5,00,000
other income	1,00,000	80,000
Expenses	3,00,000	2,40,000

Solution :

**Comparative income statement of Sivakami Ltd for the years ended
31st March, 2017 and 31st March, 2018**

Particulars	2016-17	2017-18	Absolute amount of increase of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
	₹	₹		
Revenue from operations	4,00,000	5,00,000	+ 1,00,000	+ 25
Add: Other income	1,00,000	80,000	- 20,000	- 20
Total revenue	5,00,000	5,80,000	80,000	+ 16
Less: Expenses	3,00,000	2,40,000	- 60,000	- 20
Profit before tax	2,00,000	3,40,000	1,40,000	70%

Note:

$$\text{Percentage increase for revenue from operations} = \frac{1,00,000}{4,00,000} \times 100 = 25\%$$

$$\text{Percentage decrease for other income} = \frac{-20,000}{1,00,000} \times 100 = -20\%$$

$$\text{Percentage increase for total revenue} = \frac{10,80,000}{5,00,000} \times 100 = 16\%$$

$$\text{Percentage increase for Expense} = \frac{-60,000}{3,00,000} \times 100 = 20\%$$

$$\text{Percentage increase for profit before tax} = \frac{1,40,000}{2,00,000} \times 100 = 70\%$$

2. From the following balance sheet of Gupta Ltd, prepare comparative balance sheet as on 31st March 2017 and 31st March 2018.

Particulars	31 st March 2017	31 st March 2018
	₹	₹
I. Equity and liabilities		
shareholder's fund	2,00,000	5,20,000
Non-current liabilities	1,00,000	1,20,000
Current liabilities	50,000	60,000
Total	3,50,000	7,00,000
II. Assets		
Non-current assets	2,00,000	4,00,000
Current assets	1,50,000	3,00,000
Total	3,50,000	7,00,000

Solution :

Comparative balance sheet of Gupta Ltd as on 31 st March 2017 and 31 st March 2018				
Particulars	2016-17	2017-18	Absolute amount of increase (+) or decrease (-)	Percentage increase (+) or decrease (-)
	₹	₹	₹	
I. Equity and liabilities				
Shareholder's fund	2,00,000	5,20,000	+ 3,20,000	+ 160
Non-current liabilities	1,00,000	1,20,000	+ 20,000	+ 20
Current liabilities	50,000	60,000	+ 10,000	+ 20
Total	3,50,000	7,00,000	3,50,000	+ 100
II. Assets				
Non-current assets	2,00,000	4,00,000	+ 2,00,000	+ 100
Current assets	1,50,000	3,00,000	+ 1,50,000	+ 100
Total	3,50,000	7,00,000	3,50,000	+ 100

3. From the following particulars of Vijay Ltd, prepare common size income statement for the year ended 31st March 2017 and 31st March 2018

Particulars	2016-17 ₹	2017-2018 ₹
Revenue from operations	4,00,000	6,00,000
Other income	50,000	1,50,000
Expenses	5,00,000	3,00,000
Income tax %	40	40

Solution : Common-size income statement of Vijay Ltd for the year ended 31st March 2017 and 31st March 2018

Particulars	Absolute amount 2016-17	Percentage of revenue from operations for 2016-17	Absolute amount 2017-18	Percentage of revenue from operations for 2017-18
	₹	₹	₹	
Revenue from operations	4,00,000	100	6,00,000	100
Add: other income	50,000	12.50	1,50,000	25
Total revenue	4,50,000	112.50	7,50,000	125
Less: Expenses	5,00,000	125	3,00,000	50
Profit / Loss before tax	- 50,000	- 12.50	10,50,000	125
Less: Income Tax (40 %)	-	-	4,20,000	70
Profit before tax	- 50,000	- 12.50	6,30,000	55

4. Prepare common-size statement of financial position of Raheem Ltd as on 31st March 2016 and 31st March 2018.

Particulars	31 st March 2016	31 st March 2017
	₹	₹
I. Equity and liabilities		
1. Shareholders fund		
a. Share capital	5,00,000	6,00,000
b. Reserve and surplus	4,00,000	3,60,000
2. Non-current liabilities		
Long-term borrowings	8,00,000	2,40,000
3. Current liabilities		
Trade payables	30,000	-
Total	20,00,000	12,00,000
II. Assets		
1. Non-current assets		
a. Fixed assets	10,00,000	6,00,000
b. Non-current investments	5,00,000	2,40,000
2. Current assets		
Inventories	3,00,000	1,20,000
Cash and cash equipments	2,00,000	2,40,000
Total	20,00,000	12,00,000

Solution :

Common-size balance sheet of Raheem Ltd as on 31st March, 2016 and 31st March, 2017

Particulars	Absolute amount on 31 st March 2016	Percentage of total assets on 31 st March 2016	Absolute amount on 31 st March 2017	Percentage of total assets on 31 st March 2017
	₹		₹	
I. Equity and Liabilities				
1. Shareholder's fund				
a. Share capital	5,00,000	25	6,00,000	50
b. Reserve and surplus	4,00,000	20	3,60,000	30
2. Non-current liabilities				
Long-term borrowings	8,00,000	40	2,40,000	20
3. Current liabilities				
Trade payables	30,000	15	-	-
Total	20,00,000	100	12,00,000	100
II. Assets				
1. Non-current assets				
a. Fixed assets	10,00,000	50	6,00,000	50
b. Non-current investments	5,00,000	25	2,40,000	20
2. Current assets				
Inventories	3,00,000	15	1,20,000	10
Cash and cash equivalents	2,00,000	10	2,40,000	20
Total	20,00,000	100	12,00,000	100

5. From the following information, calculate trade percentages for Malar Ltd

Particulars	₹ In lakhs		
	2015-16	2016-17	2017-18
Revenue from operations	100	120	160
Other income	20	24	20
Expenses	20	14	40
Income tax	30%	30%	30%

Solution :

Trend analysis for Malar Ltd

Particular	₹ In lakhs			Trends percentage		
	2015-16	2016-17	2017-18	2015-16	2016-17	2017-18
Revenue from operations	100	120	160	100	120	160
Add: other income	20	24	20	100	120	100
Total revenue	120	144	180	100	120	150
Less: Expenses	20	14	40	100	70	200
Profit before tax	100	130	140	100	130	140
Less: Income tax (30 %)	30	39	42	100	130	140
Profit after tax	70	91	98	100	130	140

UNIT

9

RATIO ANALYSIS

CHAPTER SNAPSHOT

- 9.1 Introduction
- 9.2 Meaning of accounting ratios
- 9.3 Meaning and definition of ratio analysis
- 9.4 Objectives of ratio analysis
- 9.5 Classification of ratios
 - 9.5.1 Traditional classification
 - 9.5.2 Functional classification
- 9.6 Computation of ratios
 - 9.6.1 Liquidity ratios
 - 9.6.2 Longterm solvency ratios
 - 9.6.3 Turnovers ratios
 - 9.6.4 Profitability ratios
- 9.7 Advantages of ratio analysis
- 9.8 Limitations of ratio analysis

Important Points

- ❑ Analysis of financial statements involves study of items in the financial statements and making a logical conclusion.
- ❑ Ratio is a mathematical expression of relationship between two related or interdependent items.
- ❑ Ratio analysis is a tool which involves analysing the financial statements by calculating various ratios.
- ❑ Traditional classification of ratios is done on the basis of the financial statements from which the ratios are calculated.
- ❑ Functional classification of ratios is based on the purpose for which ratios are computed and it is the most commonly used classification.
- ❑ Liquidity ratios help to assess the ability of a business concern to meet its short term financial obligations.
- ❑ Inventory is not considered as liquid asset because it takes some time to sell the inventory and to convert into cash.
- ❑ Debit balance in the statement of profit and loss shall be shown as a negative figure under the head Reserves and surplus.
- ❑ Fixed assets turnover ratio can also be calculated by substituting cost of net revenue from operations instead of net revenue from operations.

SELF-EXAMINATION QUESTIONS

I MULTIPLE CHOICE QUESTIONS

CHOOSE THE CORRECT ANSWER

1. The mathematical expression that provides a measure of the relationship between two figures is called

- (a) Conclusion (b) Ratio
(c) Model (d) Decision

[Ans. (b) Ratio]

2. Current ratio indicates

- (a) Ability to meet short term obligations
(b) Efficiency of management
(c) Profitability
(d) Long term solvency

[Ans. (a) Ability to meet short term obligations]

3. Current assets excluding inventory and prepaid expenses is called

- (a) Reserves (b) Tangible assets
(c) Funds (d) Quick assets

[Ans. (d) Quick assets]

4. Debt equity ratio is a measure of

- (a) Short term solvency
(b) Long term solvency
(c) Profitability
(d) Efficiency

[Ans. (b) Long term solvency]

5. Match List I with List II and select the correct answer using the codes given below:

List I		List II	
(i)	Current ratio	1.	Liquidity
(ii)	Net profit ratio	2.	Efficiency
(iii)	Debt-equity ratio	3.	Long term solvency
(iv)	Inventory turnover ratio	4.	Profitability

Codes :

- | | | | | |
|-----|-----|------|-------|------|
| | (i) | (ii) | (iii) | (iv) |
| (a) | 1 | 4 | 3 | 2 |
| (b) | 3 | 2 | 4 | 1 |
| (c) | 4 | 3 | 2 | 1 |
| (d) | 1 | 2 | 3 | 4 |

[Ans. (a) (i)-1, (ii)-4, (iii)-3, (iv)-2]

6. To test the liquidity of a concern, which of the following ratios are useful?

- (i) Quick ratio
- (ii) Net profit ratio
- (iii) Debt-equity ratio
- (iv) Current ratio

Select the correct answer using the codes given below:

- (a) (i) and (ii)
- (b) (i) and (iv)
- (c) (ii) and (iii)
- (d) (ii) and (iv)

[Ans. (b) (i) and (iv)]

7. Proportion of share holder's funds to total assets is called

- (a) Proprietary ratio
- (b) Capital gearing ratio
- (c) Debt equity ratio
- (d) Current ratio [Ans. (a) Proprietary ratio]

8. Which one of the following is not correctly matched?

(a)	Liquid ratio	-	Proportion
(b)	Gross profit ratio	-	Percentage
(c)	Fixed assets turnover ratio	-	Percentage
(d)	Debt-equity ratio	-	Proportion

[Ans. (c) Fixed assets turnover ratio - Percentage]

9. Current liabilities ₹40,000; Current assets ₹1,00,000; Inventory ₹20,000. Quick ratio is

- (a) 1:1
- (b) 2.5:1
- (c) 2:1
- (d) 1:2

[Ans. (c) 2:1]

Hint :

$$\text{Quick ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

$$\text{Quick assets} = \text{Total current assets} - \text{Inventories} - \text{prepaid expenses.}$$

$$= 1,00,000 - 20,000 - 0$$

$$= 80,000$$

$$\text{Current liabilities} = 40,000$$

$$\therefore \text{Quick ratio} = \frac{80,000}{40,000} = 2 : 1$$

10. Cost of revenue from operations ₹ 3,00,000; Inventory in the beginning of the year ₹ 60,000; Inventory at the close of the year ₹ 40,000. Inventory turnover ratio is

- (a) 2 times
- (b) 3 times
- (c) 6 times
- (d) 8 times

[Ans. (c) 6 times]

Hint :

$$\text{Inventory turnover ratio} = \frac{\text{Cost of revenue from operations}}{\text{Average inventory}}$$

$$\text{Cost of revenue from operations} = ₹ 3,00,000$$

$$\text{Average inventory} = \frac{\text{Opening inventory} + \text{Closing inventory}}{2}$$

$$= \frac{60,000 + 40,000}{2} = ₹ 50,000$$

$$\therefore \text{Inventory turnover ratio} = \frac{3,00,000}{50,000} = 6 \text{ times}$$

II VERY SHORT ANSWER QUESTIONS :

1. What is meant by accounting ratios?

Ans. (i) Ratio is a mathematical expression of relationship between two related or interdependent items.

(ii) It is the numerical or quantitative relationship between two items

(iii) It is calculated by dividing one item by the other related item.

(iv) When ratios are calculated on the basis of accounting information, these are called 'accounting ratios'.

2. What is quick ratio?

Ans. (i) Quick ratio gives the proportion of quick assets to current liabilities.

(ii) It indicates whether the business concern is in a position to pay its current liabilities as and when they become due, out of its quick assets.

(iii) It is otherwise called liquid ratio or acid test ratio.

(iv) It is calculated as follows:

$$\text{Quick ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

3. What is meant by debt equity ratio?

Ans. (i) Debt equity ratio is calculated to assess the long term solvency position of a business concern.

(ii) Debt equity ratio expresses the relationship between long term debt and shareholders' funds.

(iii) It is computed as follows:

$$\text{Debt equity ratio} = \frac{\text{Long term debt}}{\text{Shareholders funds}}$$

4. What does return on investment ratio indicate?

- Ans. (i)** Return on investment shows the proportion of net profit before interest and tax to capital employed (shareholders' funds and long term debts).
- (ii)** This ratio measures how efficiently the capital employed is used in the business.
- (iii)** It is an overall measure of profitability of a business concern.
- (iv)** It is computed as below:
Return on Investment (ROI)
- $$= \frac{\text{Net profit before interest and tax}}{\text{Capital employed}} \times 100$$

5. State any two limitations of ratio analysis.

- Ans. (i) Ratios are only means :** Ratios are not end in themselves but they are only means to achieve a particular purpose.
- (ii) Accuracy of financial information :** The accuracy of a ratio depends on the accuracy of information taken from financial statements.

III SHORT ANSWER QUESTIONS**1. Explain the objectives of ratio analysis.**

Ans. Following are the objectives of ratio analysis :

- (i)** To simplify accounting figures
- (ii)** To facilitate analysis of financial statements
- (iii)** To analyse the operational efficiency of a business
- (iv)** To help in budgeting and forecasting
- (v)** To facilitate intra firm and inter firm comparison of performance

2. What is inventory conversion period? How to calculate it?

- Ans. (i)** Inventory conversion period is the time taken to sell the inventory.
- (ii)** A shorter inventory conversion period indicates more efficiency in the management of inventory.
- (iii)** It is computed as follows :

$$\text{Inventory conversion period (in days)} = \frac{\text{Number of days in a year}}{\text{Inventory turnover ratio}}$$

$$\text{Inventory conversion period (in months)} = \frac{\text{Number of month in a year}}{\text{Inventory turnover ratio}}$$

3. How is operating profit ascertained?

- Ans. (i)** Operating profit ratio gives the proportion of operating profit to revenue from operations.
- (ii)** Operating profit ratio is an indicator of operational efficiency of an organisation.
- (iii)** It may be computed as follows:
Operating profit ratio
- $$= \frac{\text{Operating profit}}{\text{Revenue from operations}} \times 100$$
- Alternatively, it is calculated as under.
Operating profit ratio = 100 – Operating cost ratio
- Operating profit = Revenue from operations – Operating cost
- (iv)** A higher ratio indicates better profitability. Greater the operating ratio, higher is the margin available for paying non-operating expenses.

4. State any three advantages of ratio analysis.

Ans. Following are the advantages of ratio analysis:

- (i) Measuring operational efficiency :** Ratio analysis helps to know operational efficiency of a business by finding the relationship between operating cost and revenues and also by comparison of present ratios with those of the past ratios.
- (ii) Facilitating investment decisions :** Ratio analysis helps the management in making effective decisions regarding profitable avenues of investment.
- (iii) Analysing the profitability :** Ratio analysis helps to analyse the profitability of a business in terms of sales and investments.

5. Bring out the limitations of ratio analysis.

Ans. Following are the limitations of ratio analysis:

- (i) Accuracy of financial information :** The accuracy of a ratio depends on the accuracy of information taken from financial statements.
- (ii) Consistency in preparation of financial statements :** Inter-firm comparisons with the help of ratio analysis will be meaningful only if the firms follow uniform accounting procedures consistently.
- (iii) Non-availability of standards or norms :** Ratios will be meaningful only if they are compared with accepted standards or norms. Only few financial ratios have universally recognised standards.
- (iv) Change in price level :** Ratio analysis may not reflect price level changes and current values as they are calculated based on historical data given in financial statements.

IV EXERCISES**Liquidity ratios**

1. Calculate the current ratio from the following information.

Particulars	₹	Particulars	₹
Current investments	40,000	Fixed assets	5,00,000
Inventories	2,00,000	Trade creditors	80,000
Trade debtors	1,20,000	Bills payable	50,000
Bills receivable	80,000	Expenses payable	20,000
Cash and cash equivalents	10,000	Non-current liability	3,00,000

Solution :

$$\begin{aligned} \text{Current ratio} &= \frac{\text{Current assets}}{\text{Current liabilities}} \\ \text{Current assets} &= \text{Current investments} + \text{Inventories} + \text{Bills receivables} + \text{Trade debtors} + \text{Cash and cash equivalents} \\ &= ₹40,000 + ₹2,00,000 + ₹1,20,000 + ₹80,000 + ₹10,000 \\ &= ₹4,50,000 \\ \text{Current liabilities} &= \text{Trade creditors} + \text{Bills payable} + \text{Expenses payable} \\ &= ₹80,000 + ₹50,000 + ₹20,000 = ₹1,50,000 \\ \text{Current ratio} &= \frac{4,50,000}{1,50,000} = 3 : 1 \end{aligned}$$

2. Calculate quick ratio: Total current liabilities ₹ 2,40,000; Total current assets ₹ 4,50,000; Inventories ₹ 70,000; Prepaid expenses ₹ 20,000

Solution :

$$\begin{aligned} \text{Quick ratio} &= \frac{\text{Quick assets}}{\text{Current liabilities}} \\ \text{Quick assets} &= \text{Current assets} - \text{Inventories} - \text{Prepaid expenses} \\ &= ₹4,50,000 + ₹70,000 - ₹20,000 \\ &= ₹3,60,000 \\ \text{Quick ratio} &= \frac{3,60,000}{2,40,000} = 1.5 : 1 \end{aligned}$$

3. Following is the balance sheet of Lakshmi Ltd. as on 31st March, 2019:

Particulars	₹
I. EQUITY AND LIABILITIES	
1. Shareholders' funds	
Equity share capital	4,00,000
2. Non-current liabilities	
Long term borrowings	2,00,000
3. Current liabilities	
(a) Short-term borrowings	50,000
(b) Trade payables	3,10,000
(c) Other current liabilities	
Expenses payable	15,000
(d) Short-term provisions	25,000
Total	10,00,000

Particulars	₹
II. ASSETS	
1. Non-current assets	
(a) Fixed assets Tangible assets	4,00,000
2. Current assets	
(a) Inventories	1,60,000
(b) Trade debtors	3,20,000
(c) Cash and cash equivalents	80,000
(d) Other current assets Prepaid expenses	40,000
Total	10,00,000

Calculate:

(i) Current ratio (ii) Quick ratio

Solution :

(i) Current ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$

Current assets = Inventories + Trade debtors + Cash and cash equivalents + Prepaid expenses
= ₹1,60,000 + ₹3,20,000 + ₹80,000 + ₹40,000 = ₹6,00,000

Current liabilities = Short term borrowings + Trade payables + Expenses payable + Short term provisions
= ₹50,000 + ₹3,10,000 + ₹15,000 + ₹25,000 = ₹4,00,000

Current ratio = $\frac{6,00,000}{4,00,000} = 1.5 : 1$

(ii) Quick ratio = $\frac{\text{Quick assets}}{\text{Current liabilities}}$

Quick assets = Current assets – Inventories – Prepaid expenses
= ₹6,00,000 – ₹1,60,000 – ₹40,000 = ₹4,00,000

Quick ratio = $\frac{4,00,000}{4,00,000} = 1 : 1$

Long term solvency ratios

4. From the following information calculate debt equity ratio.

Balance Sheet (Extract) as on 31st March, 2019

Particulars	Amount ₹
I. EQUITY AND LIABILITIES	
1. Shareholders' funds	
(a) Share capital Equity share capital	6,00,000
(b) Reserves and surplus	2,00,000
2. Non-current liabilities	
Long-term borrowings (Debentures)	6,00,000
3. Current liabilities	
(a) Trade payables	1,60,000
(b) Other current liabilities Outstanding expenses	40,000
Total	16,00,000

Solution :

$$\begin{aligned} \text{Debt equity ratio} &= \frac{\text{Long term debt}}{\text{Shareholders funds}} \\ \text{Long term debt} &= \text{Debentures} \\ &= ₹6,00,000 \\ \text{Shareholder's funds} &= \text{Equity share capital} + \text{Reserves and surplus} \\ &= ₹6,00,000 + ₹2,00,000 = ₹8,00,000 \\ \therefore \text{Debt equity ratio} &= \frac{6,00,000}{8,00,000} = 0.75 : 1 \end{aligned}$$

5. From the following Balance Sheet of Sundaram Ltd. calculate proprietary ratio:**Balance sheet of Sundaram Ltd. as on 31.3.2019**

Particulars	Amount ₹
I. EQUITY AND LIABILITIES	
1. Shareholders' funds	
(a) Share capital	
(i) Equity share capital	2,50,000
(ii) Preference share capital	1,50,000
(b) Reserves and surplus	50,000
2. Non-current liabilities	
Long term borrowings	-
3. Current liabilities	
Trade payables	1,50,000
Total	6,00,000
II. ASSETS	
1. Non-current assets	
(a) Fixed assets	4,60,000
(b) Non-current investments	1,00,000
2. Current assets	
Cash and cash equivalents	40,000
Total	6,00,000

Solution :

$$\begin{aligned} \text{Proprietary ratio} &= \frac{\text{Shareholder's funds}}{\text{Total assets}} \\ \text{Shareholder's funds} &= \text{Equity share capital} + \text{Preference share capital} + \text{Reserves and surplus} \\ &= ₹2,50,000 + ₹1,50,000 + ₹50,000 = ₹4,50,000 \\ \text{Total assets} &= ₹6,00,000 \\ \therefore \text{Proprietary ratio} &= \frac{4,50,000}{6,00,000} = 0.75 : 1 \end{aligned}$$



ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. The financial status and financial performance of business entities can be assessed through.

- (a) financial analysis
(b) managerial analysis
(c) cash flow statement
(d) none of these [Ans. (a) financial analysis]

2. If both items in a ratio are from balance sheet, it is classified as

- (a) Inter statement ratio
(b) Income statement ratio
(c) Balance sheet ratio
(d) All of these [Ans. (c) Balance sheet ratio]

3. If the two items in a ratio are from income statement, it is classified as

- (a) balance sheet ratio
(b) income statement ratio
(c) inter statement ratio
(d) none of these
[Ans. (b) income statement ratio]

4. If a ratio is computed with one item from income statement and another item from balance sheet, it is called

- (a) Inter-statement ratio
(b) Balance sheet ratio
(c) Income statement ratio
(d) None of these
[Ans. (a) Inter-statement ratio]

5. Which ratio is the proportion of fixed income bearing funds to equity shareholders funds?

- (a) Debt equity ratio
(b) Capital gearing ratio
(c) Proprietary ratio (d) Profitability ratio
[Ans. (b) Capital gearing ratio]

6. Which ratio indicates the efficiency of utilisation of fixed assets?

- (a) Inventory turnover ratio
(b) Trade receivables turnover ratio
(c) Trade payables turnover ratio
(d) Fixed assets turnover ratio
[Ans. (d) Fixed assets turnover ratio]

7. All solvency ratios are expressed in term of

- (a) Proportion (b) Time
(c) Money (d) Percentage
[Ans. (a) Proportion]

8. All activity ratios are expressed in terms of

- (a) Money (b) Percentage
(c) Times (d) Proportion
[Ans. (c) Times]

9. All profitability ratios are expressed in terms of

- (a) Proportion (b) Percentage
(c) Times (d) Money
[Ans. (b) Percentage]

10. Shareholder funds includes

- (a) Equity share capital, preference share capital, reserve and surplus
(b) Loans from banks and financial institutions
(c) Equity share capital, preference share capital, reserves & surplus and loans from banks
(d) None of these

[Ans. (a) Equity share capital, preference share capital, reserve and surplus]

11. Operating ratio is equal to

- (a) $100 - \text{Operating profit ratio}$
(b) $100 + \text{Operating profit ratio}$
(c) Operating cost (d) None of these
[Ans. (a) $100 - \text{Operating profit ratio}$]

12. Cost of goods sold is ₹4,00,000 and average stock is ₹80,000. Stock turnover ratio will be

- (a) 5 times (b) 4 times
(c) 7 times (d) 8 times
[Ans. (a) 5 times]

Hint : Cost of goods sold / Stock turnover ratio

$$= \frac{4,00,000}{80,000} = 5 \text{ times}$$

13. Current assets of a business concern is ₹60,000 and current liabilities are ₹30,000. Current ratio will be

- (a) 1 : 2 (b) 1 : 1 (c) 2 : 1 (d) 3 : 2
[Ans. (c) 2 : 1]

Hint :

$$\begin{aligned} \text{Current ratio} &= \frac{\text{Current assets}}{\text{Current liabilities}} \\ &= \frac{60,000}{30,000} = 2 : 1 \end{aligned}$$

RATIO ANALYSIS

Sura's XII Std - Accountancy

3. (a) Liquidity ratio
(b) Turnover ratios
(c) Sacrificing ratio
(d) Profitability ratios

[Ans. (c) Sacrificing ratio]

Reason : Sacrificing ratio is the proportion of the profit which is sacrificed or foregone by the old partners in favour of the new partner. Other three are functional classification of ratio analysis.

- (v) Which one of the Following is Correctly Matched?

1.

(a)	Gross profit ratio	-	$\frac{\text{Net profit ratio}}{\text{Revenue from operations}} \times 100$
(b)	Operating cost ratio	-	$\frac{\text{Operating Cost}}{\text{Revenue from operationa}} \times 100$
(c)	Operating profit	-	Revenue from operations + Operating cost
(d)	Net profit ratio	-	$\frac{\text{Gross profit}}{\text{Revenue from operations}} \times 100$

[Ans. (b) Operating cost ratio

$$= \frac{\text{Operating Cost}}{\text{Revenue from operations}} \times 100]$$

- (vi) Which one of the Following is Not Correctly Matched?

1.

(a)	Equity share holders funds	-	Equity share capital + General reserve and surplus
(b)	Average inventory	-	$\frac{\text{Opening inventory} + \text{Closing inventory}}{2}$
(c)	Trade receivables	-	Trade debtors + Bills receivable
(d)	Trade payables	-	Trade creditors – Bills payable

[Ans. (d) Trade payables = Trade creditors – Bills payable]

2.

(a)	Current ratio	-	$\frac{\text{Current assets}}{\text{Current liabilities}}$
(b)	Quick ratio	-	$\frac{\text{Current assets}}{\text{Current liabilities}}$
(c)	Debt equity ratio	-	$\frac{\text{Long term debt}}{\text{Shareholder's funds}}$
(d)	Proprietary ratio	-	$\frac{\text{Shareholder's funds}}{\text{Total assets}}$

[Ans. (b) Quick ratio = $\frac{\text{Current assets}}{\text{Current liabilities}}$]

- (vii) Consider the Following Statement.

1. **Assertion (A) :** Liquidity Ratios measure the firms' ability to pay off current dues i.e? repayable within a year.

Reason (R) : liquidity ratios are otherwise called as Long Term Solvency Ratios.

- (a) Both (A) and (R) are true and (R) is the correct explanation of (A)
(b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
(c) (A) is true, but (R) is false
(d) (A) is false, but (R) is true

[Ans. (c) (A) is true, but (R) is false]

2. **Assertion (A) :** Fixed assets turnover ratio helps to ascertain the soundness of the long term financial position of the concern.

Reason (R) : It indicates the proportion between total long term debt and shareholders funds.

- (a) Both (A) and (R) are true and (R) is the correct explanation of (A)
(b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
(c) (A) is true, but (R) is false
(d) (A) is false, but (R) is true

[Ans. (d) (A) is false, but (R) is true]

3. **Assertion (A) :** Total long term debt includes Debentures, long term loans from banks and financial institutions.

Reason (R) : Shareholders funds includes Equity share capital, Preference share capital, Reserves and surplus.

- (a) Both (A) and (R) are true and (R) is the correct explanation of (A)
 (b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
 (c) (A) is true, but (R) is false
 (d) (A) is false, but (R) is true

[Ans. (a) Both (A) and (R) are true and (R) is the correct explanation of (A)]

4. Assertion (A) : This ratio determines the operating efficiency of the business concern.

Reason (R) : Operating ratio measures the amount of expenditure incurred in production, sales and distribution of output.

- (a) Both (A) and (R) are true and (R) is the correct explanation of (A)
 (b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
 (c) (A) is true, but (R) is false
 (d) (A) is false, but (R) is true

[Ans. (a) Both (A) and (R) are true and (R) is the correct explanation of (A)]

5. Assertion (A) : This shows the number of times the capital has been rotated in the process of carrying on business. Efficient utilisation of capital would lead to higher profitability.

Reason (R) : The relationship between Sales and Capital employed is known as liquid Ratio.

- (a) Both (A) and (R) are true and (R) is the correct explanation of (A)
 (b) Both (A) and (R) are true and (R) is not the correct explanation of (A)
 (c) (A) is true, but (R) is false
 (d) (A) is false, but (R) is true

[Ans. (b) Both (A) and (R) are true and (R) is not the correct explanation of (A)]

(viii) Choose the Correct Statement.

- 1.** (i) Financial statements normally include Trading, Profit and Loss, Account and Balance Sheet.
 (ii) A detailed cause and effect study of the profitability and financial condition is the overall objective of Ratio analysis.
 (iii) financial statements analysis is the process of determining and interpreting the numerical relationship between figures of financial statements.

- (a) (i) is correct
 (b) (i), (ii) is correct
 (c) (i), (ii) and (iii) are correct
 (d) (ii), (iii) are correct

[Ans. (a) (i) is correct]

2. (i) In the words of Spicer and Pegler "the relationship of an item to another expressed in simple mathematical form is known as a ratio".

(ii) In the words of Carter "the relationship of an item to another expressed in simple mathematical form is known as a ratio"

(iii) In the words of Kennedy and Me Millan "the relationship of an item to another expressed in simple mathematical form is known as a ratio"

- (a) (i) is correct
 (b) (ii) is correct
 (c) (i), (ii) and (iii) are correct
 (d) (iii) is correct

[Ans. (d) (iii) is correct]

3. (i) Current Ratios measure the firms' ability to pay off current dues i.e., repayable within a year. Liquidity ratios are otherwise called as Short Term Solvency Ratios.

(ii) Liquidity Ratios measure the firms' ability to pay off current dues i.e., repayable within a year. Liquidity ratios are otherwise called as Short Term Solvency Ratios.

(iii) Absolute Ratios measure the firms' ability to pay off current dues i.e., repayable within a year. Liquidity ratios are otherwise called as Short Term Solvency Ratios.

- (a) (i), (ii) and (iii) are correct
 (b) (i) and (ii) are correct
 (c) (i) is correct
 (d) (ii) is correct

[Ans. (d) (ii) is correct]

4. (i) Quick ratio is used to assess the firm's short term liquidity. The relationship of liquid assets to current liabilities is known as Current ratio.

(ii) Acid Test ratio is used to assess the firm's short term liquidity. The relationship of liquid assets to current liabilities is known as Current ratio.

(iii) This ratio is used to assess the firm's short term liquidity. The relationship of liquid assets to current liabilities is known as liquid ratio.

- (a) (i) is correct
- (b) (i) and (iii) are correct
- (c) (iii) is correct
- (d) (i), (ii) and (iii) are correct

[Ans. (c) (iii) is correct]

5. (i) Solvency refers to the firm's ability to meet its long term indebtedness. Solvency ratio studies the firm's ability to meet its long term obligations.
- (ii) A ratio is a mathematical relationship between one items expressed in a quantitative form.
- (iii) A detailed cause and effect study of the profitability and financial condition is the overall objective of Ratio analysis
- (a) (i) and (ii) are correct
 - (b) (i) and (iii) are correct
 - (c) (i) is correct
 - (d) (i), (ii) and (iii) are correct

[Ans. (c) (i) is correct]

II. VERY SHORT ANSWER QUESTIONS

1. Definition of ratio analysis.

Ans. According to Myers, "Ratio analysis is a study of relationship among various financial factors in a business".

2. What is Liquidity ratios?

Ans. Liquidity means capability of being converted into cash with ease. Liquidity ratios help to assess the ability of a business concern to meet its short term financial obligations. Liquidity ratios are also called as short term solvency ratios.

3. What is current ratio?

Ans. Current ratio gives the proportion of current assets to current liabilities of a business concern. It is computed by dividing current assets by current liabilities. It is calculated as follows:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

4. What is turnover ratios?

Ans. Turnover ratios show how efficiently assets or other items have been used to generate revenue from operations. They are also called as activity ratios or efficiency ratios.

The important turnover or activity ratios are:

- (i) Inventory turnover ratio
- (ii) Trade receivables turnover ratio
- (iii) Trade payables turnover ratio
- (iv) Fixed assets turnover ratio

III. SHORT ANSWER QUESTIONS

1. Explain the traditional classifications of ratio analysis.

Ans. Traditional classification of ratio is done on the basis of the financial statements from which the ratios are calculated. Under the traditional classification, the ratios are classified as: (i) Balance sheet ratios, (ii) Income statement ratios and (iii) Inter-statement ratio.

- (i) **Balance sheet ratio** : If both items in a ratio are from balance sheet, it is classified as balance sheet ratio.
- (ii) **Income statement ratio** : If the two items in a ratio are from income statement, it is classified as income statement ratio.
- (iii) **Inter-statement ratio** : If a ratio is computed with one item from income statement and another item from balance sheet, it is called inter-statement ratio.

2. What is functional classifications of rational analysis? and types of functional classification.

Ans. Functional classification of ratio is based on the purpose for which ratios are computed and it is the most commonly used classification. Under the functional classification, the ratios are classified as follows:

- (i) Liquidity ratios
- (ii) Long term solvency ratios
- (iii) Turnover ratios
- (iv) Profitability ratios

3. Write a note an Long-term solvency ratios.

- Ans.**
- (i) Long-term solvency means the firm's ability to meet its liabilities in the long run.
 - (ii) Long term solvency ratios help to determine the ability of the business to repay its debts in the long run.
 - (iii) The following ratios are normally computed for evaluating long term solvency of the business:
 - Debt equity ratio
 - Proprietary ratio
 - Capital gearing ratio

4. Write a short note on

- (i) **Proprietary ratio**
 (ii) **Capital gearing ratio**

Ans. (i) Proprietary ratio : Proprietary ratio gives the proportion of shareholders' funds to total assets. Proprietary ratio shows the extent to which the total assets have been financed by the shareholders' funds. It is calculated as follows:

$$\text{Proprietary ratio} = \frac{\text{Shareholder's funds}}{\text{Total assets}}$$

- (ii) **Capital gearing ratio :** Capital gearing ratio is the proportion of fixed income bearing funds to equity shareholders' funds. Fixed income bearing funds include fixed interest and fixed dividend bearing funds. It is calculated as follows:

Capital gearing ratio

$$= \frac{\text{Funds bearing fixed interest or fixed dividend}}{\text{Equity shareholders' funds}}$$

5. What do you mean by debt collection period?

Ans. Debt collection period is the average time taken to collect the amount due from trade receivables. Lesser the debt collection period, greater is the efficiency of management in collection of cash from trade receivables. It is calculated as follows:

Debt collection period (in days)

$$= \frac{\text{Number of days in a year}}{\text{Trade receivables turnover ratio}}$$

and

Debt collection period (in months)

$$= \frac{\text{Number of months in a year}}{\text{Trade receivables turnover ratio}}$$

6. What is Credit payment period?

Ans. Credit payment period is the average time taken by the business for payment of accounts payables. Lesser the credit payment period, greater is the efficiency of the management in managing accounts payable as it indicates quicker settlement of trade payable. It is calculated as follows:

Credit payment period (in days)

$$= \frac{\text{Number of days in a year}}{\text{Trade payables turnover ratio}}$$

Credit payment period (in months)

$$= \frac{\text{Number of months in a year}}{\text{Trade payables turnover ratio}}$$

7. Write a short note on

- (i) **Gross profit ratio**
 (ii) **Net profit ratio**

Ans. (i) Gross profit ratio : Gross profit ratio is the proportion of gross profit to net revenue from operations. Gross profit ratio shows the margin of profit available out of revenue from operations. It is computed as below:

Gross profit ratio

$$= \frac{\text{Gross profit}}{\text{Net revenue from operations}} \times 100$$

- (ii) **Net profit ratio :** Net profit ratio is the percentage of net profit on revenue from operations. It is calculated as under:

Net profit ratio

$$= \frac{\text{Net profit after tax}}{\text{Revenue from operations}} \times 100$$

IV. PROBLEMS.**1. Calculate the current ratio from the following information.**

Particulars	₹	Particulars	₹
Current investments	15,000	Trade creditors	36,000
Inventories	29,000	Bills payable	10,000
Cash and cash equivalents	5,000	Expenses payable	8,000
Trade receivables	5,000		

Solution :

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\begin{aligned} \text{Current assets} &= \text{Current investments} + \text{Inventories} + \text{Trade receivables} + \text{Cash and cash equivalents} \\ &\quad + \text{Prepaid expenses} \\ &= 15,000 + 29,000 + 5,000 + 5,000 + 0 \\ &= ₹54,000 \end{aligned}$$

$$\begin{aligned} \text{Current liabilities} &= \text{Trade creditors} + \text{Bills payable} + \text{Expenses payable} \\ &= 36,000 + 10,000 + 8,000 = ₹54,000 \end{aligned}$$

$$\therefore \text{Current assets} = \frac{54,000}{54,000} = 1:1$$

2. Following is the extract of the balance sheet of Hindustan Products Ltd., as on 31st March 2019.

Particulars	₹
I. EQUITY AND LIABILITIES	
1. Shareholders' funds	
(a) Share capital	2,90,000
(b) Reserves and surplus	60,000
2. Non-current liabilities	
Long term borrowings	40,000
3. Current liabilities	
(a) Trade payables	1,15,000
(b) Other current liabilities	15,000
Total	5,20,000

Net profit before interest and tax for the year was ₹50,000. Calculate the return on capital employed for the year.

Solution :

$$\text{Return on Investment (ROI)} = \frac{\text{Net profit before interest and tax}}{\text{Capital employed}} \times 100$$

$$\begin{aligned} \text{Capital employed} &= \text{Share capital} + \text{Reserves and surplus} + \text{Long term borrowings} \\ &= 2,90,000 + 60,000 + 50,000 = ₹3,90,000 \end{aligned}$$

$$\therefore \text{Return on Investment} = \frac{50,000}{3,90,000} \times 100 = 12.5\%$$

HOTS QUESTIONS AND ANSWERS

1. What does high total assets to debt ratio indicates?

Ans. High total assets to debt ratio indicates that assets have been mainly financed by owner's funds and the long-term debt is adequately covered by assets.

2. Quick ratio of a company is 1.5 : 1. State giving reason, whether the ratio will improve, decline or not change on payment of dividend by the company.

Ans. Ratio will increase as both the quick assets and current liabilities i.e., cash and creditors, will decrease by the same amount.

3. How does ratio analysis become less effective due to does ratio changes?

Ans. Accounting ratios are calculated from financial statements which are drawn on the basis of historical costs as recorded in the books of accounts. Thus, these ratios ignore the change in price level and they do not reflect the actual analysis.

4. The average age of inventory is viewed as the average length of time inventory is held by the firm or as the average number of day's sales in inventory. Explain.

Ans. (i) Inventory turnover ratio is a relationship between the cost of goods sold during a particular period of time and the cost of average inventory during a particular period. It is expressed in number of times.

(ii) Inventory turnover ratio indicates the number of times, the stock has been turned over during the period and evaluates the efficiency with which a firm is able to manage its inventory.

5. Why should the inventory turnover ratio be more important when analysing a grocery store than an insurance company?

Ans. (i) Nature of a business makes inventory turnover ratio more important in case of a grocery store as compared to an insurance company.

(ii) A grocery store is a trading concern involved in trading. On the other hand, insurance company is involved in service business and involved in delivering service, so there is no question of inventory because service is perishable in nature and cannot be stored.

6. The liquidity of a business firm is measured by its ability to satisfy its long-term obligations as they become due. Comments

Ans. Yes, it is true that the liquidity of a business firm is measured by its ability to pay its long-term obligations as they become due. Here, the long-term obligation means payment of principal amount on the due date and payment of interest on the regular basis.

For measuring the long term solvency of any business, we calculate the following ratio.

(i) Debt equity ratio

(ii) Proprietary ratio



VALUE BASED QUESTIONS AND ANSWERS

1. The current assets of Maxell Ltd. are ₹10,00,000 and its current liabilities are ₹4,00,000. Find its current ratio. It is satisfactory? What value is exhibited by the company on maintaining such a ratio?

Solution :

$$\begin{aligned} \text{Current ratio} &= \frac{\text{Current assets}}{\text{Current liabilities}} \\ &= \frac{10,00,000}{4,00,000} = 2.5:1 \end{aligned}$$

Yes, it is satisfactory, as it exceeds the ideal ratio of 2:1

Value exhibited by Maxell Ltd. is ability to honour their debts on time.

2. Write the values which can be associated with a company which carries ratio analysis on its financial statements.

Solution :

Values reflected by the company are

- (i) **Doing Your Best :** A company does its best by analysing the financial ratios and enabling the interested parties in taking better decisions about investing and tending.
- (ii) **Transparent :** A company works towards transparency by simplifying the accounting information for various users.

3. Sai Ltd had a current ratio of 3.5:1 and quick ratio of 2:1. If the excess of current assets over quick assets as represented by inventory is ₹1,50,000. calculate current assets and current liabilities. Which value can be associated with the business having such current ratio and quick ratio?

Solution :

Let the current liabilities = x ;

Current ratio = 3.5:1

Therefore, current assets = $3.5x$

Quick ratio = 2:1

Therefore, quick or liquid assets = $2x$

Liquid assets = Current assets – Inventory

$$2x = 3.5x - 1,50,000$$

$$\Rightarrow 2x - 3.5x = -1,50,000 \text{ (or)}$$

$$1.5x = -1,50,000$$

$$x = \frac{1,50,000}{1.5} = 1,00,000$$

Current liabilities = ₹1,00,000

$$\begin{aligned} \text{Current assets} &= 3.5 \times 1,00,000 \\ &= ₹3,50,000 \end{aligned}$$

Values that can be associated with the business are

- (i) **Doing Your Best :** Business is doing its best in keeping its liquidity ratios well above the ideal ratios.
- (ii) **Safety :** Business shows safety towards its short-term creditors by maintaining such short-term solvency ratios.



UNIT 10

COMPUTERISED ACCOUNTING SYSTEM - TALLY

CHAPTER SNAPSHOT

- 10.1 Introduction
- 10.2. Applications of Computerised Accounting System (CAS)
- 10.3 Automated accounting system
- 10.4 Designing the accounting reports
- 10.5 Data exchange with other information system
- 10.6 Application of computerised accounting system – Tally with GST package
- 10.7 Practical application of accounting soft ware – Tally.ERP 9

Important Points

- ❑ Automated accounting system is an approach to maintain up-to-date accounting records with the aid of accounting software.
- ❑ Gateway of Tally is the opening screen of tally. It is shown on the right pane which contains menu options such as transactions and reports.
- ❑ Accounting group is a collection of ledger accounts of same nature.
- ❑ Tally has two predefined ledgers, Cash and Profit & Loss A/c.
- ❑ Different types of vouchers such as receipt, payment, sales, purchases, etc. can be used for recording transactions in Tally.
- ❑ Deposit of cash into bank account and withdrawal of cash from bank account are recorded in contra voucher.
- ❑ Journal vouchers are used for recording transactions such as depreciation, provision for bad debts, rectification entries, etc.

SELF-EXAMINATION QUESTIONS

I MULTIPLE CHOICE QUESTIONS

CHOOSE THE CORRECT ANSWER

1. Accounting report prepared according to the requirements of the user is
 - (a) Routine accounting report
 - (b) Special purpose report
 - (c) Trial balance
 - (d) Balance sheet

[Ans. (b) Special purpose report]
2. Function key F11 is used for
 - (a) Company Features
 - (b) Accounting vouchers
 - (c) Company Configuration
 - (d) None of these

[Ans. (a) Company Features]
3. Which submenu displays groups, ledgers and voucher types in Tally?
 - (a) Inventory vouchers
 - (b) Accounting vouchers
 - (c) Company Info
 - (d) Account Info

[Ans. (d) Account Info]
4. What are the predefined Ledger(s) in Tally?
 - (i) Cash
 - (ii) Profit & Loss A/c
 - (iii) Capital A/c
 - (a) Only (i)
 - (b) Only (ii)
 - (c) Both (i) and (ii)
 - (d) Both (ii) and (iii)

[Ans. (c) Both (i) and (ii)]
5. Contra voucher is used for
 - (a) Master entry
 - (b) Withdrawal of cash from bank for office use
 - (c) Reports
 - (d) Credit purchase of assets

[Ans. (b) Withdrawal of cash from bank for office use]
6. Which is not the default group in Tally?
 - (a) Suspense account
 - (b) Outstanding expense
 - (c) Sales account
 - (d) Investments

[Ans. (b) Outstanding expense]
7. Salary account comes under which of the following head?
 - (a) Direct Incomes
 - (b) Direct Expenses
 - (c) Indirect Incomes
 - (d) Indirect Expenses

[Ans. (d) Indirect Expenses]



8. ₹25,000 withdrawn from bank for office use. In which voucher type, this transaction will be recorded

- (a) Contra Voucher (b) Receipt Voucher
(c) Payment Voucher (d) Sales Voucher

[Ans. (a) Contra Voucher]

9. In which voucher type credit purchase of furniture is recorded in Tally

- (a) Receipt voucher (b) Journal voucher
(c) Purchase voucher (d) Payment voucher

[Ans. (b) Journal voucher]

10. Which of the following options is used to view Trial Balance from Gateway of Tally?

- (a) Gateway of Tally -> Reports -> Trial Balance
(b) Gateway of Tally -> Trial Balance
(c) Gateway of Tally -> Reports -> Display -> Trial Balance

(d) None of these [Ans. (c) Gateway of Tally -> Reports -> Display -> Trial Balance]

II VERY SHORT ANSWER QUESTIONS

1. What is automated accounting system?

Ans. (i) Automated accounting is an approach to maintain up-to-date accounting records with the aid of accounting software.

(ii) Under manual accounting system entries are made in different books of accounts while accounting software packages allow manual entry in one field or one place.

2. What are accounting reports?

Ans. Accounting report is a compilation of accounting information that are derived from the accounting records of a business concern. Accounting reports may be classified as routine reports and special purpose reports.

3. State any five accounting reports.

Ans. Routine accounting reports include

- (a) Day books / Journal
(b) Ledger
(c) Trial balance
(d) Income statement
(e) Balance sheet
(f) Cash flow statement

4. What is Accounting Information System (AIS)?

Ans. Accounting Information System (AIS) collects financial data, processes them and provides information to the various users. To provide information AIS requires data from other information system that is manufacturing, marketing and human resources.

5. What is a group in Tally.ERP 9?

Ans. In 2009, Tally Solutions introduced the software Tally.ERP 9. The software offers comprehensive business management solution. It maintains all books of accounts. Different types of vouchers such as vouchers for receipt, payment, sales, purchases, etc., can be used for recording transactions.

III SHORT ANSWER QUESTIONS

1. Write a brief note on accounting vouchers.

Ans. This type of a voucher basically analyses a business transaction from the accounting stand point and is used for recording purposes

These are commonly prepared by accountants on the basis of supporting vouchers and approved by a different individual. They are further subdivided into two, Cash and Non-cash vouchers.

Examples of cash type :

1. Credit Vouchers
2. Debit Vouchers

Examples of the Non-cash type :

1. Debit note
2. Credit note
3. Invoice

2. What are the pre-defined ledgers available in Tally.ERP 9?

Ans. In Tally, to record transactions, the transactions are to be identified with the related ledger accounts. In Tally ERP 9, there are two types of pre. defined ledgers.

(i) Cash : Under the group cash-in-hand this ledger is created, you can enter the opening balance as on the books beginning from.

(ii) **Profit and loss account** : This ledger is created under the group primary. In this ledger previous year's profit or loss is entered as the opening balance of this ledger.

To create ledger :

Gateway of Tally → Masters >
Accounts Info > Ledgers >
Single Ledger > create

3. Mention the commonly used voucher types in Tally. ERP 9.

Ans. Following are some of the major accounting vouchers used in an organisation:

- (i) Receipt Voucher
- (ii) Payment Voucher
- (iii) Contra Voucher
- (iv) Purchase Voucher
- (v) Sales Voucher
- (vi) Journal Voucher

4. Explain how to view profit and loss statement in Tally. ERP 9 ?

Ans. To view Profit and Loss Account

F10: A/c Reports > Profit & Loss A/c > Alt F1 (detailed)

(or)

Gateway of Tally > Reports > Profit & Loss A/c > Alt F1 (detailed)

Robert For 1-Apr-2018		Robert For 1-Apr-2018	
Particulars		Particulars	
Purchase Accounts		Sales Accounts	
Purchases A/c	25,000.00	Sales A/c	68,000.00
Direct Expenses	3,000.00		
Wages A/c	3,000.00		
Indirect Expenses	10,000.00		
Salaries A/c	6,000.00		
Stationery A/c	4,000.00		
Nett Profit	30,000.00		
Total	68,000.00	Total	68,000.00

Profit and Loss Account

5. Explain any five applications of computerised accounting system.

Ans. The applications of CAS are as follows :

(i) **Maintaining accounting records :**

In CAS, accounting records can be maintained easily and efficiently for long time period. It facilitates fast and accurate retrieval of data and information.

(ii) **Inventory management :**

CAS facilitates efficient management of inventory. Updated information about availability of inventory, level of inventory, etc., can be obtained instantly.

(iii) **Report generation :**

CAS helps to generate various routine and special purpose reports.

(iv) **Data import/export :**

Accounting data and information can be imported from or exported to other users within the organisation as well as outside the organisation.

(v) **Taxation:**

CAS helps to compute various taxes and to deduct these and deposit the same to the Government account.

IV EXERCISES

1. Record the following transactions in Tally.
 - (a) Devi commenced a business with a capital of ₹4,00,000
 - (b) An account was opened with Indian Bank and deposited ₹60,000
 - (c) Purchased furniture by paying cash ₹ 15,000
 - (d) Goods purchased on credit from Sumathy for ₹ 50,000
 - (e) Cash sales made for ₹10,000
 - (f) Goods purchased from Raja for ₹5,000 and paid by cheque
 - (g) Goods sold to Arun on credit for ₹70,000
 - (h) Money withdrawn from bank for office use ₹25,000
 - (i) Part payment of ₹ 30,000 made to Sumathy by cheque
 - (j) Arun made part payment of ₹ 10,000 by cash
 - (k) Salaries paid to staff through ECS ₹ 36,000
 - (l) Carriage on purchases of ₹ 6,000 paid by cash
 - (m) Purchased computer from Muthu Ltd. on credit ₹ 44,000.

Solution :**Analysis of transactions, passing journal entries, identification of voucher**

S.NO.	Particulars	Debit ₹	Credit ₹	Voucher type	Group
(a)	Cash A/c Dr. To Devi's Capital A/c	4,00,000	4,00,000	Receipt Voucher	Cash-in-Hand Capital Account
(b)	Indian Bank A/c Dr. To Cash A/c	60,000	60,000	Contra Voucher	Bank Accounts Cash-in-Hand
(c)	Furniture A/c Dr. To Cash A/c	15,000	15,000	Payment Voucher	Fixed Assets Cash-in-Hand
(d)	Purchases A/c Dr. To Sumathy A/c	50,000	50,000	Purchase Voucher	Purchase Accounts Sundry Creditors
(e)	Cash A/c Dr. To Sales A/c	10,000	10,000	Sales Voucher	Cash-in-Hand Sales Accounts
(f)	Purchases A/c Dr. To Cash A/c	5,000	5,000	Purchase Voucher	Purchase Accounts Cash-in-Hand
(g)	Arun A/c Dr. To Sales A/c	70,000	70,000	Sales Voucher	Sundry Debtors Sales Accounts
(h)	Cash A/c Dr. To Bank A/c	25,000	25,000	Contra Voucher	Cash-in-Hand Bank Accounts

(i)	Sumathy A/c To Bank A/c	Dr.	30,000	30,000	Payment Voucher	Sundry Creditors Bank Accounts
(j)	Cash A/c To Arun A/c	Dr.	10,000	10,000	Receipt Voucher	Cash-in-Hand Sundry Debtors
(k)	Salaries A/c To Bank A/c	Dr.	36,000	36,000	Payment Voucher	Indirect Expenses Bank Accounts
(l)	Carriage A/c To Cash A/c	Dr.	6,000	6,000	Payment Voucher	Direct Expenses Cash-in-Hand
(m)	Computer A/c To Muthu Ltd A/c	Dr.	44,000	44,000	Journal Voucher	Indirect Expenses Sundry Creditors

2. The following balance sheet has been prepared from the books of Pearl on 1-4-2018.

Liabilities	₹	Assets	₹
Capital	1,60,000	Buildings	40,000
Sundry creditors:		Furniture	20,000
Maya A/c	20,000	Stock	10,000
		Sundry debtors	
		Peter	20,000
		Cash in hand	30,000
		Cash at bank	60,000
	<u>1,80,000</u>		<u>1,80,000</u>

During the year the following transactions took place.

- Wages paid by cash ₹ 4,000
- Salaries paid by cheque ₹ 10,000
- Cash purchases made for ₹ 4,000
- Good purchased on credit from Yazhini ₹ 30,000
- Goods sold on credit to Jothi ₹ 40,000
- Payment made to Yazhini through NEFT ₹ 6,000
- Cash received from Peter ₹ 10,000
- Cash sales made for ₹ 4,000
- Depreciate buildings at 20%
- Closing stock on 31.03.2019 ₹ 9,000

You are required to prepare trading and profit and loss account for the year ended 31-03-2019 and a balance sheet as on that date using Tally.

Solution : Following steps are to be followed to enter the transactions in Tally ERP 9

- To create company :** Company Info > Create Company
Type the Name as Peral and keep all other fields as they are and choose 'Yes' to accept.
- To maintain accounts only :**
Gateway of Tally > F11 Accounting Features > General > Maintain accounts only: Yes > Accept Yes
- To create ledger accounts with opening balances :**
Gateway of Tally > Masters > Accounts Info > Ledgers > Single Ledger > Create

Creation of	Name	Under	Opening balance	Accept
Pearl's Capital A/c	Pearl's Capital A/c	Capital Account	1,60,000	Yes
Maya A/c (Sundry creditors)	Maya A/c	Sundry Creditors	20,000	Yes
Buildings A/c	Buildings A/c	Fixed Assets	40,000	Yes
Furnitures A/c	Furnitures A/c	Fixed Assets	20,000	Yes
Opening stock	Opening stock	Stock-in-Hand	10,000	Yes
Peter A/c (Sundry debtors)	Peter A/c	Sundry Debtors	20,000	Yes
Cash in hand	Cash	Cash-in-Hand	30,000	Yes
Cast at bank	Bank	Bank Accounts	60,000	Yes

CREATION OF PEARL CAPITAL A/C

NOTE : Cash account need not be created as it is a default ledger. Only the opening balance has to be recorded by altering the cash account.

To record the opening balance of cash : Gateway of Tally > Masters > Accounts Info > Ledgers > Single Ledger > Alter

ADDITIONAL QUESTIONS AND ANSWERS

I. MULTIPLE CHOICE QUESTIONS.

(i) Choose the correct answer.

1. CAS helps to compute various taxes and to deduct these and deposit the same to the

- Private account
- Company account
- Government account
- None of the above

[Ans. (c) Government account]

2. In 2009, Tally Solutions introduced the software

- Tally. ERP 9
- Tally. ERP 10
- Tally. ERP 6.0
- Tally. 8.0

[Ans. (a) Tally. ERP 9]

3. Transactions are to be recorded through

- journal entries
- voucher entries
- accounting entries
- none of these

[Ans. (b) voucher entries]

4. All transactions related to receipt either in cash or through bank are recorded using

- payment voucher
- contra voucher
- receipt voucher
- sales voucher

[Ans. (c) receipt voucher]

3. Assertion (A) : Accounting report is a compilation of accounting information that are derived from the accounting records of a business concern.

Reason (R) : In 2009, Tally solutions introduced the software Tally. ERP 10.

- (a) Both (A) and (R) are true and (R) is the correct explanation of (A).
- (b) Both (A) and (R) are true and (R) is not the correct explanation of (A).
- (c) (A) is true, but (R) is false.
- (d) (A) is false, but (R) is true.

[Ans. (c) (A) is true, but (R) is false]

4. Assertion (A) : All transactions related to receipt either in cash or through bank are recorded using receipt voucher.

Reason (R) : Purchase vouchers are used for recording both cash and credit sale of goods.

- (a) Both (A) and (R) are true and (R) is the correct explanation of (A).
- (b) Both (A) and (R) are true and (R) is not the correct explanation of (A).
- (c) (A) is true, but (R) is false.
- (d) (A) is false, but (R) is true.

[Ans. (c) (A) is true, but (R) is false]

(vii) Choose the Correct Statement.

1. (i) Computerise Accounting System facilitates fast and accurate retrieval of data and information.
 - (ii) Accounting report may be classified as routine reports and special purpose reports
 - (iii) Accounting information system collects financial data, processes them and provides information to the various users.
- (a) (i) is correct
 - (b) (i) and (ii) are correct
 - (c) (ii) and (iii) are correct
 - (d) (i), (ii) and (iii) are correct

[Ans. (d) (i), (ii) and (iii) are correct]

2. (i) Sales vouchers are used for recording both cash and credit sales of goods.

(ii) Purchase vouchers are used for recording both cash and credit purchases of goods.

(iii) All transactions related to payments either in cash or through bank are recorded using receipt voucher.

- (a) (i) is correct
- (b) (i) and (ii) are correct
- (c) (ii) and (iii) are correct
- (d) (i), (ii) and (iii) are correct

[Ans. (b) (i) and (ii) are correct]

II. VERY SHORT ANSWER QUESTIONS :

1. What is computerised accounting system?

Ans. (i) Computerised accounting system refers to the system of maintaining accounts using computers.

(ii) It involves the processing of accounting transactions through the use of computer in order to maintain and produce accounting records and reports.

2. What are the steps involved in designing accounting reports?

Ans. Following are the steps involved in designing accounting reports:

- (i)** Define the objective of generating report
- (ii)** Specify the structure of the report
- (iii)** Creating database queries to interact with the database to retrieve, modify, add or delete data from the records.

3. What is MIS?

Ans. (i) A Management Information System (MIS) is a system that provides information for decision making at all levels of management.

(ii) It includes manufacturing information system, marketing information system, human resource information system and accounting information system.



HOTS QUESTIONS AND ANSWERS

1. Identify the value, violated by the employee of company? Who uses office computer for chatting on social networking sites?

Ans. Ethical values are being violated as the employer is not right in his conduct.

2. A chemist as per the requirement of law makes use of computer for recording the stock of all the medicines including their manufacturing and expiry dates. What benefits he will get from computerised records also tell the values indicated in the question.

Ans. The benefits he will get from computerised records are

- (i) High speed
- (ii) Accuracy
- (iii) Reliability
- (iv) Versatility
- (v) Storage

Value indicated is - Taking care of public health by showing manufacturing and expiry date electronically.

