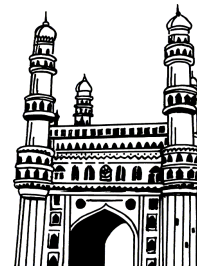


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Introduction to Financial Accounting

Accounting as an Information System, Importance and Scope, Limitations; Users of accounting information; Accounting Principles, Accounting Concepts, Principles and Conventions – Generally Accepted Accounting Principles (GAAP); Nature of Accounts

UNIT - II

Types of Books (Primary and Secondary)

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UNIT - III

Preparation of Financial Statements

Trading Account, Profit & Loss Account and Balance Sheet, Adjustment Entries, Understanding contents of financial statements of a joint stock company as per the Companies Act 2013.

UNIT - IV

Financial Statement Analysis using Ratios

Objective of financial statement analysis, sources of information, Techniques of financial statement analysis: Horizontal analysis, Vertical analysis and Ratio Analysis; Financial Ratios: Meaning and Usefulness of Financial Ratios. Analysis of ratios- Liquidity Ratios, Solvency Ratios, Profitability Ratios and Turnover Ratios; Limitation of ratio analysis.

UNIT - V

Indian Accounting Standards (Ind-AS)

Concept, benefits, procedure for issuing Ind- AS in India, salient features of Ind-AS issued by ICAI; International Financial Reporting Standards (IFRS): Main features, uses and objectives of IFRS, IFRS issued by IASB.

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Ans : (June-18, July-17)

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Refer Unit-V, Q.No. 16.

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Ans : (Imp.)

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UNIT I

Introduction to Financial Accounting

Accounting as an Information System, Importance and Scope, Limitations; Users of accounting information; Accounting Principles, Accounting Concepts, Principles and Conventions – Generally Accepted Accounting Principles (GAAP); Nature of Accounts

1.1 INTRODUCTION TO FINANCIAL ACCOUNTING

Q1. Define the term accounting.

Ans :

Introduction

Accounting is termed as a language of business which is used to communicate the information or the results of business operations to several interested people like proprietors, investors, creditors, government etc.

Accounting plays a vital role in the process of decision making. It is considered as a common language used in the world of industry and commerce. Accounting principles refer to those rules and regulations which are followed by the accountants for recording, classifying and summarizing the accounting transactions.

Accounting is an art and science of providing meaningful information about financial activities of the company's as a tool for management. This is used by a business for maintaining financial records on cash basis or accrual basis.

Accounting is an important part of information system. It is an important profession. Study of accounting is must for all the people concerned with business, trade and commerce.

Definitions of Accounting

- (i) **According to American Institute of Certified Public Accountants** Financial Accounting is "the art of recording, classifying and summarizing in a significant manner in terms of money transactions and events which are in part, at least of a financial character and interpreting the results thereof."

- (ii) **According to American Accounting Association** Accounting is "the process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information".

- (iii) **According to Accounting Principles Board (APB)** Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic activities that is useful in making economic decision in making reasoned choices among alternative course of action.

- (iv) **According to H. Bierman and AR Drebin** Accounting may be defined "as the identifying, measuring, recording and communicating of financial information."

- (v) **According to Smith & Ashburne** "Accounting is the science of recording and classifying business transactions and events, primarily of a financial character and the act of making significant summaries analysis and interpretation of these transactions and events and communicating the results to persons who must , make decisions or form judgements."

From the above the following attributes of accounting emerge :

- (i) **Identifying the transactions and events**
Accounting identifies transactions and events of a separate entity. A transaction is a particular type of external event which can be expressed in terms of money and bring change in the financial position of a business

unit. An event (whether internal or external) is a happening of consequence to an entity (e.g. use of raw material for production). An entity means an economic unit that performs economic activities (e.g. Reliance Industries Ltd., TISCO).

(ii) It is the art of recording business transactions

First, all financial transactions should be recorded in the journal or in the books of original entry known as subsidiary books as and when they take place so that a complete record of financial transactions is available.

(iii) It is the art of classifying business transactions

All entries in the journal or subsidiary books should be classified by posting them to the appropriate ledger accounts to find out at a glance the total effect of all such transactions in a particular account. For example, all transactions relating to Shyam Sunder in the journal or various subsidiary books will be posted to Shyam Sunder's Account. It may be noted that business transactions are recorded and classified in such a way that it may be possible to determine profit or loss made by the business and its financial position on a specified date.

(iv) The transactions or events of a business must be recorded in monetary terms

If there are certain events which cannot be measured in terms of money, these will not be recorded in financial accounting. For example, a quarrel between production manager and financial manager may be affecting the business but it cannot be measured in terms of money and thus will not be recorded in the books of accounts.

(v) It is the art of summarising financial transactions

After recording and classifying financial transactions next stage is to prepare the trial balance and final accounts with a view to

ascertaining the profit or loss made during a trading period and the financial position of the business on a particular date.

(vi) It is an art of analysis and interpretation of these transactions

The accounting information must be analysed and interpreted by calculating various ratios and percentages or other relationship in order to evaluate the past performance of the business and to make sound plans for the future.

(vii) The results of such analysis must be communicated to the persons who are to make decisions or form judgements

All information must be provided in time and presented to the different categories of the persons so that appropriate decisions may be taken at the right time.

Q2. What are the objectives of accounting ?

Ans :

The main objectives of accounting are :

➤ **Systematic record of the business transactions**

When the business transactions are huge in number, it is difficult to remember. Therefore, a systematic record of the business transactions helps the business in the proper preparation of the financial reports.

➤ **Ascertainment of financial result and financial position for the given period**

The aim of every business is to earn profits. Preparation of financial statements enables the business enterprise to ascertain the financial result and financial position on the last day of the financial year. Management, investors, creditors, government etc. will be in a position to know whether the running of the business has proved to be remunerative or not (profit and loss account), so that steps can be taken to improve the position. What the business owns and owes can be known with the help of Balance Sheet prepared at

the end of the period. Thus, it serves as the barometer of the financial health of the business.

➤ **Generation and communication of the required accounting information**

Accounting information so generated is communicated to various interested parties such as management, employees, creditors etc., which helps them in various aspects of planning, control and evaluation. The American Accounting Association has stressed upon the importance of accounting in its definition as "accounting is the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information."

Q3. What is the need for accounting ?

Ans : (Dec.-17)

The main motto of any business organization would be to earn profit, which is the excess-income over expenditure.

- The ultimate profit of an organization can be ascertained only when the business is wound up, but the investors would like to get a regular return on their investment in the form of dividends.
- Therefore, there is a need to ascertain the profit at periodical intervals (accounting period) in order to pay dividends to the investors, and ascertain the financial result of the organization in which the stakeholders are interested in.
- A large number of transactions take place in the business everyday which have to be analyzed in order to know the total incomes, expenses, amount due to the creditors, amount due from the debtors, cash position, expenses and incomes outstanding, expenses paid in advance, income received in advance, etc.,.
- In a sole trading concern and a small concern, it would not be difficult to find out the net figures as only a few transactions take place whereas in the case of large concerns, where

a large number of transactions take place, it would be practically impossible to remember all the transactions and to ascertain the net figure.

- Therefore there is a need to record the transactions in a systematic and chronological order and this is done with the help of accounting which involves the accounting cycle of recording the transactions in the journal, posting them in the ledger, preparing the trial balance and analyzing the balances of ledger accounts by preparing the final accounts.
- Hence, all the business concerns, small or big, are relying on recording of transactions and preparing the accounts to have an accurate result of the organization, replacing the human memory.

Q4. Explain about Advantages and Limitations of Accounting.

Ans : (June-18)

Advantages of Accounting

Following are main advantages of accounting:

1. Replacement of Memory

In a large business it is very difficult for a businessman to remember all the transactions. Accounting provides records which will furnish information as and when desired and thus it replaces human memory.

2. Evidence in Court

Properly maintained accounts are often treated as a good evidence in the court to settle a dispute.

3. Settlement of Taxation Liability

If accounts are properly maintained, it will be of great assistance to the businessman in settling the income tax and sale tax liability otherwise tax authorities may impose any amount of tax which the businessman will have to pay.

4. Comparative Study

It provides the facility of comparative study of the various aspects of the business such as

profits, sales, expenses etc. with that of previous year and helps the businessman to locate significant factor leading to the change, if any.

5. **Sale of Business**

If accounts are properly maintained, it helps to ascertain the proper purchase price in case the businessman is interested to sell his business.

6. **Assistance to the Insolvent Person**

If a person is maintaining proper accounts and unfortunately he becomes insolvent (i.e. when he is unable to pay to his creditors), he can explain many things about the past with the help of accounts and can start a fresh life.

7. **Assistance to Various Parties**

It provides information to various parties, i.e., owners, creditors, investors, government, managers, research scholars, public and employees and financial position of a business enterprise from their own view point.

8. **Facilitate in Raising Loans**

Accounting facilitates raising loans from lenders by providing them the required financial information.

9. **Assistance to the Management**

Accounting assists the management in taking managerial decisions. For example, Projected Cash Flow Statement facilitates the management to know the future receipts and payments and to take decisions regarding anticipated surplus or shortage of funds.

10. **Facilitate Control Over Assets**

Accounting facilitates control over assets by providing information regarding Cash Balance, Bank Balance, Stock, Debtors, Fixed Assets, etc.

Limitations / Disadvantages of Accounting

Following are the main limitations of accounting:

1. **Records only Monetary Transactions**

Accounting records only those transactions which can be measured in monetary terms.

Those transactions which cannot be measured in monetary terms as conflict between production manager and marketing manager, efficient management etc., may be very important for a concern but not recorded in the business books.

2. **Effect of Price Level Changes not Considered**

Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books with the result that comparison of the various years becomes difficult.

For example, the sales to total assets in 2007 would be much higher than in 2002 due to rising prices, fixed assets being shown at cost and not at market price.

3. **No realistic information**

Accounting information may not be realistic as accounting statements are prepared by following basic concepts and conventions. For example, going concern concept gives us an idea that the business will continue and assets are to be recorded at cost but the book value which the asset is showing may not be actually realisable. Similarly, by following the principle of conservatism the financial statements will not reflect the true position of the business.

4. **Personal bias of the Accountant affects the accounting statements**

Accounting statements are influenced by the personal judgement of the accountant. He may select any method of depreciation, valuation of stock, amortisation of fixed assets, treatment of deferred revenue expenditure. Such judgement based on integrity and competency of the accountant will definitely affect the preparation of accounting statements.

5. **Permits alternative treatments**

Accounting permits alternative treatments within generally accepted accounting concepts and conventions. For example, method of charging depreciation may be straight line method or diminishing balance method or some other method. Similarly, closing stock may be valued by FIFO (First-

in-First-Out) or LIFO (Last-in-First-out) or average price method. Application of different methods may give different results and results may not be comparable.

6. Profit no real test of managerial performance

Profit earned during an accounting period is the test of managerial performance. Profit may be shown in excess by manipulation of accounts by suppressing such costs as depreciation, advertisement and research and development or taking excess value of closing stock. Consequently real idea of managerial performance may not be available by manipulated profit.

7. Historical in nature

Usually accounting supplies information in the form of Profit and Loss Account and Balance Sheet at the end of the year. So, the information provided is of historical interest and only gives post-mortem analysis of the past accounting information. For control and planning purposes management is interested in quick and timely information which is not provided by financial accounting.

8. Window Dressing in Balance Sheet

When an accountant resorts to window dressing in the Balance Sheet, then Balance Sheet cannot exhibit the true and fair view of the state of affairs of the business.

1.1.1 Book Keeping

Q5. Define book keeping? What are the objectives of book keeping?

Ans :

Book-Keeping is an activity concerned with the recording of financial data relating to business operations in a significant and orderly manner. Book-Keeping is the record making phase of accounting. Accounting is based on a careful and an efficient book-keeping system.

Book-Keeping is defined by different authors. A few of such definitions are given below. Carter in his Advanced Accounts defined Book-keeping as "the Science and art of correctly recording in books

of account are those business transactions that result in the transfer money or money's worth".

Definitions

i) **According to B.G. Vickery :** In his 'principles and Practice of Book-Keeping' defined Book-keeping as "The art of recording pecuniary or business transactions in a regular and systematic manner."

ii) **According to Kohler** in his book 'A Dictionary for Accountant's defined Book-keeping as "the process of analysing, classifying and recording transactions in accordance with preconceived plan."

Objectives of Book-Keeping

i) Book-keeping is concerned with recording of the financial transactions of business in a methodical manner so that information on any point in relation to them may be quickly obtained.

ii) Book-keeping activity is responsible for keeping all the financial records of a business (or only a minor segment such as maintenance of the customer's accounts).

iii) Book-keeping is to prepare original books of accounts trial balance and final accounts.

iv) To avoid financial frauds in business entity.

Q6. What are the differences between Book Keeping and Accounting ?

Ans :

Book-keeping is recording of the financial transactions of a business in a methodical manner so that information on any point in relation to them may be quickly obtained. A book-keeper may be responsible for keeping all the financial records of a business or only a minor segment such as maintenance of the customers' accounts in a departmental store. Much of the work of a book-keeper is clerical in nature and can be accomplished through the use of mechanical and electronic equipment.

On the other hand, Accounting is primarily concerned with the design of the system of records, the preparation of reports based on the recorded data, the interpretation of the reports and finally

communicating the results of the interpretation to persons who are interested in such results. Accountants often direct and review the work of book-keepers. The work of accountants at the beginning may include some book-keeping but accountants must possess a much higher level of knowledge, conceptual understanding and analytical skill than is required of the book-keepers.

The main differences between Book-keeping and Accounting are as follows :

<i>Point of Distinction</i>	<i>Book-keeping</i>	<i>Accounting</i>
1. Object	The object of book-keeping is to prepare original books of accounts, trial balance and final accounts and to maintain systematic records of financial results.	The object of accounting is to record, classify, summarise, analyse and interpret the business transactions and to ascertain operating results & financial position and to communicate to various users.
2. Scope	It has limited scope and is concerned with recording, classifying, and summarising of business transactions.	It has a wide scope and covers book-keeping plus analysis and interpretation.
3. Level of Work	It is restricted to clerical work and is done by lower levels of management.	It is concerned with all levels of management. Lower level clerks prepare the accounts, medium level report it and top level interpret it.
4. Mutual Dependence	It has to depend on accounting for making the accounting records more useful.	It has to depend on book-keeping for getting the required information from accounting records and for making them useful for planning, control and decision making.
5. Results of the Business	It shows the net result and financial position of the business as the scope extends to the preparation of final accounts.	It analyses the operating results and financial position of the business.
6. Stages	Bookkeeping is a primary stage.	Accounting is the secondary stage. It begins where book-keeping ends.
7. Nature of Job	The job of book-keeper is often routine and clerical in nature.	The job of an accountant is analytical in nature.
8. Knowledge Required	The book-keeper is not required to have higher level of knowledge than that of an accountant.	The accountant must have higher level of knowledge than that of bookkeeper.
9. Staff for Performing Work	Book keeping work is performed by junior staff.	Accounting work is performed by senior staff.

1.2 ACCOUNTING AS AN INFORMATION SYSTEM

Q7. Explain briefly about Accounting as a Information System.

Ans :

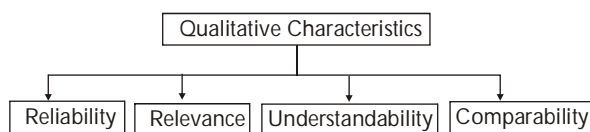
(Jan.-21)

An analysis of the accounting show that accounting may rightly be termed as an information system that provides reports to various individuals or groups about economic activities of an organisation. It is the means by which most business information is communicated to different sections of public having interest in the business, viz., owners, creditors, prospective investors, etc. Accounting information system is considered to be the most important part of overall management information system (MIS) on account of the following reasons:

- (i) It enables both the insiders, i.e., the management and the outsiders, i.e., external information users to have a clear picture of the whole organisation;
- (ii) The integration of the accounting information system with other important information systems like marketing, personnel, production, etc., provide useful information for financial planning;
- (iii) The integration of non-financial information such as social costs and benefits, development of human resources, etc., help the business as well as the government to take appropriate decisions keeping in view the interests of both the society and the business;
- (iv) The integration of system with other sub-systems like personnel, marketing, production, etc., lead to greater accuracy and higher speed in the delivery of relevant information to the concerned users.

Qualitative Characteristics of Accounting Information System

In order that the information provided by an accounting system is useful to the users, it should possess characteristics as shown in the following chart:



1. Reliability

Accounting information is said to be reliable if it is accurate, free from bias and it faithfully represents what it seeks to represent. Reliability of the accounting information, therefore, depends on the following factors.

- (a) **Accuracy:** The information should be free from any material error and capable of being verified.
- (b) **Unbiased:** The information provided must be free from any personal influence or judgement of the persons providing the information. In other words, it should be neutral.
- (c) **Faithful Presentation:** The accounting information must represent faithfully the transactions and other events which it represents or expected, to represent. For instance, if the financial information is subject to certain business risks or uncertainties, it must be disclosed in the accounting information.
- (d) **Completeness:** The information can be reliable if it is complete in all aspects. Any omission may cause the information to be false or misleading and this makes it unreliable.

2. Relevance

The accounting information is said to be relevant if it influences the decision making. It should enable the users to evaluate their past, present or future events in entirety. The information should also be available in time and must help both in prediction and appropriate feedback.

3. Understandability

The accounting information should be readily understandable by the users. Of course the users are expected to have a reasonable working knowledge of the business and the economic activities and also a willingness to

readily understand the accounting information with reasonable diligence. It does not, however, mean that complex accounting information should not be excluded from the financial statements on the ground that such information is of complex nature and, therefore, will not be understood by the users.

4. Comparability

The accounting information should be capable of being compared either over a period of time or between two or more entities. This requires that financial 'statements or accounting reports provide accounting information which relate to the same period based on same account principles and policies and use a common format. Comparability of accounting information will enable an entrepreneur to evaluate its performances vis-a-vis other entrepreneurs for evaluation with its own performance over different periods of time.

1.3 BRANCHES OF ACCOUNTING / SCOPE OF ACCOUNTING

Q8. Explain the various Branches of Accounting.

Ans :

Accounting has many branches. The following are the main branches :

1. Financial Accounting

It deals with the recording of the monetary transactions that take place in the business, ascertains profit or loss for a specific accounting period i.e. a period of twelve months (calendar year or financial year) and presents the financial position of the business on a given date.

2. Management Accounting

It is concerned with making available the relevant information to assist the management in discharging cross sectional functions such as planning, control, and other decision making related issues. According to Chartered Institute of Management Accountants, London, "management accounting is the

application of professional information in such a way as to assist the management in the formation of policies and in the planning and control of the operations of the undertaking."

3. Cost Accounting

The main function of Cost Accounting is ascertainment of cost in relation to different activities of the business so as to enable the management to exercise cost control. It deals with the collection and interpretation of cost related data of the current business activities and plan for the future business operations.

4. Human Resource Accounting

Successful operation of any organization depends upon the effective and significant utilization of men, materials and money.

➤ The dichotomy in accounting between human and non-human capital is fundamental. The latter is recognized as an asset and is therefore recorded in the books and reported in the financial statements, whereas the former is totally ignored by accountants.

➤ An asset, whether tangible or intangible, can be defined as something, which is capable to generating future income stream.

➤ From this point of view, Human Resources are as good as other physical or intangible assets, which an enterprise owns for production of goods and services and earning profitability on its investments.

➤ In fact, Human Resource is the only 'active asset' in the asset portfolio of an organization and its performance, profitability and growth depend to a large extent on the quality of its Human Resources. Buildings, plants, computers and other physical and financial resources are unproductive without human efforts and decisions.

5. Inflation Accounting

Inflation Accounting has been developed in order to overcome the limitations of Financial Accounting with regard to the historical costs. Inflation Accounting is concerned with the recording of the business transactions taking into consideration the price level changes which the Financial Accounting fails to do so.

1.4 FINANCIAL ACCOUNTING

Q9. Define the term Financial Accounting and Explain its objectives

(or)

What are the objectives of Financial Accounting

Ans : (July-19, Dec.-18)

The purpose of accounting is to provide the information that is needed for sound economic decision making.

- The main purpose of financial accounting is to prepare financial reports that provide information about a firm's performance to external parties such as investors, creditors, and tax authorities.
Financial accounting is performed according to Generally Accepted Accounting Principles (GAAP) guidelines.
- Financial accounting is concerned with recording of day to day transactions.
Financial Accountancy or Financial Accounting is the field of accountancy concerned with the preparation of financial statements for decision makers, such as stockholders, suppliers, banks, employees, government agencies, owners, and other stakeholders.
- The fundamental need for financial accounting is to reduce principal-agent problem by measuring and monitoring agents' performance and reporting the results to interested users.
Financial accountancy is used to prepare accounting information for people outside the organization or not involved in the day to day running of the company.
- Financial Accounting is the process of summarizing financial data taken from an organization's accounting records and publishing in the form of annual reports for the benefit of people outside the organization.
- Financial accountancy is governed by both local and international accounting standards.

Objectives of Financial Accounting

Some of the important objectives of Financial Accounting are as under :

- **Finding Out Various Balances**
Systematic recording of business transactions provides vital information about various balances like cash balance, bank balance, etc.
- **Providing Knowledge of Transactions**
Systematic maintenance of books provides the details of every transaction.
- **Ascertaining Net Profit or Loss**
Summarization in form of Profit and Loss Account provides business income over a period of time.
- **Depicting Financial Position**
Balance sheet is prepared to depict financial position of business means what the business owns and what owes to others.
- **Information to all Interested Users**
After analysis and interpretation, business performance and position are communicated to the interested users.
- **Fulfilling Legal Obligations**
Vital accounting information helps in fulfilling legal obligations e.g. sales tax, income tax etc.

1.4.1 Importance of Financial Accounting

Q10. Explain the Importance of Financial Accounting

(or)

Accounting is indispensable tool- Explain

Ans : (July-19, Dec.-18)

1. Maintenance of business records
2. Preparation of financial statements
3. Comparison of results
4. Decision making
5. Evidence in legal matters

6. Provides information to related parties
7. Helps in taxation matters
8. Valuation of business
9. Replacement of memory

1. Maintenance of Business Records

It records all the financial transaction pertaining to the respective year systematically in the books of accounts. It is not possible for management to remember each and every transaction for a long time due to their size and complexities.

2. Preparation of Financial Statements

Financial statements like Trading and profit and loss account, Balance Sheet can be prepared easily if there is a proper recording of transactions. Proper recording of all the financial transactions is very important for the preparation of financial statements of the entity.

3. Comparison of Results

It facilitates the comparison of the financial results of one year with another year easily. Also, the management can analyze the systematic recording of all the financial transactions according to the policies of the entity.

4. Decision Making

Decision making becomes easier for management if there is a proper recording of financial transactions. Accounting information enables management to plan its future activities, make budgets and coordination of various activities in various departments.

5. Evidence in Legal Matters

The proper and systematic records of the financial transactions act as evidence in the court of law.

6. Provides Information to Related Parties

It makes the financial information of the organization available to stakeholders like owners, creditors, employees, customers, government etc. easily.

7. Helps in Taxation Matters

Various tax authorities like income tax, indirect taxes depends on the accounts maintained by the management for settlement of taxation matters.

8. Valuation of Business

For proper valuation of an entity's business accounting information can be utilized. Thus, it helps in measuring the value of the entity by using the accounting information in the case of sale of the entity.

9. Replacement of Memory

Proper recording of accounting transactions replaces the need to remember transactions.

1.4.2 Limitations of Financial Accounting

Q11. What are the limitations of financial accounting?

Ans : (Dec.-18)

Financial accounting well answered the needs of business in the initial stages when the business was not so complex. The growth and complexities of modern business brought out the following limitations of financial accounting:

1. Provides only limited information

There are now no set patterns of business on account of radical changes in business activities. An expenditure may not bring an immediate advantage to the business but it may have to be incurred because it may bring advantage to the business in the long run or may be necessary simply to sell the name of the business. The management needs a lot of varied information to decide whether on the whole it will be justifiable to incur a particular expenditure or not. Financial accounting fails to provide such information.

2. Treats figures as single, simple and silent items

Financial accounting fails to make the people realize that accounting figures are not mere isolated phenomena but they represent a chain of purposeful and pertinent events. The role of accountant these days is not only of a

book-keeper and auditor, but also that of a financial adviser. Recording of transactions is now the secondary function of the accountant. His primary function now is to analyse and interpret the results.

3. Provides only a post-mortem record of business transactions

Financial accounting provides only a post-mortem record of business transactions since it records transactions only on historical basis. These days business decisions are made on the basis of estimates and projections rather than historical facts. Of course, past records are helpful in making future projections but they alone are not sufficient. Thus, needs of modern management demand a break-up from the principles and practice of traditional accounting.

4. Considers only quantifiable information

Financial accounting considers only those factors which are capable of being quantitatively expressed. In modern times, the concept of welfare state has resulted in increased government interference in all sectors of the national economy. The management has, therefore, to take into account government decisions over and above purely commercial considerations. Some of these factors are not capable of being quantitatively expressed and hence their impact is not reflected in financial statements.

5. Fails to provide informational needs of different levels of management

The shareholders are only rentiers of capital. The business is run in reality by different executives, each an expert in his area. These executives have powers based on the level of management to which they belong. There are usually three levels of management—top management, middle management and lower management.

- The type of information required by each level of management is different.

- The top management is mainly concerned with the policy decisions.
- They, therefore, are interested in knowing about the soundness of the plans, proper structuring of the organization, proper delegation of authority and its effectiveness.
- The middle management executives function as coordinators. They must know:
 - (i) What happened?
 - (ii) Where it happened? and
 - (iii) Who is responsible?

The lower management people function as operating supervisors. They should get information regarding effectiveness of their operations.

- The reports submitted to them should give details about the planned performance, actual performance and the deviations with their reasons. Financial accounting does not have a built-in system to provide all such information.

1.5 USERS OF ACCOUNTING INFORMATION

Q12. State the persons who should be interested in accounting information.

Ans : (Jan.-21, Dec.-19, June-18)

Accounting is of primary importance to the proprietors and the managers. However, other persons such as creditors, prospective investors, employees, etc., are also interested in the accounting information.

1. Proprietors

A business is done with the objective of making profit. Its profitability and financial soundness are, therefore, matters of prime importance to the proprietors who have invested their money in the business.

2. Managers

In a sole proprietary business, usually the proprietor is the manager. In case of a

partnership business either some or all the partners participate in the management of the business. They, therefore, act both as managers as well as owners. In case of joint stock companies, the relationship between ownership and management becomes all the more remote. In most cases the are holders act merely as rentiers of capital and the management of the company passes into the hands of professional managers. The accounting disclosures greatly help them in knowing about what has happened and what should be done to improve the profitability and financial position of the enterprise in the period to come.

3. Creditors

Creditors are the persons who have extended credit to the company. They are i so interested in the financial statements because these will help them in ascertaining whether the enterprise will be in a position to meet its commitment towards them both regarding payment of interest and principal.

4. Prospective

Investors A person who is contemplating an investment in a business will like to know about its profitability and financial position.

5. Government

The Government is interested in the financial statements of business enterprise in account of taxation, labour and corporate laws. If necessary, the Government may ask its officials to examine the accounting records of a business.

6. Employees

The employees are interested in the financial statements on account of various profit sharing and bonus schemes. Their interest may further increase in case they purchase shares of the companies in which they are employed.

7. Citizen

An ordinary citizen may be interested in the accounting records of the institutions -ith which he comes in contact in his daily life, e.g., bank, temple, public utilities such as gas,

transport and electricity companies. In a broader sense, he is also interested in the accounts of a government company, a public utility concern etc., as a voter and a tax-payer.

1.6 ACCOUNTING PRINCIPLES

Q13. Define Accounting Principles. Explain the categories of Accounting Principles.

Ans : (Jan.-21)

Accounting principles may be defined as those rules of action adopted by the accountants universally while recording accounting transaction. "They are a body of doctrines commonly associated with the theory and procedures of accounting, serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternatives exist". These principles can be classified into two categories:

- (i) Accounting Concepts
- (ii) Accounting Conventions

Accounting Concepts

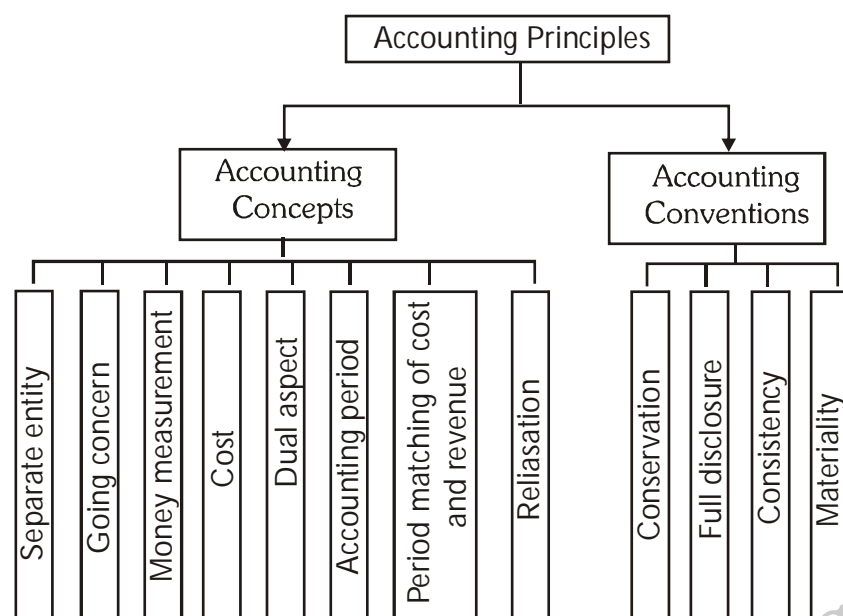
The term 'concepts' includes those basic assumptions or conditions upon which the science of accounting is based. The following are the important accounting concepts:

- (i) Separate Entity Concept
- (ii) Going Concern Concept
- (iii) Money Measurement Concept
- (iv) Cost Concept
- (v) Dual Aspect Concept
- (vi) Accounting Period Concept
- (vii) Periodic Matching of Cost and Revenue Concept
- (viii) Realisation Concept

Accounting Conventions

The term 'conventions' includes those customs or traditions which guide the accountant while preparing the accounting statements. The following are the important accounting conventions.

- (i) Convention of Conservatism
- (ii) Convention of Full Disclosure
- (iii) Convention of Consistency
- (iv) Convention of Materiality



1.6.1 Accounting Concepts

Q14. What are the various Accounting Concepts?

Ans :

(Jan.-21, Dec.-19, July-19, Dec.-18, June-18, Dec.-17)

1. Separate Entity Concept

In accounting business is considered to be a separate entity from the proprietor(s).

- It may appear to be so foolish that one person can sell goods to himself but this concept is extremely helpful in keeping business affairs strictly free from the effect of private affairs of the proprietor(s).
- Thus, when one person invests ₹ 10,000 into business, it will be deemed that the proprietor has given that much of money to the business which will be shown as a 'liability' in the books of the business.
- In case the proprietor withdraws ₹ 2,000 from the business, it will be charged to him and the net amount payable by the business will be shown only as ₹ 8,000.
- The concept of separate entity is applicable to all forms of business organisations.
- For example, in case of a partnership business or sole proprietorship business, though the partners or sole proprietor are not considered as separate entities in the eyes of law, but for accounting purposes they will be considered as separate entities.

2. Going Concern Concept

According to this concept it is assumed that the business will continue for a fairly long time to come.

- There is neither the intention nor the necessity to liquidate the particular business venture in the foreseeable future.
- On account of this concept, the accountant while valuing the assets does not take into account forced sale value of assets.

- Moreover, he charges depreciation on fixed assets on the basis of their expected lives rather than on their market value.
- It should be noted that the 'going concern concept' does not imply permanent continuance of the enterprise.
- It rather presumes that the enterprise will continue in operation long enough to charge against income, the cost of fixed assets over their useful lives, to amortise over appropriate period other costs which have been deferred under the actual or matching concept, to pay liabilities when they become due and to meet the contractual commitments.
- Moreover, the concept applies to the business as a whole. When an enterprise liquidates a branch or one segment of its operations, the ability of the enterprise to continue as a going concern is normally not impaired.
- The enterprise will not be considered as a going concern when it has gone into liquidation or it has become insolvent.
- Of course, the receiver or the liquidator may endeavour to carry on business operations for some period pending arrangement with the creditors or the final buyer for the sale of the business as a going concern, the going concern status of the concern will stand terminated from the date of his appointment or will be at least regarded as suspended, pending the results of his efforts.

3. Money Measurement Concept

Accounting records only monetary transactions.

- Events or transactions which cannot be expressed in money do not find place in the books of accounts though they may be very useful for the business.
- For example, if a business has got a team of dedicated and trusted employees, it is definitely an asset to the business but

since their monetary measurement is not possible, they are not shown in the books of the business.

- Measurement of business event in money helps in understanding the state of affairs of the business in a much better way.
- For example, if a business owns ` 10,000 of cash, 600 kg of raw materials, two trucks, 1,000 square feet of building space etc., these amounts cannot be added together to produce a meaningful total of what the business owns.
- However, if these items are expressed in monetary terms such as ` 10,000 of cash, ` 12,000 of raw materials, ` 2,00,000 of trucks and ` 50,000 of building, all such items can be added and much more intelligible and precise estimate about the assets of the business will be available.

4. Cost Concept

The concept is closely related to going concern concept. According to this concept:

- (a) An asset is ordinarily entered in the accounting records at the price paid to acquire it, and
 - (b) This cost is the basis for all subsequent accounting for the assets.
- If a business buys a plot of land for ` 50,000, the asset would be recorded in the books at ` 50,000 even if its market value at that time happens to be ` 60,000.
 - In case a year later the market value of this assets comes down to ` 40,000, it will ordinarily continue to be shown at ` 50,000 and not at ` 40,000.
 - The cost concept does not mean that the asset will always be shown at cost.
 - It has also been stated above that cost becomes the basis for all future accounting for the asset. It means that asset is recorded at cost at the time of its purchase, but it may systematically be reduced in its value by charging depreciation.

- Cost concept has the advantage of bringing objectivity in the preparation and presentation of financial statements.
- In the absence of this concept the figures shown in the accounting records would have depended on the subjective views of a person.
- However, on account of continued inflationary tendencies the preparation of financial statements on the basis of historical costs, has become largely irrelevant for judging the financial position of the business.
- This is the reason for the growing importance of inflation accounting.

5. Dual Aspect Concept

This is the basic concept of accounting. According to this concept every business transaction has a dual effect) For example, if A starts a business with a capital of 10,000, there are two aspects of the transaction. On the one hand, the business has asset of ₹ 10,000 while on the other hand the business has to pay to the proprietor a sum of ₹ 10,000 which is taken as proprietor's capital. This expression can be shown in the form of following equation:

$$\begin{aligned}\text{Capital (Equities)} &= \text{Cash (Assets)} \\ 10,000 &= 10,000\end{aligned}$$

The term 'assets' denotes the resources owned by a business while the term "Equities" denotes the claims of various parties against the assets. Equities are of two types. They are: owners' equity and outsiders' equity. Owners' equity (or capital) is the claim of owners against the assets of the business while outsiders' equity (for liabilities) is the claim of outside parties, such as creditors, debenture-holders etc., against the assets of the business. Since all assets of the business are claimed by some one (either owners or outsiders), the total of assets will be equal to total of liabilities, Thus:

$$\begin{aligned}\text{Equities} &= \text{Assets} \\ (\text{or})\end{aligned}$$

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

In the example given above, if the business purchases furniture worth ₹ 5,000 out of the money provided by A, the situation will be as follows:

Equities = Assets
Capital ₹ 10,000 = Cash ₹ 5,000 + Furniture ₹ 5,000
Subsequently, if the business borrows ₹ 30,000 from a bank, the new position would be as follows:

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

$$\begin{aligned}\text{Capital ₹ 10,000} &+ \text{Bank Loan ₹ 30,000} = \\ \text{Cash ₹ 35,000} &+ \text{Furniture ₹ 5,000}\end{aligned}$$

The term 'accounting equation' is also used to denote the relationship of equities to assets. The equation can be technically stated as "for each debit, there is an equivalent credit". As a matter of fact the entire system of double entry book-keeping is based on this concept. This has been explained in detail later in the chapter.

6. Accounting Period Concept

According to this concept, the life of the business is divided into appropriate segments for studying the results shown by the business after each segment.

- This is because though the life of the business is considered to be indefinite (according to going concern concept), the measurement of income and studying the financial position of the business after a very long period would not be helpful in taking proper corrective steps at the appropriate time.
- It is, therefore, absolutely necessary that after each segment or time interval the businessman must 'stop' and 'see back', how things are going.
- In accounting such a segment or time interval is called 'accounting period'. It is usually of a year.
- At the end of each accounting period an Income Statement and a Balance Sheet are prepared.
- The Income Statement discloses the profit or loss made by the business during the accounting period while the Balance Sheet depicts the financial position of the business as on the last day of the accounting period.
- While preparing these statements a proper distinction has to be made between capital and revenue expenditure.

7. Periodic Matching of Costs and Revenue Concept

This is based on the accounting period concept. The paramount objective of running a business is to earn profit.

- In order to ascertain the profit made by the business during a period, it is necessary that 'revenues' of the period should be matched with the costs (expenses) of the period.
- The term matching, means appropriate association of related revenues and expenses.
- In other words, income made by the business during a period can be measured only when the revenue earned during a period is compared with the expenditure incurred for earning that revenue. The question when the payment was received or made is irrelevant'.
- For example, if a salesman is paid commission in January, 2011, for sales made by him in December, 2010, the commission paid to the salesman in January, 2011 should be taken as the cost for sales made by him in December, 2010. This means that revenues of December, 2010 (i.e., sales) should be matched with the costs incurred for earning that revenue (i.e., salesman's commission) in December, 2010 (though paid in January, 2011).
- On account of this concept, adjustments are made for all outstanding expenses, accrued incomes, prepaid expenses and unearned incomes, etc., while preparing the final accounts at the end of the accounting period.

8. Realisation Concept

According to this concept revenue is recognized when a sale is made.

- Sale is considered to be made at the point when the property in goods passes to the buyer and he becomes legally liable to pay. This can be well understood with the help of the following example:
- A places an order with B for supply of certain goods yet to be manufactured. On receipt of order, B purchases raw materials, employs

workers, produces the goods and delivers them to A. A makes payment on receipt of goods. In this case the sale will be presumed to have been made not at the time of receipt of the order for the goods but at the time when goods are delivered to A.

However, there are certain exceptions to this concept:

- (i) In case of hire purchase the ownership of the goods passes to the buyer only when the last instalment is paid, but sales are presumed to have been made to the extent of installments received and installments outstanding (i.e. installments due but not received).
- (ii) In case of contracts accounts, though the contractor is liable to pay only when the whole contract is completed as per terms of the contract, the profit is calculated on the basis of work certified year after year as per certain accepted accounting norms.

1.6.2 Accounting Conventions

Q15. What are the various Accounting Conventions ?

Ans.: (Jan.-21, Dec.-18, June-18, Dec.-17)

1. Conservatism

- In the initial stages of accounting, certain anticipated profits which were recorded, "did not materialize.
- This resulted in less acceptability of accounting figures by the end-users.
- On account of this reason, the accountants follow the rule 'anticipate no profit but provide for all possible losses' while recording business transactions.
- In other words, the accountant follows the policy of "playing safe". On account of this convention, the inventory is valued 'at cost or market price whichever is less'.
- Similarly, a provision is made for possible bad and doubtful debts out of current year's profits. This concept affects principally the category of current assets.

- The convention of conservatism has become the target of serious criticism these days especially on the ground that it goes against the convention of full disclosure.
- It encourages the accountant to create secret reserves (e.g., by creating excess provision for bad and doubtful debts, depreciation etc.), and the financial statements do not depict a true and fair view of the state of affairs of the business.
- The Income Statement shows a lower net income, the Balance Sheet understates assets and overstates liabilities.
- The research studies conducted by the American Institute of Certified Public Accountants have indicated that conservatism concept needs to be applied with much more caution and care if the results reported are not to be distorted.

2. Full disclosure

According to this convention accounting reports should disclose fully and fairly the information they purport to represent.

- They should be honestly prepared and sufficiently disclose information which is of material interest to proprietors, present and potential creditors and investors.
- The convention is gaining more importance because most of big businesses are run by joint stock companies where ownership is divorced from management.
- The Companies Act, 1956 not only requires that Income Statement and Balance Sheet of a company must give a true and fair view of the state of affairs of the company but it also gives the prescribed forms in which these statements are to be prepared.
- The practice of appending notes to the accounting statements (such as about contingent liabilities or market value of investments) is in pursuance to the convention of full disclosure.

3. Consistency

According to this convention, accounting practices should remain unchanged from one period to another.

- For example, if stock is valued at "cost or market price whichever is less", this principle should be followed year after year.
- Similarly, if depreciation is charged on fixed assets according to diminishing balance method, it should be done year after year.
- This is necessary for the purposes of comparison. However, consistency does not mean inflexibility.
- It does not forbid introduction of improved accounting techniques.
- However, if adoption of such a technique results in inflating or deflating the figures of profit as compared to the previous period, a note to that effect should be given in the financial statements.

4. Materiality

According to this convention the accountant should attach importance to material details and ignore insignificant details.

- This is because otherwise accounting will be unnecessarily overburdened with minute details. The question what constitutes a material detail, is left to the discretion of the accountant.
- Moreover, an item may be material for one purpose while immaterial for another.
- For example, while sending each debtor "a statement of his account", complete details upto paise have to be given. However, when a statement of outstanding debtors is prepared for sending to top management, figures may be rounded to the nearest ten or hundred.
- The Companies Act also permits ignoring of 'paise' while preparing financial statements. Similarly, for tax purposes, the income has to be rounded to nearest ten.
- Thus, the term 'materiality' is a subjective term.

- The accountant should regard an item as material if there is reason to believe that knowledge of it would influence the decision of the informed investor.
- According to Kohler, "materiality means the characteristic attaching to a statement, fact or item whereby its disclosure or method of giving it expression would be likely to influence the judgement of a reasonable person."
- It should be noted that accounting is a man-made art designed to help man in achieving certain objectives.
- "The accounting principles, therefore, cannot be derived from or proven by laws of nature. They are rather in the category of conventions or rules developed by man from experience to fulfil the essential and useful needs and proposes in establishing reliable financial and operating information control for business entities.
- In this respect, they are similar to the principles of commercial and other social disciplines."

1.7 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

Q16. What is meant by the term Generally Accepted Accounting Principles (GAAP) ?

Ans : (Dec.-19)

Accounting practices follow certain guidelines. The rules that govern how accountants measure progress and communicate financial information fall under the heading "Generally Accepted Accounting Principles" (GAAP).

- GAAP comprises of conventions, rules and procedures that constitute accepted accounting practices at any given time. They are like the law or rules for conducting behaviour in a way acceptable to majority of the people.
- They may readily be defined as rules of action or conduct which are adopted by the accountants universally while recording accounting transactions.

- They are a body of doctrines commonly associated with the theory and procedures of accounting, serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternatives exist.
- It should be noted that GAAP differ from country to country because of the legislative requirements of each country, local accounting practices, customs, usage and business environment peculiar to each country.
- Each country has set up its own professional accounting body/regulatory authority to frame, implement and regulate the application of the GAAPs in the country.
- For example, in USA the Financial Accounting Standard Board (FASB) set up in 1973 makes major pronouncements called Statements of Financial Accounting Standards (SFAS) from time to time.
- Similarly, in UK the Accounting Standard Board set up in 1990 issues financial reporting standards. The Board has replaced the Accounting Standards Committee which was responsible for issuing Statements of Standard Account Practices (SSAPs) earlier from time to time.
- In India, the Accounting Standard Board set up by the Institute of Chartered Accountants of India issues the accounting standards to be observed by all business entities.
- However, the Ministry of Corporate Affairs (MCA) has also notified presently 40 Indian Accounting Standards (Ind AS), as a step towards convergence of International Financial Reporting Standards (IFRS) in India.
- It may be noted that Ind AS would be applicable to various classes of entities as may be prescribed by the relevant authorities such as Ministry of Corporate Affairs for the companies governed under the Companies Act, 2013 from the notified date(s).
- The existing Accounting Standards (AS) would continue to apply to entities other than those to which Ind AS would apply.

- In case of differences between the two standards i.e. AS issued by the Institute of Chartered Accountants of India and Ind AS notified by the Ministry of Corporate Affairs, Government of India, the Institute of Chartered Accountants of India would harmonise their differences.
- This, in some cases, has already been done e.g. withdrawal of AS 6 Depreciation Accounting and replacement of AS 10: Fixed Assets by AS 10: Property, Plant and Equipment.

1.8 NATURE OF ACCOUNTS

Q17. Explain the nature of accounting.

(or)

Elucidate the nature of accounting.

Ans :

Nature of Accounting

The various definitions and explanations of accounting has been propounded by different accounting experts from time to time and the following aspects comprise the nature of accounting

1. Accounting as a service activity

Accounting is a service activity.

- Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions, in making reasoned choices among alternative courses of action.
- It means that accounting collects financial information for the various users for taking decisions and tackling business issues.
- Accounting in itself cannot create wealth though, if it produces information which is useful to others, it may assist in wealth creation and maintenance.

2. Accounting as a profession

Accounting is very much a profession. A profession is a career that involve the acquiring of a specialised formal education before rendering any service.

- Accounting is a systematized body of knowledge developed with the development of trade and business over the past century.
- The accounting education is being imparted to the examinees by national and international recognised the bodies like The Institute of Chartered Accountants of India (ICAI), New Delhi in India and American Institute of Certified Public Accountants (AICPA) in USA etc. The candidate must pass a vigorous examination in Accounting Theory, Accounting Practice, Auditing and Business Law.
- The members of the professional bodies usually have their own associations or organisations, where in they are required to be enrolled compulsorily as Associate member of the Institute of Chartered Accountants (A.C.A.) and fellow of the Institute of Chartered Accountants (F.C.A.).
- In a way, accountancy as a profession has attained the stature comparable with that of lawyer, medicine or architecture.

3. Accounting as a social force

In early days, accounting was only to serve the interest of the owners.

- Under the changing business environment the discipline of accounting and the accountant both have to watch and protect the interests of other people who are directly or indirectly linked with the operation of modern business.
- The society is composed of people as customer, shareholders, creditors and investors.
- The accounting information/data is to be used to solve the problems of the public at large such as determination and controlling of prices.
- Therefore, safeguarding of public interest can better be facilitated with the help of proper,

adequate and reliable accounting information and as a result of it the society at large is benefited.

4. Accounting as a language

Accounting is rightly referred the "language of business".

- It is one means of reporting and communicating information about a business. As one has to learn a new language to converse and communicate, so also accounting is to be learned and practised to communicate business events.
- A language and accounting have common features as regards rules and symbols. Both are based and propounded on fundamental rules and symbols.
- In language these are known as grammatical rules and in accounting, these are termed as accounting rules.
- The expression, exhibition and presentation of accounting data such as a numerals and words and debits and credit are accepted as symbols which are unique to the discipline of accounting.

5. Accounting as science or art

Science is a systematised body of knowledge. It establishes a relationship of cause and effect in the various related phenomenon.

- It is also based on some fundamental principles. Accounting has its own principles e.g. the double entry system, which explains that every transaction has two fold aspect i.e. debit and credit.
- It also lays down rules of journalising. So we can say that accounting is a science.
- Art requires a perfect knowledge, interest and experience to do a work efficiently.
- Art also teaches us how to do a work in the best possible way by making the best use of the available resources.
- Accounting is an art as it also requires knowledge, interest and experience to maintain the books of accounts in a systematic manner.

- Everybody cannot become a good accountant. It can be concluded from the above discussion that accounting is an art as well as a science.

6. Accounting as an information system

Accounting discipline will be the most useful one in the acquisition of all the business knowledge in the near future.

- They will realise that people will be constantly exposed to accounting information in their everyday life. Accounting information serves both profit-seeking business and non-profit organisations.
- The accounting system of a profit-seeking organisation is an information system designed to provide relevant financial information on the resources of a business and the effect of their use.
- Information is relevant and valuable if the decision makers can use it to evaluate the financial consequences of various alternatives.
- Accounting generally does not generate the basic information (raw financial data), rather the raw financial data result from the day to day transactions of the business.
- As an information system, accounting links an information source or transmitter (generally the accountant), a channel of communication (generally the financial statements) and a set of receivers (external users).

Short Question & Answers

1. Define the term accounting.

Ans :

Accounting is termed as a language of business which is used to communicate the information or the results of business operations to several interested people like proprietors, investors, creditors, government etc.

Accounting plays a vital role in the process of decision making. It is considered as a common language used in the world of industry and commerce. Accounting principles refer to those rules and regulations which are followed by the accountants for recording, classifying and summarizing the accounting transactions.

Accounting is an art and science of providing meaningful information about financial activities of the company's as a tool for management. This is used by a business for maintaining financial records on cash basis or accrual basis.

Accounting is an important part of information system. It is an important profession. Study of accounting is must for all the people concerned with business, trade and commerce.

Definitions of Accounting

- (i) **According to American Institute of Certified Public Accountants**, financial Accounting is "the art of recording, classifying and summarizing in a significant manner in terms of money transactions and events which are in part, at least of a financial character and interpreting the results thereof."
- (ii) **According to American Accounting Association**, accounting is "the process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information".
- (iii) **According to Accounting Principles Board (APB)**, accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic activities that is useful in

making economic decision in making reasoned choices among alternative course of action.

- (iv) **According to H. Bierman and AR Drebin**, accounting may be defined "as the identifying, measuring, recording and communicating of financial information."

2. Need for accounting ?

Ans :

The main motto of any business organization would be to earn profit, which is the excess-income over expenditure.

- The ultimate profit of an organization can be ascertained only when the business is wound up, but the investors would like to get a regular return on their investment in the form of dividends.
- Therefore, there is a need to ascertain the profit at periodical intervals (accounting period) in order to pay dividends to the investors, and ascertain the financial result of the organization in which the stakeholders are interested in.
- A large number of transactions take place in the business everyday which have to be analyzed in order to know the total incomes, expenses, amount due to the creditors, amount due from the debtors, cash position, expenses and incomes outstanding, expenses paid in advance, income received in advance, etc.,.

3. Disadvantages of Accounting

Ans :

Following are the main limitations of accounting:

- i) **Records only Monetary Transactions**
Accounting records only those transactions which can be measured in monetary terms. Those transactions which cannot be measured in monetary terms as conflict between

production manager and marketing manager, efficient management etc., may be very important for a concern but not recorded in the business books.

ii) **Effect of Price Level Changes not Considered**

Accounting transactions are recorded at cost in the books. The effect of price level changes is not brought into the books with the result that comparison of the various years becomes difficult.

For example, the sales to total assets in 2007 would be much higher than in 2002 due to rising prices, fixed assets being shown at cost and not at market price.

iii) **No realistic information**

Accounting information may not be realistic as accounting statements are prepared by following basic concepts and conventions. For example, going concern concept gives us an idea that the business will continue and assets are to be recorded at cost but the book value which the asset is showing may not be actually realisable. Similarly, by following the principle of conservatism the financial statements will not reflect the true position of the business.

4. **Define book keeping**

Ans :

Book-Keeping is an activity concerned with the recording of financial data relating to business operations in a significant and orderly manner. Book-Keeping is the record making phase of accounting. Accounting is based on a careful and an efficient book-keeping system.

Book-Keeping is defined by different authors. A few of such definitions are given below. Carter in his Advanced Accounts defined Book-keeping as "the Science and art of correctly recording in books of account are those business transactions that result in the transfer money or money's worth".

Definitions

- i) **According to B.G. Vickery :** In his 'principles and Practice of Book-Keeping' defined Book-keeping as "The art of recording pecuniary or business transactions in a regular and systematic manner."

- ii) **According to Kohler** in his book 'A Dictionary for Accountant's defined Book-keeping as "the process of analysing, classifying and recording transactions in accordance with preconceived plan."

5. **Human Resource Accounting**

Ans :

Successful operation of any organization depends upon the effective and significant utilization of men, materials and money.

- The dichotomy in accounting between human and non-human capital is fundamental. The latter is recognized as an asset and is therefore recorded in the books and reported in the financial statements, whereas the former is totally ignored by accountants.
- An asset, whether tangible or intangible, can be defined as something, which is capable to generating future income stream.
- From this point of view, Human Resources are as good as other physical or intangible assets, which an enterprise owns for production of goods and services and earning profitability on its investments.
- In fact, Human Resource is the only 'active asset' in the asset portfolio of an organization and its performance, profitability and growth depend to a large extent on the quality of its Human Resources. Buildings, plants, computers and other physical and financial resources are unproductive without human efforts and decisions.

6. **What are the limitations of financial accounting ?**

Ans :

Financial accounting well answered the needs of business in the initial stages when the business was not so complex. The growth and complexities of modern business brought out the following limitations of financial accounting:

1. **Provides only limited information**

There are now no set patterns of business on account of radical changes in business activities. An expenditure may not bring an immediate advantage to the business but it

may have to be incurred because it may bring advantage to the business in the long run or may be necessary simply to sell the name of the business. The management needs a lot of varied information to decide whether on the whole it will be justifiable to incur a particular expenditure or not. Financial accounting fails to provide such information.

2. Treats figures as single, simple and silent items

Financial accounting fails to make the people realize that accounting figures are not mere isolated phenomena but they represent a chain of purposeful and pertinent events. The role of accountant these days is not only of a book-keeper and auditor, but also that of a financial adviser. Recording of transactions is now the secondary function of the accountant. His primary function now is to analyse and interpret the results.

3. Provides only a post-mortem record of business transactions

Financial accounting provides only a post-mortem record of business transactions since it records transactions only on historical basis. These days business decisions are made on the basis of estimates and projections rather than historical facts. Of course, past records are helpful in making future projections but they alone are not sufficient. Thus, needs of modern management demand a break-up from the principles and practice of traditional accounting.

7. Separate Entity Concept

Ans :

In accounting business is considered to be a separate entity from the proprietor(s).

- It may appear to be so foolish that one person can sell goods to himself but this concept is extremely helpful in keeping business affairs strictly free from the effect of private affairs of the proprietor(s).
- Thus, when one person invests ₹ 10,000 into business, it will be deemed that the

proprietor has given that much of money to the business which will be shown as a 'liability' in the books of the business.

- In case the proprietor withdraws ₹ 2,000 from the business, it will be charged to him and the net amount payable by the business will be shown only as ₹ 8,000.
- The concept of separate entity is applicable to all forms of business organisations.
- For example, in case of a partnership business or sole proprietorship business, though the partners or sole proprietor are not considered as separate entities in the eyes of law, but for accounting purposes they will be considered as separate entities.

8. Dual Aspect Concept

Ans :

This is the basic concept of accounting. According to this concept every business transaction has a dual effect) For example, if A starts a business with a capital of 10,000, there are two aspects of the transaction. On the one hand, the business has asset of ₹ 10,000 while on the other hand the business has to pay to the proprietor a sum of ₹ 10,000 which is taken as proprietor's capital. This expression can be shown in the form of following equation:

$$\text{Capital (Equities)} = \text{Cash (Assets)}$$

$$10,000 = 10,000$$

The term 'assets' denotes the resources owned by a business while the term "Equities" denotes the claims of various parties against the assets. Equities are of two types. They are: owners' equity and outsiders' equity. Owners' equity (or capital) is the claim of owners against the assets of the business while outsiders' equity (for liabilities) is the claim of outside parties, such as creditors, debenture-holders etc., against the assets of the business. Since all assets of the business are claimed by some one (either owners or outsiders), the total of assets will be equal to total of liabilities, Thus:

Equities = Assets

(or)

Liabilities + Capital = Assets

In the example given above, if the business purchases furniture worth ₹ 5,000 out of the money provided by A, the situation will be as follows:

Equities = Assets
Capital ₹ 10,000 = Cash ₹ 5,000 + Furniture ₹ 5,000
Subsequently, if the business borrows ₹ 30,000 from a bank, the new position would be as follows:

Equities = Assets

Capital ₹ 10,000 + Bank Loan ₹ 30,000 =
Cash ₹ 35,000 + Furniture ₹ 5,000

9. Accounting Period Concept

Ans :

According to this concept, the life of the business is divided into appropriate segments for studying the results shown by the business after each segment.

- This is because though the life of the business is considered to be indefinite (according to going concern concept), the measurement of income and studying the financial position of the business after a very long period would not be helpful in taking proper corrective steps at the appropriate time.
- It is, therefore, absolutely necessary that after each segment or time interval the businessman must 'stop' and 'see back', how things are going.
- In accounting such a segment or time interval is called 'accounting period'. It is usually of a year.
- At the end of each accounting period an Income Statement and a Balance Sheet are prepared.

10. Consistency

Ans :

According to this convention, accounting practices should remain unchanged from one period to another.

- For example, if stock is valued at "cost or market price whichever is less", this principle should be followed year after year.
- Similarly, if depreciation is charged on fixed assets according to diminishing balance method, it should be done year after year.
- This is necessary for the purposes of comparison. However, consistency does not mean inflexibility.
- It does not forbid introduction of improved accounting techniques.
- However, if adoption of such a technique results in inflating or deflating the figures of profit as compared to the previous period, a note to that effect should be given in the financial statements.

Choose the Correct Answers

1. The prime function of accounting is to: [c]
(a) Record economic data (b) Provide the informational basis for action
(c) Classify and record business transactions (d) Attain non-economic goals.
2. The basic function of financial accounting is to: [a]
(a) Record all business transactions
(b) Interpret the financial data
(c) Assist the management in performing functions effectively
(d) All of the above
3. Management Accounting provides invaluable services to management in performing: [a]
(a) All management functions (b) Interpret the financial data
(c) Controlling functions (d) All of the above
4. Book-keeping is mainly concerned with: [a]
(a) Recording of financial data relating to business operations
(b) Designing the systems in recording classifying, summarizing the recorded data.
(c) Interpreting the data for internal and external end-users.
(d) All of the above
5. Accounting principles are generally based on [c]
(a) Practicability (b) Subjectivity
(c) Convenience in recording (d) All of the above
6. Revenue from sale of products ordinarily is reported as part of the earning in the period [a]
(a) The sale is made. (b) The cash is collected.
(c) The products are manufactured. (d) The planning takes place.
7. Which type of accounting change should always be accounted for in current and future periods [a]
(a) Change in accounting principle (b) Change in reporting entity.
(c) Change in accounting estimate. (d) Correction of an error.
8. "Conservatism" is an orientation to financial reporting under which it is considered preferable, in instances of doubts, as to which of two acceptable accounting practices to use in a particular situation, and to choose the accounting practice that [a]
(a) Is most objective.
(b) Is most fair to company's creditors.
(c) Appears to be followed by the majority of similar companies.
(d) Tends to result in lower net income and owner's equity.

9. The 'going concern concept' is the underlying basis for [a]
- (a) Depreciating fixed asset over their useful lives.
 - (b) Disclosing the market value of securities.
 - (c) Consolidating the accounts of subsidiary companies with those of parent company.
 - (d) Disclosing the sales and other operating information in the income statement.
10. Accounting is an act of [d]
- (a) Recording
 - (b) Classifying
 - (c) Summarizing
 - (d) All the above

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Fill in the Blanks

1. _____ plays a vital role in the process of decision making.
2. _____ is an activity concerned with the recording of financial data relating to business operations in a significant and orderly manner.
3. _____ accounting has been developed in order to overcome the limitations of Financial Accounting with regard to the historical costs.
4. _____ are as good as other physical or intangible assets.
5. The main function of _____ is ascertainment of cost in relation to different activities of the business.
6. _____ accounting is the application of professional information in such a way as to assist the management in the formation of policies.
7. GAAP stands for _____.
8. _____ It is assumed that the business will continue for a fairly long time to come.
9. Assets = _____ + _____.
10. FASB stands for _____.

ANSWERS

1. Accounting
2. Book-Keeping
3. Inflation
4. Human Resources
5. Cost Accounting
6. Management
7. Generally Accepted Accounting Principles
8. Going Concern Concept
9. Liabilities + Capital
10. Financial Accounting Standard Board

UNIT II

Types of Books (Primary and Secondary) :

The Accounting Equation Rules of Debit and Credit; Recording Transactions in Journal; Preparation of Ledger Accounts; ledger balancing; Opening and Closing Entries, Preparation of Trial Balance.

2.1 TYPES OF BOOKS (PRIMARY AND SECONDARY)

**Q1. Explain in detail various types of books used in financial accounting
(OR)**

Explain any four subsidiary books.

Ans :

(July-19)

Following are the various types of books in financial accounting :

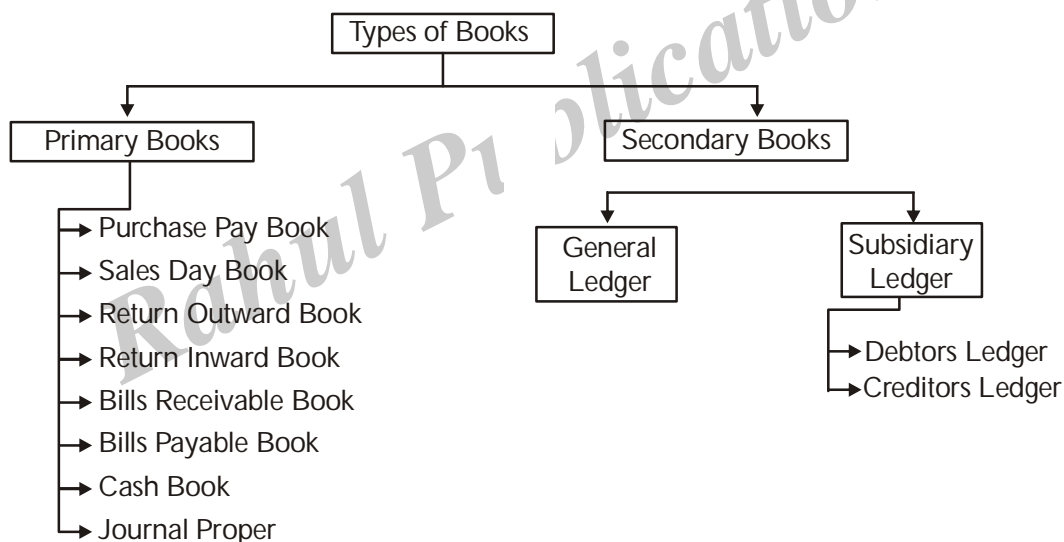


Fig.: Various types of Books in Financial Accounting

I. Primary Book/Subsidiary Books

A primary book is considered as a book of first entry or prime entry. It is a book wherein all the business transactions are recorded on the daily basis in a systematic manner. Whenever, a transaction takes place in business they are first recorded in primary book which is also called as 'Journal'. The process of recording the transactions in journal is called 'Journalizing'. The Proforma of Journal is as follows,

Journal

Date	Particulars	L.F	Debit(°)	Credit(°)

1. Date Column

This column records the date on which the transaction is being entered.

2. Particular Column

The details of transaction are recorded in particulars i.e., which account is to be debited and which account is to be credited. A brief explanation is also written in brackets known as narration.

3. L.F (Ledger Folio) Column

In this column, the page number of ledger containing the relevant account is recorded.

4. Debit Column

The amount that must be debited is recorded in this column.

5. Credit Column

The amount that must be credited is recorded in this column.

These are further classified into following types.

6. Purchase Day Book

A purchase book records all the credit purchase transactions taking place during a day, week or month. At the end of certain period, total of the purchase book is transferred to the purchases account.

Format of Purchases Book**Purchase Book**

Date	Particulars	Invoice No.	Ledger Folio	Credit()

(ii) Sales Day book

Sales book records all the 'credit sales' transaction took place during a day week or month. At the end of certain period, the total of sales book is transferred to sales account. This book is also called as 'Sales Journal' (or) 'Sales day book'.

Sales Book

Date	Particulars	Invoice No.	Ledger Folio	Amount()

Format of Sales Book

Sales Book

(iii) Return Outward Book

The return outward book is also called as 'Purchases Return Book'.

A purchases returns book records the details of defective and faulty goods that are returned back to the supplier. However, along with the goods returned, a 'debit note' is sent to the supplier which consists of amount of goods returned that has to be deducted from the actual amount payable to the supplier.

Format of Purchases Return Book**Purchases Returns Book**

Date	Particulars	Ledger Folio	Debit Note	Amount()

(iv) Return Inward Book

The return inward book is also called as 'Sales Return Book'.

A sales return book records the details of goods returned by the customer. A 'credit note' is prepared when the goods are returned by the customer which consists of the amount of the goods returned that has been deducted from actual amount payable by the customer.

Format of Sales Returns Book**Sales Returns Book**

Date	Particulars	Ledger Folio	Debit Note	Amount()

(v) Bills Receivable Book

Bills receivable book record all the details of the bills which are to be received on sales

Format of Bills Receivable Book**Bills Receivable Book**

Date	Particulars (To Whom Payable)	Term	Due Date	L.F	Amount()	Remarks

(vi) Bills Payable Book

Bills payable book records all the details of bills which are to be paid for purchases.

Format of Bills Payable Book**Bills Payable Book**

Date	Particulars (To Whom Payable)	Term	Due Date	L.F	Amount()	Remarks

(vii) Cash Book

A cash book is a special journal which is used for recording all cash receipts and cash payments. It is a book of original entry and a ledger wherein, cash receipts are recorded on the debit side and cash payments are recorded on the credit side. Therefore, the cash book is both a journal and a ledger.

(viii) Journal Proper

A journal proper is the last subsidiary book. Which records only those transactions that cannot be recorded in any other subsidiary books. This book is also called as special journal.

Format of Journal Proper

Journal Proper				
Date	Particulars	L.F	Debit()	Credit()

II. Secondary Book

Secondary books are the books where transactions are recorded for the second time. The secondary book is also called as Ledger.

Ledger is a accounting book where the journalized transactions are being classified. It consider set of accounts and includes all types of business accounts i.e., personal, nominal or real.

A company can maintain ledger in two forms i.e., Bound Ledger and Loose-leaf Ledger. The process of transferring the debit and credit items from the journal to the ledger in their respective accounts is known as posting.

The proforma of ledger account is as follows :

Dr.				Name of the Account				Cr.			
Date	Particulars	JF	Amount ()	Date	Particulars	JF	Amount ()	Date	Particulars	JF	Amount ()

The ledger is further classified as follows :

(i) General Ledger

General ledger is a permanent record of all the accounts used in the business. It is a self-sufficient secondary book where all the entries of primary books are posted directly or indirectly. It is also known as "book of final entry". All financial transactions of the business are summarized in the general ledger.

(iii) Subsidiary Ledger

Subsidiary ledger is a ledger which contains the details of a general ledger. It reduces the burden on the main ledger. The subsidiary ledger consists of two types. They are, the main icugw.

(a) Debtors Ledger : Debtors ledger consists of separate accounts for each customer and it will shows the transactions entered into with the customers.

For example : Sale of goods on credit, collections from customers, goods returned by customers, bad debts, discount allowed etc.

(b) Creditors Ledger : Creditor ledger has separate account for each supplier.

For example : Purchases on credit cash paid to suppliers, goods returned, discount received and the balance due to them.

Ans :

A cash book is a special journal which is used for recording all cash receipts and cash payments. It is a book of original entry and a ledger wherein, cash receipts are recorded on the debit side and cash payments are recorded on the credit side. Therefore, the cash book is both a journal and a ledger.

There are four types of cash books. They are as follows :

This cash book has one amount column on each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. In fact, this book is nothing but a cash account.

Dr.				Cr.			
Single - Column Cash Book (or) Simple Cashbook							
Date	Particulars	LF	Amount (₹)	Date	Particulars	LF	Amount (₹)

Preparation of Single Column/Book

A single column cash book involves four columns i.e.,

In date column of single column cash book, date of receiving cash is recorded on debit side whereas date of paying cash is recorded on the credit side.

In particulars column of single column cash book, the name of account from which cash is received is recorded on the debit side while the name of the account to which payment is made is recorded on the credit side. A little explanation is given in particulars column which explains about the entry.

L.F. column represents the ledger folio of the account wherein the transaction posted is being documented/recorded.

Amount column is prepared in order to record the amount which is received on the debit side and the amount which is paid on the credit side.

At the end time of the given period, the cash book must be balanced which would show cash in hand amount at the end of period. At the debit side total of cash book must be always more than the total of the credit side because the cash payments would not be more than the cash receipts.

This cash book has two amount columns, one for Cash and another for Discount on each side. All cash receipts and discount allowed are recorded on the debit side and all cash payments and discount received are recorded on the credit side. The format is as follows.

Dr. Cash Book with Discount Column (or) Two column Cashbook Cr.

Date	Particulars	LF	Discount allowed	Amount (`)	Date	Particulars	LF	Discount received	Amount (`)

Preparation Of Double/Two Column Cash Book

Double column cash book is the expansion/extension of the cash book. In double column cash book both on debit Side and credit side an extra column is added for recording discount allowed and discount received.

1. Cash Discount

Cash discount refers to the rebate which is made by the receiver of cash to the payer. Cash discount takes place when payment is made prior to the stipulated period.

On the other hand, the cash discount received by traders from his creditor is called a gain which is also known as "Discount Received" which, is, recorded on credit side of the cash book.

Cash discount is different from trade discount and allowance is given by the manufacturer or wholesaler to the retailer on the catalogue price of goods sold is known as "Trade Discount".

2. Balancing

The discount columns are not balanced, they are just totalled. The amount of discount allowed for customer is shown on the discount column on the debit side of the discount account. In the discount account, total discount received is entered on credit side of discount column. Similarly, like single column cash book, cash columns are balanced in double column cash book.

(iii) Three / Triple Column Cash Book

Cash book has three amount columns-one for Cash, one for Bank and one for Discount on each side. All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on the credit side.

One important feature of three-column cash book is that if a transaction involves both the cash and the bank account, it is entered on both the sides of the cash book, one in the cash column and second in the bank column, on the opposite side. This is called a 'contra' entry. The word 'C' is indicated in the L.F column against that item.

The three-column cash book serves the purpose of Cash Account and Bank Account. Hence, there is no need to open these two accounts in the ledger. The format is as follows,

(iv) Petty Cash Book

Normally, one person is handed over a small amount to meet the petty expenses of a given period (say a week, fortnight or a month) and is authorized to make such payments and record them in a separate Cash Book. Such person, such amount and such Cash Books are called as "Petty Cashier", "Imprest" and "Petty Cash Book" respectively. The Petty Cash Book may or may not be maintained on "Imprest System".

Under both the systems, the petty cashier submits the Petty Cash Book to the Head Cashier who examines the Petty Cash Book. Under the imprest system, the Head Cashier makes the reimbursement of the amount spent by the Petty Cashier but under non-imprest system, the Head Cashier may handover the Cash to the Petty Cashier equal to/ more than/less than the amount spent.

The form of petty cash book depends upon requirements of the business, however, the simple form is as follows.

The following are th

2.2 ACCOUNTING SYSTEM

Q3. Define accounting system.

Ans :

Accounting system and process includes single entry system, double entry system and transactions of journal and ledger, which are very important for the initial steps of accounting. Single entry system is a system of book-keeping in which, as a rule only records of cash and of personal accounts are maintained, it is always incomplete double entry system.

Double entry system seeks to record every transactions in money in its double aspects. It is a complete record. Accounting process involves accounting equation, accounting terminology, accounting transactions, events, journal and ledger. A Journal is a chronological record of transactions entered into by a business. Journalising is the process of recording entries in a journal. Ledger is an analytical record of transaction, as transactions are classified in the ledger.

Accounting equation is another form of dual aspect concept. It is balance concept where assets equal to liabilities. Accounting process involves debit and credit role of different accounts, where debit means increase and credit means decrease. Thus, accounting system and process is the most important parts of accounting.

Popular Way of Classification

There are many ways the system of classification of Book-keeping, which are as follows:

- ▶ Single Entry System of Book-keeping
- ▶ Double Entry System of Book-keeping.

Q4. Define single entry system. What are the features of single entry system?

Ans :

Meaning of Single Entry System

Single entry system is an incomplete form of recording financial transactions. It is the system, which does not record two aspects or accounts of all the financial transactions. It is the system, which has no fixed set of rules to record the financial transactions of the business.

Single entry system records only one aspect of transaction. Thus, single entry system is not a proper system of recording financial transactions, which fails to present complete information required by the management. Single entry system mainly maintains cash book and personal accounts of debtors and creditors. Single entry system ignores nominal account and real account except cash account. Hence, it is incomplete form of double entry system, which fails to disclose true profit or loss and financial position of a business organization.

Features of Single Entry System

The following are the main features of single entry system:

1. No Fixed Rules

Single entry system is not guided by fixed set of accounting rules for determining the amount of profit and preparing the financial statements.

2. Incomplete System

Single entry system is an incomplete system of accounting, which does not record all the aspects of financial transactions of the business.

3. Cash Book

Single entry system maintains cash book for recording cash receipts and payments of the

business organization during a given period of time.

4. Personal Account

Single entry system maintains personal accounts of all the debtors and creditors for determining the amount of credit sales and credit purchases during a given period of time.

5. Variations in Application

Single entry system has no fixed set of principles for recording financial transactions and preparing different financial statements. Hence, it has variations in its application from one business to another

Q5. What are the Advantages and Disadvantages of Single Entry System?

Ans :

Advantages of Single Entry System

The following are the important advantages of single entry system:

1. Simple and Easy

Single entry system is simple to understand and easy to maintain as it has no fixed set of principles to follow while recording financial transactions.

2. Economy

Single entry system is an economical system of recording financial transactions. It does not require hiring skilled accounting personnel to record financial transactions of the business. Further, it does not require large number of books to record the limited number of financial transactions.

3. Easy to Calculate Profit

Under single entry system, the amount of profit can be determined easily. The amount of profit or loss of the period can be determined by making comparison between

the amounts of closing capital and opening capital.

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4. Suitable for Small Business

The single entry system is simple, easy, and economical system. It is suitable for small businesses because they can not afford the cost of double entry system. Besides, small business are not required to maintain their books of accounts under double entry system.

Disadvantages of Single Entry System

The following are the notable disadvantages of single entry system:

1. Unscientific and Unsystematic

The single entry system is unsystematic and unscientific system of recording financial transactions. It does not have any set of fixed rules and principles for recording and reporting the financial transactions.

2. Incomplete System

Single entry system is incomplete system because it does not record the two aspects or accounts of all the financial transactions of the business. It does not maintain any record of the transactions relating to the nominal account and real account except cash account.

3. Lack of Arithmetical Accuracy

Single entry system is not based on the principles of debit and credit. It fails to provide the arithmetical accuracy of the books of accounts. Trial balance can not be prepared under this system to check the arithmetical accuracy of books of accounts.

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4. Does not Reflect True Profit or Loss

Under single entry system, the true amount of profit or loss can not be ascertained because it does not maintain the nominal accounts.

5. Does Not Reflect True Financial Position

The single entry system does not maintain real accounts except cash book. Therefore, it can not reveal the true financial position of the business.

6. Frauds and Errors

The single entry system of book-keeping is incomplete, inaccurate and unscientific. It does not help to check the arithmetical accuracy of the books of accounts. Therefore, there is always a possibility of committing frauds and errors in the books of accounts.

7. Unacceptable for Tax Purpose

The single entry of book keeping has incomplete records of the financial transactions of the business. Hence, the tax office can not accept the account maintained under this system for the purpose of assessment of tax.

Q6. Define double entry system.

Ans : (Dec.-18)

Luca Pacioli, an Italian merchant, was the first person to write a book named "De computiset scripturis" on double entry system of book keeping in the year 1494. As said earlier, every business transaction has two aspects i.e. receiving aspect and giving aspect. The method of recording these aspects in two accounts is known as Double Entry System of Accounting. The two accounts are a debit account and a credit account. For every transaction, the total amount debited is equal to that of the total amount credited. Thus, on any given day, the sum of all debits must be equal to the sum of all credits'

Features of Double Entry System

The features of double entry system are as follows :

1. Set Rules

Every transaction is recorded as per the set rules of personal, real and nominal accounts. For this purpose every transaction is divided in two parts.

2. Entry in Two Accounts

Each transaction affects two accounts whether it is a cash or credit transaction.

3. Scientific System

Each transaction is divided in two parts which are personal and impersonal and then the rules of these accounts are applied. Since it has certain rules, it can be called as a scientific system.

4. Preparation of Trial Balance

Under double entry system, a trial balance is prepared to check the arithmetical accuracy of the accounts. If the total of debit column is equal to the total of credit column, then it means the accounts are arithmetically accurate.

5. Preparation of Final Accounts

Under double entry system, the final accounts are prepared through which one can know the profit and loss earned during the year. It also tells the final position of the business on the date of preparation of final accounts.

Q7. What are the Advantages and Disadvantages of Double Entry System?

Ans :

Advantages of Double Entry System

It has the following advantages :

1. Scientific System

Double entry is treated as a scientific system since there are certain principles and rules of recording the transaction according to which entries are made in the books of accounts.

2. Complete Record of Transactions

All types of transactions whether they are related with personal, real, nominal accounts are recorded in the books of accounts on the basis of specified rules. Thus, it is called a complete system and helps to narrate the transactions in future easily.

3. Knowledge about Different Accounts

This system gives the information and knowledge about the different types of accounts which are maintained in the ledger. Therefore, any information relating to any person, expense or income can easily be obtained.

4. Knowledge about Financial Position

This system also enables the businessman to know the financial position of his business. It also presents the assets and liabilities of the business on a certain date.

5. Elasticity

This system is flexible in nature and it can be expanded or contracted as per the changed requirements of the business. For example, if the number of transactions in the business increases, the subsidiary books can be used.

6. Less Possibility of Fraud and Mistakes

Since this system is scientific in nature, each transaction is recorded on two sides. Thus there is less possibility of fraud, mistakes and misappropriation. In case of any fraud and mistake it can be detected and rectified quickly.

7. Suitable for all types of Businesses

This system can be used for all types of business houses whether they are sole proprietorship firms or partnership firms or joint stock companies. That's why this system of accounting is used throughout the world as it is adequate for all.

8. Comparative Study is Possible

The accounts of current year can be compared with the accounts of previous year

in the double entry system. Thus, the progress of business can be measured along, with accounting. It also helps in controlling the unnecessary expenses.

9. Proof as Evidence

The books prepared under this system are recognised as evidences since they are treated as accurate, reliable and scientific.

10. Facility of Adjustments

Under this system, adjustments relating to unearned incomes, outstanding expenses, prepaid expenses and accrued income, etc. can be made at the end of the year. This helps in ascertaining the true profit or loss and actual financial position of the business.

Disadvantages of Double Entry System

The double entry system has the following disadvantages :

1. Costlier System

A number of accounting books such as journal, ledger, cash book and subsidiary journals, etc. are maintained under this system. Therefore this system becomes costlier especially for small business houses.

2. Accounting Errors

Only the arithmetical accuracy of accounts can be checked by preparing the trial balance. But many of accounting errors, like error of omission, error of principle, error of commission and compensating errors may remain uncorrected despite the agreement of trial balance.

3. Requires Practical Knowledge

A person without the knowledge of accounts cannot record and understand the transactions. Therefore, the system needs a well educated, practical and trained professional to maintain and understand the accounts under this system.

Q8. What are the difference between Double Entry System and Single Entry System ?

Ans :

S.No	Double Entry System	S.No	Single Entry System
(i)	It is a complete and scientific system of book-keeping and dual entries of a transaction should be made in two different accounts.	(i)	It is an incomplete unscientific unsatisfactory system of accounting, where each and every transaction is not kept under this system.
(ii)	All accounts like personal, real and nominal trained by this system.	(ii)	Only personal accounts and cash book are maintained under this system.
(iii)	Financial position can be easily ascertained by preparing a Balance sheet, which is cannotbe prepared without much records.	(iii)	Financial position cannot be ascertained, by a Balance sheet because it is prepared with much records.
(iv)	Under this system, the arithmetical accuracy of the books of accounts can be checked by preparing a Trial balance	(iv)	Under single entry system the arithmetical accuracy cannot be checked because of a Trial balance cannot be prepared.
(v)	This system has statutory recognition and records are maintained under this system. Which are accepted as evidence in the court of law.	(v)	This system has no statutory recognition and are normally accepted by the court of law.

2.3 THE ACCOUNTING EQUATION

Q9. What do you understand by accounting equation?

Ans :

(Dec.-18)

Every business transaction has two aspects. One aspect is debited other aspect is credited. Both the aspects have to be recorded in accounts appropriately. American Accountants have derived the rules of debit and credit through a 'novel' medium, i.e., accounting equation. The equation is as follows:

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

The equation is based on the principle that accounting deals with property and rights to property and the sum of the properties owned is equal to the sum of the rights to the properties. The properties owned by a business are called assets and the rights to properties are known as liabilities or equities of the business. Equities can be subdivided into equity of the owners which is known as capital and equity of creditors who represent the debts of the business know as liabilities. These equities may also be called internal equity and external equity. Internal equity represents the owner's equity in the assets and external represents he outsider's interest in the asset. Based on the bifurcation of equity, the accounting equation can be restated as follows:

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

(Or)

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

(Or)

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

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

Q10. State the rules for accounting equation?

Ans :

Following rules help in making the accounting equation:

- (i) **Assets:** If there is increase in assets, this increase is debited in assets account. If there is decrease in assets, this decrease credited in assets account.
- (ii) **Liabilities:** When liabilities are increase, outsider's equities are credited and when liabilities are decreased, outsider's equities are debited.
- (iii) **Capital:** When capital is increased, it is credited and when capital is withdrawn, it is debited.
- (iv) **Expenses:** Owner's equity is decreased by the amount of revenue expenses.
- (v) **Income or profits:** Owner's equity is increased by the amount of revenue income.

PROBLEMS

1. Show that the accounting equation is satisfied after taking into consideration each of the following transactions in the books of Mr. N

1. Started business with capital 1,00,000
2. Bought furniture 25,000
3. Bought goods for cash 20,000
4. Bought goods from Ram on Credit 5,000
5. Sold goods for cash for 15,000
6. Sold goods to Shyam on credit 8,000
7. Paid cash to Ram 4,000
8. Received cash from Shyam 5,000
9. Paid Cash into Bank 25,000
10. Withdrawn from bank 10,000

Sol :

1.	Capital	+	Liabilities	=	Assets
	1,00,000	+	0	=	1,00,000 (Cash)
2.	Capital	+	Liabilities	=	Assets
	1,00,000	+	0	=	75,000 (Cash)
				+	25,000 (Furniture)

3.	Capital	+	Liabilities	=	Assets
	1,00,000	+	0	=	55,000 (Cash)
					+ 25,000 (Furniture)
					+ 20,000 (Goods)
4.	Capital	+	Liabilities	=	Assets
	1,00,000	+	5,000 (Ram)	=	55,000 (Cash)
					+ 25,000 (Furniture)
					+ 25,000 (Goods)
5.	Capital	+	Liabilities	=	Assets
	1,00,000	+	5,000 (Ram)	=	70,000 (Cash)
					+ 25,000 (Furniture)
					+ 10,000 (Goods)
6.	Capital	+	Liabilities	=	Assets
	1,00,000	+	5,000 (Ram)	=	70,000 (Cash)
					+ 25,000 (Furniture)
					+ 2,000 (Goods)
					+ 8,000 (Shyam)
7.	Capital	+	Liabilities	=	Assets
	1,00,000	+	1,000 (Ram)	=	66,000 (Cash)
					+ 25,000 (Furniture)
					+ 2,000 (Goods)
					+ 8,000 (Shyam)
8.	Capital	+	Liabilities	=	Assets
	1,00,000	+	1,000 (Ram)	=	71,000 (Cash)
					+ 25,000 (Furniture)
					+ 2,000 (Goods)
					+ 3,000 (Shyam)
9.	Capital	+	Liabilities	=	Assets
	1,00,000	+	1,000 (Ram)	=	46,000 (Cash)
					+ 25,000 (Furniture)
					+ 2,000 (Goods)
					+ 3,000 (Shyam)
					+ 25,000 (Bank)
10.	Capital	+	Liabilities	=	Assets
	1,00,000	+	1,000 (Ram)	=	56,000 (Cash)
					+ 25,000 (Furniture)
					+ 2,000 (Goods)
					+ 3,000 (Shyam)
					+ 15,000 (Bank)

2. Following are the accounting transactions relating to Mr. P's business. Use the accounting equation to show their effect on his assets, liabilities and capital.

1. Commenced business with a Capital of 50,000
2. Bought Machinery for cash 10,000
3. Purchased goods for cash 15,000
4. Purchased goods from A on credit 5,000
5. Sold goods for cash 10,000
6. Paid to A 2,000
7. Sold goods to B on credit 3,000
8. Paid into Bank 6,000
9. Paid to A by cheque 1,000
10. Received from B a cheque for 2,000

Sol.:

This solution differs from the first only in the way the data is presented. Data here is presented in the form of a mathematical equation while in the previous it is presented in the form of a statement.

1.	Capital	+	Liabilities	=	Assets
	50,000	+	0	=	50,000 (Cash)
2.	Capital	+	Liabilities	=	Assets
	50,000	+	0	=	40,000 (Cash)
				+	10,000 (Machinery)
3.	Capital	+	Liabilities	=	Assets
	50,000	+	0	=	25,000 (Cash)
				+	10,000 (Machinery)
				+	15,000 (Goods)
4.	Capital	+	Liabilities	=	Assets
	50,000	+	5000 (A)	=	25,000 (Cash)
				+	10,000 (Machinery)
				+	20,000 (Goods)
5.	Capital	+	Liabilities	=	Assets
	50,000	+	5,000 (A)	=	35,000 (Cash)
				+	10,000 (Machinery)
				+	10,000 (Goods)
6.	Capital	+	Liabilities	=	Assets
	50,000	+	3,000 (A)	=	33,000 (Cash)
				+	10,000 (Machinery)
				+	10,000 (Goods)

7.	Capital	+	Liabilities	=	Assets
	50,000	+	3,000 (A)	=	33,000 (Cash)
					+ 10,000 (Machinery)
					+ 7,000 (Goods)
					+ 3,000 (B)
8.	Capital	+	Liabilities	=	Assets
	50,000	+	3,000 (A)	=	27,000 (Cash)
					+ 10,000 (Mechinery)
					+ 7,000 (Goods)
					+ 3,000 (B)
					+ 6000 (Bank)
9.	Capital	+	Liabilities	=	Assets
	50,000	+	2,000 (A)	=	27,000 (Cash)
					+ 10,000 (Mechinery)
					+ 7,000 (Goods)
					+ 3,000 (B)
					+ 5,000 (Bank)
10.	Capital	+	Liabilities	=	Assets
	50,000	+	2000 (A)	=	27,000 (Cash)
					+ 10,000 (Mechinery)
					+ 7,000 (Goods)
					+ 1,000 (B)
					+ 7,000 (Bank)

3. Prepare Accounting equation for the given transactions.

1. Mohan commenced business with cash 50,000
2. Purchased goods for cash 30,000
3. Purchased goods on credit 20,000
4. Sold goods (cost Rs. 10,000) for 12,000
5. Bought furniture on credit Rs. 2,000
6. Paid cash to creditor 15,000
7. Salary paid Rs. 1000
8. Purchased goods for cash 50,000 & on credit 20,000
9. Sold goods for cash costing 40,000
10. Salary outstanding Rs. 1000
11. Paid rent in advance for 1 month Rs. 4000
12. Bought a second hand scooter for personal use 10,200 and payment made from office cash.
13. Cash sales Rs. 12,000

14. Bought goods from Deepak Rs. 1200
15. Sold goods to Anand Rs. 600
16. Sold goods to krishna for cash Rs. 8.75
17. Goods returned by Satish Rs. 150
18. Purchased for from Vijay traders Rs. 1,450
19. Purchased stationary for cash Rs. 70
20. Paid rent to land lord Rs. 300
21. Paid for advertisement Rs. 400
22. Paid wages Rs. 500
23. Purchased machinery for Rs. 20,000 from Raju and paid him Rs. 10,000
24. Received Dividend on shares Rs. 1000

Sol :

	Assets =	Capital	+	Liabilities
(1)	+ 50,000 =	50,000	+	0
	50,000 =	50,000	+	0
(2)	+ 30,000 (goods)	0	+	0
	- 30,000 (cash)			
	30,000 =	50,000	+	0
(3)	+ 20,000 =	0	+	20,000
	70,000 =	50,000	+	20,000
(4)	- 10,000 (goods) =	3000 (Profit)	+	0
	+ 12,000 (cash) =			
	72,000 =	52,000	+	20,000
(5)	+ 2,000(F) =	0	+	2000
	74,000 =	52,000	+	22,000
(6)	- 15,000 =	0	-	15,000
	59,000 =	52,000	+	7,000
(7)	- 1000 =	- 1,000	+	0
	58,000 =	51,000	+	7,000
(8)	+ 70,000 (g)	0	+	20,000
	- 50,000 (c)			
	78,000 =	51,000	+	27,000
(9)	+ 80,000 (c) =	+ 40,000	+	0
	- 40,000 (g)			
	1,18,000 =	91,000	+	27,000

(10)	0 =	- 1,000	+	1000
	1,18,000 =	90,000	+	28,000
(11)	- 4000 (C) =	0	+	0
	+ 4000 (A)			
	1,18,000 =	79,800	+	28,000
(12)	- 10,200 (C)	- 10,200 (D)	+	0
	1,07,800 =	79,800	+	28,000
(13)	- 12,000 (g) =	0	+	0
	+ 12,000 (c)			
	1,07,800 =	79,800	+	28,000
(14)	+ 1200 =	0	+	1200
(15)	1,09,000 =	79,800	+	29,200
	- 600 (G)	0	+	0
	+ 600 (D)			
	1,09,000 =	79,800	+	29,200
(16)	- 875 (G)	0	+	0
	+ 875 (C)			
	1,09,000 =	79,800	+	29,200
(17)	- 150 (D)	0	+	0
	+ 150 (G)			
	1,09,000 =	79,800	+	29,200
(18)	+ 1,450 (F) =	0	+	1,450
	1,10,450 =	79,800	+	30,650
(19)	- 70 (C) =	- 70 (S)	+	0
	1,10,380 =	79,730	+	30,650
(20)	- 300 =	- 300	+	0
	1,10,080 =	79,430	+	30,650
(21)	- 400 =	- 400	+	0
	1,09,680 =	79,030	+	30,650
(22)	- 500 =	- 500	+	0
	1,09,180 =	78,530	+	30,650
(23)	+ 20,000	0	+	10,000
	- 10,000			
	1,19,180 =	78,530	+	40,650
(24)	+ 1000 =	+ 1,000	+	0
	1,20,180 =	79,530	+	40,650

2.4 RULES OF DEBIT AND CREDIT

Q11. Briefly describe the classification of accounts.

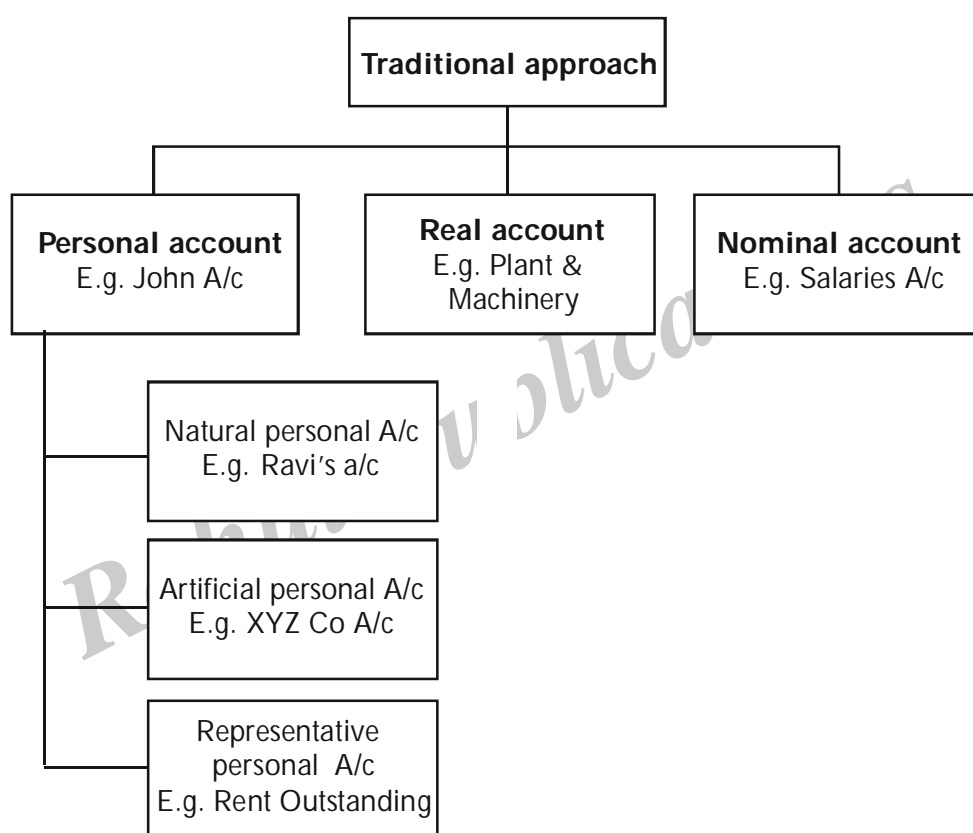
Ans :

(Jan.-21, July-19, June-18)

An account is a summary of relevant transaction and events at one place under a particular head. It records the amount of the transactions and also depicts their effect and direction. Classification of accounting is broadly divided into two heads:

1. Classification according to Traditional approach
2. Classification according to accounting equation

1. Classification of Accounts according to traditional approach



A) Personal Account

Account related to individual, banks, firm, companies, etc. are known as personal account. The personal accounts are related to natural person, artificial persons and representative person. It may be classified into three categories:

1. Natural Personal Account

Account of individuals (natural person) such as Rakesh a/c is known as natural personal account.

2. Artificial Personal Account

Accounts of firms, companies, banks, are artificial accounts. For examples, Tata Groups A/c, Coca Cola Corporation bank A/c.

3. Representative Account

The account related to outstanding expenses, prepaid expenses, income received in advance, accrued income is representative personal accounts. For examples, Rent outstanding, insurance Prepaid, Interest due but not paid, etc.

Rule

Debit the Receiver

Credit the Giver

B) Real Account

Real Account is related to tangible or intangible assets. Tangible assets are one which can be touch and seen such as building, plant, cash etc. Intangible assets are related to intangible objects which neither be touched or seen. For example, goodwill, trademarks, etc.

Rule

Debit what comes in
Credit what goes out

C) Nominal Account

The account related to income, expense, losses, and gains are classified as nominal accounts. For examples, wage accounts, salaries account, etc.

Rule

Debit all expenses and losses
Credit all incomes and gains (or) profits

2. Classification of account according to Accounting Equations

There are five types of accounts:

1. **Assets A/c** : It relates to tangible or intangible assets. Ex. Plant A/c
2. **Liabilities A/c** : These accounts represent the final obligation of the enterprise towards outsiders. Ex. Trade creditors, bills payable
3. **Capital A/c** : These accounts relates to owners of an enterprise. Ex. Capital A/c, Drawings A/c
4. **Revenue A/c** : These accounts relate to amount earned by the enterprise by rendering goods and services. Ex. Sales A/c, Discount received A/c
5. **Expense A/c** : These accounts relate to the amount of loss or incurred in the process of earning revenue. Ex. Purchase A/c, Loss by Theft A/c.

Q12. Explain the Distinction between Different Types of Accounts

Or

Distinguish between Personal, Real and Nominal Accounts

Or

What are the differences between various types of accounts.

Ans :

Personal Accounts	Real Accounts	Nominal Accounts
Personal accounts refer to accounts of a person, a firm or a company and contain transactions relating to those persons, firm or company.	Real accounts contain transaction relating to assets.	Nominal accounts record transactions relating to any income, gain, expense or loss.
They include debtors' accounts having debit balances and creditors' accounts having credit balances.	They always have debit balances and never credit balances. Any asset being sold at a price above the book value may cause credit balance in the asset account.	They may have debit or credit balances – expenses and losses accounts have debit balances and incomes and gains accounts have credit balances.
From personal account balances, money payable to or receivable from third parties can be known.	From balances of real accounts, the values of assets in possession as on a particular date can be known.	From the balances of nominal accounts net profit or net loss for the accounting period is ascertained.
They are kept both under double entry and single entry methods.	Real accounts except cash book are kept under double entry method.	They are kept under double entry method but not under single entry method.
Personal accounts balances are shown in balance sheet.	Real accounts balances are also known in balance sheet.	Since the nominal accounts balances are closed to final accounts, their balances do not appear in balance sheet.
They are kept in separate ledger called personal ledger.	They are kept in general ledger along with nominal accounts.	They are kept in general ledger along with real accounts.

4. From the following transactions find out the nature of account and also state which account should be debited and which account should be credited.

- | | |
|-----------------------------------|---|
| (a) Rent paid | (b) Salaries paid. |
| (c) Interest received | (d) Dividends received. |
| (e) Furniture purchased for cash. | (f) Machinery sold. |
| (g) Outstanding for salaries. | (h) Telephone charges paid. |
| (i) Paid to Suresh. | (j) Received from Mohan (the proprietor). |
| (k) Lighting. | |

Sol:

S.No	Transaction	Accounts involved	Nature of Accounts	Debit/Credit
(a)	Rent paid	Rent A/c	Nominal A/c	Debit
	Cash A/c	Real A/c	Credit	
(b)	Salaries paid	Salaries A/c	Nominal A/c	Debit
	Cash A/c	Real A/c	Credit	
(c)	Interest received	Cash A/c	Real A/c	Debit
	Interest A/c	Nominal A/c	Credit	
(d)	Dividends received	Cash A/c	Real A/c	Debit
	Interest A/c	Nominal A/c	Credit	
(e)	Furniture purchased	Furniture A/c	Real A/c	Debit
	Cash A/c	Real A/c	Credit	
(f)	Machinery sold	Cash A/c	Real A/c	Debit
	Interest A/c	Real A/c	Credit	
(g)	Outstanding for salaries	Salaries A/c	Nominal A/c	Debit
	Outstanding	Personal A/c	Credit	
	Salaries A/c			
(h)	Telephone charges paid	Telephone Charges A/c	Nominal A/c	Debit
	Cash A/c	Real A/c	Credit	
(i)	Paid to Suresh	Suresh	Personal A/c	Debit
	Cash A/c	Real A/c	Credit	
(j)	Received from Mohan (the proprietor)	Cash A/c	Real A/c	Debit
	Capital A/c	Personal A/c	Credit	
(k)	Lighting	Lighting A/c	Nominal A/c	Debit
	Cash A/c	Real A/c	Credit	

2.5 RECORDING TRANSACTIONS IN JOURNAL

Q13. What is journal ? Explain the objectives of journal.

Ans :

A journal is known as a primary book of accounts or a book of original entry. With the increase in the size of business, the number of business transactions also increases. It is very difficult for a human-being to remember all those transactions. Therefore, to overcome this drawback, journal is prepared. Although, as stated above, the transactions can be recorded directly in the ledger. But such procedure will be cumbersome and confusing. Under this process, it will be very difficult to locate a transaction after several recordings. But in journal, the transactions can easily be located as it provides chronological record of transactions.

Definitions

- i) **According to Carter says,** "The journal or daily record as originally used, is a book of prime entry in which transactions are copied in order of date from a memorandum or a waste book. The entries as they are copied, classified into debit and credit, so as to facilitate their being correctly posted afterwards in the ledger."
- ii) **According to L.C. Cropper,** "A journal is a book employed to classify or sort out transactions in a form convenient for their subsequent entry in the ledger."
- iii) **According to Roland,** "Journal means a day book, diary or a log book. It is called prime subsidiary book of double entry system."

Objectives of Journal

The following are the objectives and importance of journal:

1. Complete Record of Each Transaction

Date-wise complete record of each business transaction is recorded in the journal. Summary of each transaction is also written which is known as narration. This narration is helpful in getting full information about the transaction.

2. As a Proof

Journal is treated as a proof in the eye of the court for settling down the disputes among two or more parties. In some countries like France, Italy, Germany, etc. it is mandatory to prepare ledger.

3. Ledger Hosting

To prepare ledger from the journal is easier than preparing directly from vouchers or memorandum book. Chances of mistakes or errors are very less when we post the entries in the ledger from journal.

4. Correct Knowledge

Each and every transaction is recorded by debiting and crediting two accounts. This helps in knowing which two accounts are affected by the transaction.

Q14. Explain the Proforma (or) Format of Journal

Ans :

JOURNAL

Date	Particulars	Ledger Folio	Amount Dr.	Amount Cr.

The description of the above columns is as follows :

1. **Date:** The date on which a particular transaction takes place is recorded here. The year is written on the top and the month and dates are written afterwards.
2. **Particulars:** The two aspects of transactions, i.e., debit and credit are recorded in first two lines. Every debit aspect is written in the first line with a word 'Dr.' at the end of column. The second line starts with 'To' and the credit aspect is written in this line. The second line starts a few spaces away from the margin of the first line. 'Cr.' is not written at the end of this column.

3. **Ledger Folio or L.F:** Ledger folio is the page number of the ledger on which the corresponding entry is posted. It shows whether an entry has been posted or not. If a page number does not appear against an entry, it indicates that the entry has not been posted to ledger.
4. **Debit Amount:** The amount to be debited is recorded against debit amount in this column.
5. **Credit Amount:** The amount to be credited is recorded against credit amount in this column.

Q15. Explain the Procedure of Journalising.

Ans :

(Dec.-17)

The procedure of journalising is as follows :

1. Nature of Transaction

First of all, we should see or classify the nature of transaction from the business point of view. Whether it has taken place or not, whether it can be expressed in money or money's worth or not and the effect of transaction on the business.

2. Selection of Two Aspects of Accounts

In the next step, where two or more accounts will be affected by the transaction are, selected.

3. To Know the Type of Accounts

Afterwards, the type of selected accounts is determined, whether they are personal or real or nominal.

4. To Determine the Effect of Account

After selecting the type of account, the effect of account is determined, i.e., whether the items are coming in or going out of the business or business is the receiver or giver, or whether business has made expenses or earned income, etc.

5. Application of Rules

At the end, the rules of journalising are applied as per their type and effect.

2.5.1 Types of Journal Entries

2.5.1.1 Compound Entry

Q16. Explain the term Compound Entry.

Ans :

(Dec.-17)

Sometimes there are a number of transactions on the same date relating to one particular account or of one particular nature. Such transactions may be recorded by means of a single journal entry instead of passing several journal entries. Such entry regarding recording a number of transactions is termed as a "Compound Journal Entry". It may be recorded in any of the following three ways:

- (i) One particular account may be debited while several other accounts may be credited.
- (ii) One particular account may be credited while several other accounts may be debited.
- (iii) Several accounts may be debited and several other accounts may also be credited.

Example :

Pass a compound journal entry in each of the following cases:

1. Payment made to Ram ₹ 1,000. He allowed a cash discount of ₹ 50.
2. Cash received from Suresh ₹ 800 and allowed him ₹ 50 as discount.
3. A running business was purchased by Mohan with the following assets and liabilities:
Cash ₹ 2,000; Land ₹ 4,000; Furniture ₹ 1,000; Stock ₹ 2,000; Creditors ₹ 1,000;
Bank Overdraft ₹ 2,000.

Sol:

S.No.	Particulars	L.F	Debit	Credit
1.	Ram Dr. To Cash A/c To Discount (Being payment made to Ram ₹ 1,000, and he allowed ₹ 50 as discount)		1,050	1,000 50
2.	Cash A/c Dr. Discount A/c To Suresh (Being cash received from Suresh ₹ 800 and discount allowed ₹ 50)		800	
3.	Cash A/c Dr. Land A/c Dr. Furniture A/c Dr. Stock A/c Dr. To Creditors To Bank Overdraft To Capital A/c (Being commencement of business by Mohan by taking over a running business)		2,000 4,000 1,000 2,000	1,000 2,000 6,000

2.5.1.2 Opening and Closing Entry

Q17. Define the term Opening and Closing Entries.

Ans :

(June-18, Dec.-17)

i) Opening Entry

In case of a running business, the assets and liabilities of the previous year are brought forward in the current year by passing a journal entry called as Opening Entry. In this case, all the assets are debited

and all the liabilities are credited and the excess of the assets over the liabilities is taken as the proprietor's capital which is credited to his capital account.

ii) Closing Entry

Closing entries, also called closing journal entries, are entries made at the end of an accounting period to zero out all temporary accounts and transfer their balances to permanent accounts. In other words, the temporary accounts are closed or reset at the end of the year. This is commonly referred to as closing the books.

Temporary accounts are income statement accounts that are used to track accounting activity during an accounting period. For example, the revenues account records the amount of revenues earned during an accounting period not during the life of the company. We don't want the 2015 revenue account to show 2014 revenue numbers.

Permanent accounts are balance sheet accounts that track the activities that last longer than an accounting period. For example, a vehicle account is a fixed asset account that is recorded on the balance. The vehicle will provide benefits for the company in future years, so it is considered a permanent account.

At the end of the year, all the temporary accounts must be closed or reset, so the beginning of the following year will have a clean balance to start with. In other words, revenue, expense, and withdrawal accounts always have a zero balance at the start of the year because they are always closed at the end of the previous year. This concept is consistent with the matching principle.

Closing Entry Types

Temporary accounts can either be closed directly to the retained earnings account or to an intermediate account called the income summary account. The income summary account is then closed to the retained earnings account. Both ways have their advantages.

Closing all temporary accounts to the income summary account leaves an audit trail for accountants to follow. The total of the income summary account after the all temporary accounts have been close should be equal to the net income for the period.

Closing all temporary accounts to the retained earnings account is faster than using the income summary account method because it saves a step. There is no need to close temporary accounts to another temporary account (income summary account) in order to then close that again.

Example :

Pass the opening entry on April 1, 2010 on the basis of the following information taken from the books of Shipla.

- a) Cash in hand ` 3,000
- b) Sundry Debtors ` 8,000
- c) Sundry Creditors ` 5,000
- d) Stock of the goods ` 6,000
- e) Bills payable ` 3,000
- f) Bills receivable ` 3,000

- g) Furniture ` 7,000
- h) Machinery ` 6,000
- i) Land & Building ` 15,000
- j) Secured Loan ` 10,000

Sol :

Date	Particulars	L.F	Debit Amount	Credit Amount
2010	Cash in hand A/c Dr.		3,000	
April	Sundry Debtors A/c Dr.		8,000	
1	Stock of the goods A/c Dr.		6,000	
	Bills receivable A/c Dr.		3,000	
	Furniture A/c Dr.		7,000	
	Machinery A/c Dr.		6,000	
	Land & Building A/c Dr.		15,000	
	To Sundry Creditors A/c			5,000
	To Bills payable A/c			3,000
	To Secured Loan A/c			10,000
	To capital Account*			30,000
	(Being balances brought forward from the last year)			

* Balance in the amount of debits and credits is taken as capital contributed as per the Accounting Equation i.e., Capital + Liabilities = Assets

PROBLEMS

5. Journalise the following transactions :

2008

July 1	Opened a bank account	50,000
5	Purchased goods for cash	5,000
10	Purchased machinery from A	15,000
12	Paid wages	500
13	Goods sold to B for cash	2,000
15	Paid electricity bill	200
18	Paid to A on account	5,000
20	Sold old newspapers	50

*Sol :***Journal**

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2008 July 1	Bank A/c Dr. To Cash A/c (Being an account opened with bank)		50,000	50,000
July 5	Purchases A/c Dr. To Cash A/c (Being goods purchased for cash)		5,000	5,000
July 10	Machinery A/c Dr. To A A/c (Being machinery purchased from A)		15,000	15,000
July 12	Wages A/c Dr. To Cash A/c (Being wages paid)		500	500
July 13	Cash A/c Dr. To Sales A/c (Being goods sold for cash)		2,000	2,000
July 15	Electricity bill A/c Dr. To Cash A/c (Being electricity bill paid)		200	200
July 18	A A/c Dr. To Cash A/c (Being amount paid to A for purchase of machinery)		15,000	15,000
July 20	Cash A/c Dr. To Newspaper A/c (Being old newspaper sold)		50	50

6. Journalise the following transactions:

- 1. Paid wages Rs. 500 and salaries Rs. 1,000 and rent Rs. 1,000.**
- 2. Bought goods from A Rs. 10,000 and paid the half amount in cash.**
- 3. Cash received from B Rs. 2,900 and allowed him a discount of Rs. 100.**
- 4. Withdrew for personal use, cash Rs. 900 and goods Rs. 100.**
- 5. Purchased building Rs. 50,000 and furniture for Rs. 10,000 for cash.**

Sol.:

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
1.	Wages A/c Dr. Salaries A/c Dr. Rent A/c Dr. To Cash A/c (Being wages, salaries and rent paid in cash)		500 1,000 1,000	2,500
2.	Purchases A/c Dr. To Cash A/c To A A/c (Being goods purchased from A and half the amount paid in cash)		10,000	5,000 5,000
3.	Cash A/c Dr. Discount allowed A/c Dr. To B A/c (Being cash received and discount allowed)		2,900	100 3,000
4.	Drawings A/c Dr. To Cash A/c To Purchases A/c (Being cash and goods withdrawn by proprietor)		1,000	900 100
5.	Building A/c Dr. Furniture A/c Dr. To Cash A/c (Being building and furniture purchased)		50,000 10,000	60,000

7. Journalize the following transactions in the books of 'X' with narrations.

2008

March 1	'X' started business with	50,000
March 3	Bought goods from 'Y'	20,000
March 4	Purchased a typewriter for office use	5,000
March 5	Paid Telephone Rent	300
March 8	Sold goods to Rajkumar & Co.	10,000

*Sol :***Journal Entries in the Books of 'X'**

Date	Particulars	LF No.	Debit Amount	Credit Amount
2008 March 1	Cash A/c Dr To Capital A/c [Being Business Commenced with cash]		50,000 –	– 50,000
March 3	Purchases A/c Dr To 'y' A/c [Being goods purchased from 'y']		20,000 –	– 20,000
March 4	Typewriter A/c Dr To Cash A/c [Being Typewriter purchased]		5,000 –	– 5,000
March 5	Telephone charges A/c Dr To Cash A/c [Being Telephone rent paid]		300 –	– 300
March 8	Rajkumar & Co. A/c Dr To Sales A/c [Being goods sold to Rajkumar & Co.]		10,000 –	– 10,000

8 . Write journal entries for the following transactions in the books of Naveen & Co.**2008**

June 1	Naveen & Co. started business with	40,000
June 4	Purchased Typewriter for	5,700
June 6	Sold goods to Arunachalam	4,200
June 10	Purchased goods from Ramnath	6,100
June 15	Commission paid	500
June 18	Interest received	450
June 20	Purchased stationery	175
June 25	Salaries paid for June month	3,500

Sol.:

Journal Entries in the Books of Naveen & Co.

Date	Particulars	L.F. No.	Debit Amount	Credit Amount
1999 June 1	Cash A/c Dr. To Capital A/c [Being cash brought into business towards capital]		40,000	40,000
" 4	Typewriter A/c Dr. To Cash A/c [Being Typewriter Purchased for cash]		5,700	5,700
" 6	Arunachalam A/c Dr. To Sales A/c [Being goods sold to Arunachalam]		4,200	4,200
" 10	Purchases A/c Dr. To Ramnath A/c [Being goods purchased from Ramnath]		6,100	6,100
" 15	Commission A/c Dr. To Cash A/c [Being Commission paid]		500	500
" 18	Cash A/c Dr. To Interest A/c [Being interest received]		450	450
" 20	Stationery A/c Dr. To Cash A/c [Being stationery purchased]	175	175	
" 25	Salaries A/c Dr. To Cash A/c [Being salaries paid]	3,500	3,500	

9. From the following data pass necessary journal entries.

- Jan 1, 2005 - Business commenced with cash Rs. 10,000
 Jan 3 - Goods purchased from 'x' Rs. 5,000
 Jan 4 - Goods sold to Mahesh Rs. 2,500
 Jan 5 - Cash received from Raghu Rs. 3,000
 Jan 6 - Cash paid to Shiva Rs. 4,000
 Jan 7 - Cash sales Rs. 2,000
 Jan 8 - Goods purchased from 'x' Rs. 1,500 for cash
 Jan 9 - Cash withdrawn from bank for personal use Rs. 1,000
 Jan 10 - Rent paid Rs. 2,000
 Jan 11 - Salaries paid Rs. 3,000

*Sol :***Journal Entries**

Date	Particulars	LF No.	Debit Amount	Credit Amount
2005 Jan 1	Cash A/c Dr To Capital A/c [Being Business Commenced with cash]		10,000 –	– 10,000
Jan 3	Purchases A/c Dr To 'x' A/c [Being goods purchased from 'x']		5,000 –	– 5,000
Jan 4	Maresh A/c Dr To Sales A/c [Being goods sold to Maresh]		2,500 –	– 2,500
Jan 5	Cash A/c Dr To Raghu A/c [Being cash received from Raghu]		3,000 –	– 3,000
Jan 6	Shiva A/c Dr To Cash A/c [Being cash paid to Shiva]		4,000 –	– 4,000
Jan 7	Cash A/c Dr To Sales A/c [Being goods sold for cash]		2,000 –	– 2,000
Jan 8	Purchases A/c Dr To Cash A/c [Being goods purchased for cash]		1,500 –	– 1,500
Jan 9	Drawings A/c Dr To Bank A/c [Being Cash withdrawn for personal use]		1,000 –	– 1,000
Jan 10	Rent A/c Dr To Cash A/c [Being rent paid]		2,000 –	– 2,000
Jan 11	Salaries A/c Dr To Cash A/c [Being salaries paid]		3,000 –	– 3,000

10. For the following transactions write journal entries.

- Aug 1, 2007 - Business commenced with cash Rs. 25,000
- 3 - Cash sales Rs. 2,000
- 5 - Cash purchases Rs. 4,000
- 6 - Rent paid Rs. 1,000
- 8 - Rent received Rs. 2,000
- 10 - Discount allowed Rs. 600
- 12 - Cash received from Hanumanthu Rs. 700
- 14 - Cash paid to Rohit Rs. 300

Sol.:

Journal Entries

Date	Particulars	LF No.	Debit Amount	Credit Amount
Aug 1	Cash A/c Dr To Capital A/c [Being Business Commenced with cash]		25,000 -	- 25,000
Aug 3	Cash A/c Dr To Sales A/c [Being goods sold for cash]		2,000 -	- 2,000
Aug 5	Purchases A/c Dr To Cash A/c [Being goods purchased for cash]		4,000 -	- 4,000
Aug 6	Rent A/c Dr To Cash A/c [Being rent paid]		1,000 -	- 1,000
Aug 8	Cash A/c Dr To Rent A/c [Being rent received]		2,000 -	- 2,000
Aug 10	Discount A/c Dr To Cash A/c [Being discount allowed]		600 -	- 600

Aug 12	Cash A/c Dr To Hanumanthu A/c [Being cash received from Hanumanthu]		700 –	– 700
Aug 14	Rohit A/c Dr To Cash A/c [Being cash paid to Rohit] [Being cash paid to Rohit]		300 –	– 300

11. Journalize the following transactions in the books of Gopal

1999

Sept. 1	Gopal commenced business with	75,000
" 2	Deposited into bank	30,000
" 5	Purchased furniture and paid by cheque	1,500
" 7	Goods purchased from Srividya	20,000
" 9	Goods returned to Srividya	400
" 13	Paid to Srividya in full settlement	19,500
" 17	Goods sold to Prakash	500
" 20	Goods distributed by way of free samples	1,000
" 24	Commission received	250
" 30	Paid salaries	5,000

Sol:

Journal of Gopal

Date	Particulars	LF No.	Debit Amount	Credit Amount
1999 Sept. 1	Cash A/c Dr. To Gopal's capital A/c [Being cash invested by Gopal]		75,000	75,000
" 2	Bank A/c Dr. To Cash A/c [Being cash deposited into bank]		30,000	30,000
" 5	Furniture A/c Dr. To Bank A/c [Being furniture purchased and paid by issue of cheque]		1,500	1,500

" 7	Purchases A/c Dr. To Srividya's A/c [Being goods purchased]	20,000	20,000
" 9	Srividya's A/c Dr. To purchases returns A/c [Being goods returned]	400	400
" 13	Srividya's A/c Dr. To Cash A/c To Discount A/c [Being cash paid to Srividya and she allowed Rs. 100 as discount]	19,600	19,500 100
" 17	Prakash A/c Dr. To Sales A/c [Being goods sold to Prakash]	500	500
" 20	Advertisement A/c Dr. To Purchases A/c [Being goods distributed as free samples]	1,000	1,000
" 24	Cash A/c Dr. To Commission A/c [Being commission received]	250	250
" 30	Salaries A/c Dr. To Cash A/c [Being salaries paid]	5,000	5,000

12. Journalize the following transactions for the month of Dec. 2016. Also state the nature of each account involved in the Journal entry.

1999

- | | | | |
|----|---------|---|--------|
| 1. | Dec. 1 | Ajit started business with Cash | 40,000 |
| 2. | Dec. 3 | He paid into the Bank | 2,000 |
| 3. | Dec. 5 | He purchased goods for cash | 15,000 |
| 4. | Dec. 8 | He sold goods for cash | 6,000 |
| 5. | Dec. 10 | He purchased furniture and paid by cheque | 5,000 |
| 6. | Dec. 12 | He sold goods to Arvind | 4,000 |
| 7. | Dec. 14 | He purchased goods from Amrit | 10,000 |
| 8. | Dec. 15 | He returned goods to Amrit | 5,000 |

9.	Dec. 16	He received from Arvind in full settlement	3,960
10.	Dec. 18	He withdraw goods for personal use	1,000
11.	Dec. 20	He withdraw cash from business for personal use	2,000
12.	Dec. 24	He paid telephone charges	1,000
13.	Dec. 26	Cash paid to Amrit in full settlement	4,900
14.	Dec. 31	Paid for stationary	200
		Rent	500
		Salaries to staff	2,000
15.	Dec. 31	Goods distributed by way of free samples	1,000

Sol :

Journal of Gopal

S.No.	Date	Particulars	LF	Debit	Credit
1.	Dec. 1	Cash A/c Dr. To Capital A/c (Being commencement of business)		40,000	40,000
2.	Dec. 3	Bank A/c Dr. To Cash A/c (Being cash deposited in the bank)		20,000	20,000
3.	Dec. 5	Purchases A/c Dr. To Cash A/c (Being purchase for cash)		15,000	15,000
4.	Dec. 8	Cash A/c Dr. To Sales (Being goods sold for cash)		6,000	6,000
5.	Dec. 10	Furniture A/c Dr. To Bank A/c (Being purchase of furniture, paid by cheque)		5,000	5,000
6.	Dec. 12	Arvind A/c Dr. To Sales A/c (Being sales of goods)		4,000	4,000
7.	Dec. 14	Purchase A/c Dr. To Amrit (Being purchase of goods from Amrit)		10,000	10,000
8.	Dec. 15	Amrit Dr. To Purchase Returns A/c (Being goods returned to Amrit)		5,000	5,000

9.	Dec. 16	Cash A/c Discount A/c To Arvind (Being cash received from Arvind in full settle and allowed with ₹ 40 as discount)	Dr. Dr.	3,960 40	4,000
10.	Dec. 18	Drawing A/c To Purchases A/c (Being withdrawal of goods for personal use)	Dr.	1,000	1,000
11.	Dec. 18	Drawing A/c To Cash A/c (Being cash withdrawal from the business for personal use)	Dr.	2,000	2,000
12.	Dec. 24	Telephone Expenses A/c To Cash A/c (Being telephone expenses paid)	Dr.	1,000	1,000
13.	Dec. 26	Amrit To Cash A/c To Discount A/c (Being cash paid to Amrit and he allowed ₹ 100 as discount)	Dr.	5,000	4,900 100
14.	Dec. 31	Stationery Expenses Rent A/c Salaries A/c To Cash (Being expenses paid)	Dr. Dr. Dr.	200 500 2,000	2,700
15.	Dec. 31	Advertisement Expenses A/c To Purchases A/c (Being distribution of goods by way of free samples)		1,000	1,000
		Total		1,21,700	1,21,700

2.6 PREPARATION OF LEDGER ACCOUNTS

Q18. Define ledger. Explain the advantages of ledger ?

Ans :

(Dec.-19)

Ledger is a book where the journalized transactions are being classified. Ledger is a set of accounts and includes all the accounts of business i.e., personal, nominal or real.

A company can maintain ledger in two forms i.e., Bound Ledger and Loose-leaf Ledger. The process of transferring the debit and credit items from the journal to the ledger in their respective accounts is known as posting. Posting must be made/done before the preparation of final accounts. The accounts which are active in nature must be updated on the timely basis.

Definitions of Ledger

- i) **According to J.R. Batliboi**, "The Ledger is the chief book of accounts and it is in this book that all the business transactions would ultimately find their place under their accounts in a duly classified form".
- ii) **According to L.C. Croper**, The book which contains a classified and permanent record of all the transactions of a business is called a ledger'.
- iii) **According to O.P. Gupta**, "Ledger is that principal book of accounts in which all the business transactions find their ultimate place in the shape of accounts in a classified form. This book supplies all the information regarding the working of a business.

Advantages of Ledger

The main advantages of ledger are as follows:

1. Knowledge of Business Results

With the help of ledger the important information relating to business can easily be obtained as all the business transactions relating to an item are recorded in the form of separate accounts in the ledger in such a way as their effect on assets, liabilities and capital can easily be understood.

2. Knowledge of Incomes and Expenses

A separate account is opened for each item of income and expense. Thus, it enables to understand that what are the sources of income and where the amount is spent.

3. Helpful in Preparing Trial Balance

Ledger is also helpful in the preparation of trial balance. Without preparing the ledger, trial balance cannot be made.

4. Helpful in Preparing Final Accounts

It is mandatory for the businessman to prepare final accounts. Ledger helps in preparing the final accounts as the total or balances of accounts appear in Trading A/c, P/L A/c and balance sheet.

5. Overcoming the Limitations of Journal

Ledger fulfills all those objects which lack in journal. Journal does not provide complete

description of all the transactions relating to an account in classified and summarised form, but the ledger provides it.

Q19. Explain the significance of Ledger

Or

Explain the Importance of Ledger

Ans :

Ledger is an important book of Account. It contains all the accounts in which all the business transactions of a business enterprise are classified. At the end of the accounting period, each account will contain the entire information of all the transactions relating to it.

Following points highlight the importance of ledger :

➤ **Knowledge of Business Results**

Ledger provides detailed information about revenues and expenses at one place. While finding out business results the revenue and expenses are matched with each other.

➤ **Knowledge of Book Value of Assets**

Ledger records every asset separately. Hence, you can get the information about the Book value of any asset whenever you need.

➤ **Useful for Management**

The information given in different ledger accounts will help the management in preparing budgets. It also helps the management in keeping the check on the performance of business it is managing.

➤ **Knowledge of Financial Position**

Ledger provides information about assets and liabilities of the business. From this we can judge the financial position and health of the business.

➤ **Instant Information**

The business always need to know what it owes to others and what the others owe to it. The ledger accounts provide this information at a glance through the account receivables and payables.

Q20. Explain the format of a ledger account.*Ans :*

The debit and credit aspects of each transaction recorded in the Journal are transferred to a book called Ledger which records the dual aspect of the transactions, account-wise. The format of a Ledger is given below.

..... Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount ₹	Date	Particulars	L.F.	Amount ₹
	To				By		

"T" accounts are simplified representation of ledger accounts and are widely used. A "T" Account is divided into two sides, the left hand side represents the debit side and the right hand side represents the credit side. Each side of the ledger has columns for the

- **Date**
It represents the date of the transaction taken place.
- **Particulars**
It gives reference to the name of the other corresponding Account, debited or credited in the Journal on that date.
- **Folio**
It shows the page number of the Journal from where the posting has been done. This serves the purpose of cross reference in both the Journal and Ledger as in Journal; Ledger Folio number is recorded showing the page number of the Ledger on which the posting has been made.
- **Amount**
Here, the amount of the account debited or credited is recorded.
Debit items are recorded on the left hand side and the credit items are recorded on the right hand side of each account in the ledger.

Q21. Define the term ledger posting. Explain the rules regarding ledger posting.*Ans :*

The term "Posting" means transferring the debit and credit items from the Journal to their respective accounts in the Ledger. It should be noted that the exact names of accounts used in the Journal should be carried to the Ledger.

For example, if in the Journal, Expenses Account has been debited, it would not be correct to debit the Office Expenses Account in the Ledger. Though, in the Journal, it might have been indicated clearly in the narration that it is an item of office expenses the correct course would have been to record the amount to the Office Expenses Account in the Journal as well as in the Ledger.

Posting may be done at any time. However, it should be completed before the financial statements are prepared. It is advisable to keep the more active accounts posted to date. The examples of such accounts are the cash account, personal accounts of various parties etc.

The posting may be done by the book-keeper from the Journal to the Ledger by any of the following methods:

- (i) He may take a particular side first. For example, he may take the debits first and make the complete postings of all debits from the Journal to the Ledger.
- (ii) He may take a particular account and post all debits and credits relating to that account appearing on one particular page of the Journal. He may then take some other accounts and follow the same procedure.
- (iii) He may complete postings of each journal entry before proceeding to the next journal entry.

It is advisable to follow the last method. One should post each debit and credit item as it appears in the Journal.

The Ledger Folio (L.F.) column in the Journal is used at the time when debits and credits posted to the Ledger. The page number of the Ledger on which the posting has been done is rationed in the L.F. column of the Journal. Similarly, a folio column in the Ledger can also be rat where the page from which posting has been done from the Journal may be mentioned. Thus, are cross references in both the Journal and the Ledger.

A proper index should be maintained in the Ledger giving the names of the accounts and the page numbers.

Rules Regarding Posting

- (i) Separate accounts should be opened in the Ledger for posting transactions relating to different accounts recorded in the Journal.

For example, separate accounts may be opened for sales, purchases, sales returns, purchases returns, salaries, rent, cash, etc.

- (ii) The concerned account which has been debited in the Journal should also be debited in the Ledger. However, a reference should be made of the other account which has been credited in the Journal. For example, for salaries paid, the salaries account should be debited in the Ledger, but reference should be given of the Cash Account which was has been credited in the Journal.

- (iii) The concerned account, which has been credited in the Journal should also be credited in the Ledger, but reference should be given of the account, which has been debited in the Journal.

For example, for salaries paid, Cash Account has been credited in the Journal. It will be credited in the Ledger also, but reference will be given of the Salaries Account in the Ledger.

2.6.1 Ledger Balancing

Q22. Explain briefly about Ledger Balancing (or) Balancing of an account.

Ans. :

(Dec.-17)

In business, there may be several transactions relating to one particular account. In Journal, these transactions appear on different pages in a chronological order while they appear in a classified form under that particular account in the Ledger. At the end of a period (say, a month, a quarter or a year), the businessman will be interested in knowing the position of a particular account. This means, he should total the debits and credits of the account separately and find out the net balance. This technique of finding out the net balance of an account, after considering the totals of both debits and credits appearing in the account is known as 'Balancing the Account'. The balance is put on the side of the account which is smaller and a reference is given that it has been carried forward or carried down (c/f or c/d) to the next period. On the other hand, in the next period, a reference is given (hat the opening has been brought forward or brought down (b/f or b/d) from the previous period.

Q23. Compare and contrast journal and ledger.*Ans. :***(July-19, Imp.)**

S.No.	Basis	Journal	Ledger
1.	Meaning	Journal is a primary book wherein all the business transactions are recorded on a daily basis in a systematic manner.	Ledger is a book where the journalized transaction are being classified.
2.	Type of book	It is a book of primary record.	It is a book of final entry.
3.	Process	The process of recording transactions in a journal is called as 'Journalizing'.	The process of recording transactions in a ledger is called as posting.
4.	Organization of data	The organising of each of the data within journal is known as the transaction.	The organising of each of the data within ledger is known as the account.
5.	Nature	Journal is not balanced except for the cash book.	Every account in the ledger is balanced.
6.	Accuracy	It is very difficult to test the accuracy of the books.	The availability of lists of balances ensures easy accuracy testing.
7.	Narration	Narration is required for each entry.	Narration is not required.
8.	Record	It maintains the record in sequential manner.	It maintains the record in conclusive manner.
9.	Folio	It includes the ledger folio.	It includes the journal or sub-journal folio.
10.	Preparation of final accounts	It does not facilitate the preparation of final accounts.	It serves as a basis for the preparation of final accounts.
11.	Required information	It does not provide a ready information with relation to any accounts.	It enables easy availability of information with relation to any accounts, as the similar nature are recorded in a specific transactions of group.
12.	Recording transaction	The transactions debit and credit amount are recorded in two adjacent columns.	The transactions debit and credit amounts are recorded in two different sides of two different accounts.
13.	Appearance	Journal includes one debit column and one credit column.	Ledger includes two sides, the left side is known as the debit side and the right side is known as credit side.
14.	Importance	Computerization of accounting eliminates the importance of journal for recording routine transaction such as sales, purchases, etc.	Computerization of accounts cannot eliminate the importance of ledger. Ledger cannot be avoided as it is must.

PROBLEMS ON LEDGER

13. Pass necessary Journal entries for the following transactions and post them in the appropriate ledger accounts of Lal.

1999

Jan. 1	Lal started business with cash	40,000
" 4	Goods purchased from Gopal	23,000
" 6	Goods sold to Prakash	16,000
" 8	Goods returned to Gopal	5,000
" 10	Goods returned by Prakash	800
" 13	Deposited into bank	3,000
" 15	Interest received	50
" 31	Salaries paid	5,000

Sol :

Journal Entries

Date	Particulars	LF No.	Debit Amount	Credit Amount
1999 Jan. 1	Cash Account Dr. To Capital account [Being cash brought into business]		40,000	40,000
" 4	Purchases Account Dr. To Gopal Account [Being goods purchased for Gopal]		23,000	23,000
" 6	Prakash Account Dr. To Sales Account [Being goods sold to Prakash]		16,000	16,000
" 8	Gopal Account Dr. To Purchases Returns Account [Being goods returned to Gopal]		5,000	5,000
" 10	Sales Returns Account Dr. To Prakash Account [Being goods returned by Prakash]		800	800
" 13	Bank Account Dr. To Cash Account [Being cash deposited into Bank]		3,000	3,000
" 15	Cash Account Dr. To Interest Account [Being interest received]		50	50
" 31	Salaries Account Dr. To Cash Account [Being salaries paid]		5,000	5,000

Cash Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999 Jan. 1	To Capital Account		40,000	1999 Jan. 1	By Bank Account		3,000
Jan. 15	To Interest Account		50	Jan. 31	By Salaries Account		5,000
				Jan. 31	By Balance (c/d)		32,050
			40,050				40,050
Feb. 1	To balance (b/d)		32,050				

Capital Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999 Jan. 31	To Balance (c/d)		40,000	1999 Jan. 1	By Cash Account		40,000
			40,000				40,000
				Feb. 1	By Balance (b/d)		40,000

Purchase Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999 Jan. 4	To Gopal Account		23,000	1999 Jan. 31	By Balance (c/d)		23,000
			23,000				23,000
Feb. 1	To Balance (b/d)		23,000				

Gopal Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999 Jan. 8	To Purchase Returns Account		5,000	1999 Jan. 4	By Purchases Account		23,000
Jan. 31	To Balance c/d		18,000				23,000
			23,000	Feb. 1	By Balance (c/d)		18,000

Prakash Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999 Jan. 6	To Sales Account		16,000	1999 Jan. 10	By Sales Return A/c		800
				Jan. 31	By Balance c/d		15,200
			16,000				16,000
Feb. 1	To Balance (b/d)		15,200				

Sales Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999 Jan. 31	To Balance (c/d)		16,000	1999 Jan. 6	By Purchases		16,000
			16,000		By Prakash Account		16,000
				Feb. 1	By Balance (b/d)		16,000

Purchases Returns Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999 Jan. 31	To Balance c/d		5,000	1999 Jan. 8	By Gopal Account		5,000
			5,000				5,000
				Feb. 1	By Balance (b/d)		5,000

Sales Returns Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999 Jan. 10	To Prakash Account		800	1999 Jan. 31	By Balance (c/d)		800
			800				800
Feb. 1	To Balance (b/d)		800				

Bank Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999				1999			
Jan. 13	To Cash Account		3,000	Jan. 31	To Balance (c/d)		3,000
			3,000				3,000
Feb. 1	To Balance (b/d)		3,000				

Interest Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999				1999			
Jan. 31	To Balance c/d		50	Jan. 15	By Cash Account		50
			50				50
				Feb. 1	By Balance (b/d)		50

Salaries Account

Dr.

Cr.

Date	Particulars	L.F.	Amount	Date	Particulars	L.F.	Amount
1999				1999			
Jan. 31	To Cash Account		5,000	Jan. 31	By Balance c/d		5,000
			5,000				5,000
Feb. 1	To Balance (b/d)		5,000				

14. Journalise the following transactions, post them in the concerned ledger accounts and balance the accounts

1997	Particulars	Rs.
Jan. 1	Manoj commenced business with	80,000
" 2	Deposited in bank	75,000
" 5	Bought goods on credit from Srinath	8,000
" 8	Sold goods to Sridhar on credit	10,000
" 10	Purchased machinery, payment made by cheque	25,000
" 12	Paid Srinath - by cheque	6,000
" 16	Received cash from Sridhar	7,500
" 20	Bought Stationery from Govind Venkatesh for cash	300
" 24	Paid Rs. 500 as travelling expenses to Mukesh	
" 27	Bought goods for cash	3,000
" 31	Paid rent to landlord by cheque	400

*Sol.:***JOURNAL**

Date	Particulars	LF No.	Debit Amount	Credit Amount
1997 Jan 1	Cash Account Dr. To Capital Account [Being cash brought into business]		80,000	80,000
Jan 2	Bank Account Dr. To Cash Account [Being cash deposited in bank]		75,000	75,000
Jan 5	Purchases Account Dr. To Srinath's Account [Being goods purchased on credit]		8,000	8,000
Jan 8	Sridhar's Account Dr. To Sales Account [Being goods sold on credit]		10,000	10,000
Jan 10	Machinery Account Dr. To Bank Account [Being machinery purchased]		25,000	25,000
Jan 12	Srinath's Account Dr. To Bank Account [Being cheque issued to Srinath]		6,000	6,000
Jan 16	Cash Account Dr. To Sridhar's Account [Being cash received from Sridhar]		7,500	7,500
Jan 20	Stationery Account Dr. To Cash Account [Being stationery purchased for cash]		300	300
Jan 24	Travelling Expenses Account Dr. To Cash Account [Being travelling expenses paid]		500	500
Jan 27	Purchases Account Dr. To Cash Account [Being goods purchased for cash]		3,000	3,000
Jan 31	Rent Account Dr. To Bank Account [Being rent paid by cheque]		400	400

Ledger Accounts

Capital Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997 Jan. 31	To Balance c/d		80,000	1997 Jan. 1	By Cash A/c		80,000
			80,000				80,000
				Jan. 1	By Balance b/d		80,000

Bank Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997 Jan. 2	To Cash A/c		75,000	1997 Jan. 10	By Machinery A/c		25,000
				Jan. 12	By Srinath A/c		6,000
				Jan. 31	By Rent A/c		400
				Jan. 31	By Balance c/d		43,600
			75,000				75,000
Feb. 1	To Balance b/d		43,600				

Purchases Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997 Jan. 5	To Srinath A/c		8,000	1997 Jan. 31	By Balance c/d		11,000
Jan. 27	To Cash A/c		3,000				11,000
			11,000				
Feb. 1	To Balance b/d		11,000				

Sales Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997 Jan. 10	To Balance c/d		10,000	1997 Jan. 8	By Sridhar A/c		10,000
			10,000				10,000
				Feb. 1	By Balance b/d		10,000

Srinath Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997				1997			
Jan. 10	To Bank A/c		6,000	Jan. 5	By Purchase A/c		8,000
Jan. 31	To Balance c/d		2,000				
			8,000				8,000
				Feb. 1	By Balance b/d		2,000

Sridhar Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997				1997			
Jan. 10	To Sales A/c		10,000	Jan. 16	By Cash A/c		7,500
				Jan. 31	By Balance c/d		2,500
			10,000				10,000
Feb. 1	To Balance b/d		2,500				

Machinery Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997				1997			
Jan. 10	To Bank A/c		25,000	Jan. 31	By Balance c/d		25,000
			25,000				25,000
Feb. 1	To Balance b/d		25,000				

Stationery Account

Dr.				Cr.			
Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997				1997			
Jan. 20	To Cash A/c		300	Jan. 31	By Balance c/d		300
			300				300
Feb. 1	To Balance b/d		300				

Travelling Expenses Account

Dr.

Cr.

Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997				1997			
Jan. 10	To Cash A/c		500	Jan. 31	By Balance c/d		500
			500				500
Feb. 1	To Balance b/d		500				

Rent Account

Dr.

Cr.

Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997				1997			
Jan. 10	To Bank A/c		400	Jan. 31	By Balance c/d		400
			400				400
Feb. 1	To Balance b/d		400				

Cash Account

Dr.

Cr.

Date	Particulars	L.F.	Amount Rs.	Date	Particulars	L.F.	Amount Rs.
1997				1997			
Jan. 1	To Capital A/c		80,000	Jan. 2	By Bank A/c		75,000
Jan. 10	To Sridhar A/c		7,500	Jan. 20	By Stationery		300
				Jan. 24	By Travelling expenses A/c		500
				Jan. 27	By Purchases A/c		3,000
				Jan. 31	By Balance (c/d)		8,700
			87,500				87,500
Feb. 1	To Balance (b/d)		8,700				

2.7 PREPARATION OF TRIAL BALANCE**Q24. Define trial balance. What are the objectives of trial balance?***Ans. :***(Imp.)**

Trial balance is a worksheet in which the balances of all ledgers are compiled into debit and credit columns. Under the double entry system, the total of debits must be equal to total of credits. This worksheet helps in evaluating whether or not the total debits for the period are equal to total number of credits generated for the same period.

Every businessman prepares the trial balance after journal and ledger. It is a tradition to prepare the trial balance before the preparation of the final accounts. It serves as a tool to detect errors. If the trial balance is balanced, it means there are no mathematical errors in the ledgers. However this does not mean that there are no errors in a company's accounting system. By preparing a trial balance on a regular basis makes it possible to quickly identify a specific accounting period where the imbalance took place and correct it quickly. Therefore many businessman choose to prepare a trial balance on monthly basis.

Definitions of Trial Balance

- i) **According to Carter**, "Trial Balance is a statement of debit and credit balances derived from the ledger, including cash and bank balances."
- ii) **According to William Pickles**, "The statement prepared with the help of ledger balances, at the end of financial year or at any other date, to find out whether debit total agrees with credit total, is called a Trial Balance."
- iii) **According to J. R. Battiboi**, "Trial Balance is a statement prepared with the help of debit and credit balances derived from the ledger, the objective of which is to check the arithmetical accuracy of the ledger."
- iv) **According to M.S. Gosar**, "Trial Balance is a statement containing the balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accuracy of ledger posting."

Objectives of Trial Balance

The objectives of preparing a trial balance are:

(a) To check Arithmetical Accuracy

Arithmetical accuracy in ledger posting means writing correct amount, in the correct account and on its correct side while posting transactions from various original books of accounts, such as Cash Book, Purchases Book, Sales Book, etc. It also means not only the correct balance of ledger account but also the totals of the special purpose Books.

(b) To help in preparing Financial Statements

The ultimate objective of the accounting is to prepare financial statements i.e. Trading and Profit and Loss Account, and Balance sheet of a business enterprise at the end of an accounting year. These statements contain balances of various ledger accounts. As Trial Balance contains balances of all ledger accounts, in financial statements the balances of ledger accounts are carried from the Trial balance for proper analysis.

(c) Helps in Locating Errors

If total of two columns of the trial balance agrees it is a proof of arithmetical accuracy in the ledger posting. However, if the totals of the two columns do not tally it indicates that there is some mistake in the ledger accounts. This prompts the accountant to find out the errors.

(d) Helps in Comparison

Comparison of ledger account balances of one year with the corresponding balances with the previous year help the management taking some important decisions. This is possible by using the Trial Balances of the two years.

(e) Helps in Making Adjustments

While making financial statements adjustments regarding closing stock, prepaid expenses, outstanding expenses etc. are to be made. Trial balance helps in identifying the items requiring adjustments in preparing the financial statements.

Trial Balance is generally prepared at the end of the year. However it can be prepared at any time during the accounting year to check the accuracy of the posting.

Q25. What are the reasons for the preparation of Trial Balance.

Ans :

Following are the reason why a trial balance has to be prepared :

- (a) It ensures that the transactions recorded in the books of accounts have identical debit and credit amount.
- (b) Balance of each ledger account has been computed correctly.
- (c) Balance of each and every ledger account has been transferred accurately and on the correct side of the sheet on which trial balance has been prepared.
- (d) The debit and the credit columns of trial balance have been added up correctly.
- (e) Preparation of final accounts is not possible without preparing trial balance first.
- (f) Agreed trial balance is a prima facie evidence of the arithmetical accuracy of the accounting books maintained.
- (g) Errors which are revealed by preparing trial balance (listed below) are rectified even before the preparation of final accounts.

Q26. What are the features of Trial Balance.

Ans :

Following are the essential features of trial balance:

- It is a statement and not a part of the double entry system of book-entry.
- It can be prepared at regular interval.
- It contains the summary of all ledger accounts.
- Its purpose is to find out the arithmetical accuracy of the books of accounts.
- It shows the debit balances and the credit balances in two separate columns.
- In the trial balance the ledger folio number of each ledger account is noted beside its name, to facilitate easy reference.

Q27. What are the utilities of Trial Balance

Or

What are the advantages of Trial Balance

Or

What are the merits of Trial Balance

Ans :

The following are the advantages of using Trial Balance :

- It helps to ascertain the arithmetical accuracy of the book-keeping work done during the period.
- It supplies in one place ready reference of all the balances of the ledger accounts.
- It is the basis on which final accounts are prepared.
- Where a trial balance has agreed, there can be no reason why a balance sheet should not agree.
- Final accounts and balance sheet can be prepared on the basis of the balances as shown in the trial balance.
- From a trial balance all ledger accounts balances including cash and bank balances can be obtained.
- It ensures that the transactions recorded in the books of accounts have identical debit and credit amount.
- Balance of each ledger account has been computed correctly.
- The debit and the credit columns of trial balance have been added up correctly.
- Errors which are revealed by preparing trial balance (listed below) are rectified even before the preparation of final accounts.

Q28. What are the disadvantages of Trial Balance

Or

What are the demerits of Trial Balance

Or

What are the limitations of Trial Balance

Ans :

Limitations of Trial Balance

Following are the limitations of Trial Balance :

- All transactions have been correctly analyzed and recorded in proper accounts. For example wages paid for installation of fixed asset might have wrongly been debited to wages account.

- All the transactions have been recorded and nothing has been omitted.
 - Certain types of errors remain undetected even after the preparation of trial balance.
 - Entry might be posted twice in the ledger.
 - An entry has not at all posted in the ledger.
- Thus it is quite well known and said that "agreement of trial balance is not the conclusive proof of the accuracy of the books maintained."

Q29. Explain the format of trial balance. State the rules for preparing trial balance.

Ans :

Trial Balance as on

Date	Particulars (Name of Account)	L.F.	Dr. Amount	Cr. Amount

1. **Name of Account :** Names of all the accounts are given in this column.
2. **Ledger Folio :** It is the page number of the ledger on which a particular account is opened.
3. **Debit Amount :** In this column, the balance of that account will be shown that has debit balance or the total of the debit side of the account will be written.
4. **Credit Amount :** In this column, the balance of that account will be shown that has credit balance or the total of the credit side will be written.

Rules for preparing Trial Balance :

When balances of the accounts are given and asked to prepare Trial Balance from reliances, one should follow the following rules :

- All expenses and losses are debit balances and they are shown on the debit side. E.g. : Purchases, discount allowed, salaries, rent paid etc.
- All incomes and gains are credit balances and they are shown on the credit side. E.g. : Sales, Purchase Returns, Interest and Discount received etc.
- All assets, drawings and reserve on liabilities are debit balances and they are shown on the debit side. E.g. : Furniture, Bills Receivable, Plant and Machinery, Prepaid Expenses etc.
- Capital, reserve on assets, reserves created out of profit and other liabilities are credit balances and they are shown on the credit side. E.g. : Loan, Bills Payable, Outstanding Expenses, Discounts on Debts, Provident Fund etc.
- Opening Stock is a debit balance.

Q30. Explain the various methods of preparing trial balance.

Ans :

In balance may be prepared according to any of the two methods:

1. Total Method

In case of this method after totaling each side of the ledger account, the respective debit and credit totals of the ledger accounts are transferred to the respective sides of the trial balance. Thus, in case

of this method, the trial balance can be prepared soon after totaling various accounts and the time taken in balancing the account is saved to that extent. This method is not generally followed since it does not help in preparation of financial statements.

2. Balance Method

According to this method, every ledger account is balanced and only the balance of the ledger account is carried forward to the trial balance. This method is generally used since the preparation of the financial statements where only balances are to be taken.

3. Total and Balance Method

This method combines the first two methods explained above. In case of this method, the trial balance contains both the totals of both sides of the respective accounts as well as their final balances. This method has the advantage that it helps in immediate location of a mistake incurred, if any in the balancing the account. However, it has disadvantage of increasing the workload of the staff.

Q31. Explain various errors disclosed by trial balance.

Ans :

Some of the errors disclosed by trial balance are as follows:

1. Error of Partial Omission

If an item is not posted from journal or subsidiary book to ledger, two sides of trial balance shall not agree, e.g., if goods are sold for cash are recorded properly in sales book but not debited in cash account, the debit side of the trial balance shall fall short.

2. Omission to Post an Account in Trial Balance

If an account is not written in the trial balance, the two sides of trial balance shall not agree.

3. Wrong Totalling or Balancing of Ledger Account

If any account in the ledger is wrongly totalled or balanced, then also the trial balance shall not agree.

4. Posting of Wrong Amount

If wrong amount is posted in one of the two accounts while posting, it will not allow the trial balance to agree, e.g., goods worth Rs. 560 have been sold to 'A' but 'A's account has been debited with Rs. 650. It will increase the debit side of trial balance by Rs. 90.

5. Posting on the Wrong Side

When an item is by mistake posted on the wrong side of the ledger account it would cause disagreement in the trial balance, e.g., if the goods are sold to Ram on credit for Rs. 500 and while posting into Ram's account the amount is credited to Ram's account instead of being debited, it will result in a difference of Rs. 1,000 on two sides of trial balance.

6. Wrong Totalling of Subsidiary Books

If the totalling of any subsidiary book is wrongly made it would result into disagreement of trial balance.

7. Double Posting

If any posting is made twice in an account, then such errors are disclosed by the trial balance.

Q32. Explain various errors not disclosed by trial balance.

Ans :

The following errors are not disclosed by the trial balance. It means that the trial balance may agree inspite of some errors. These errors are :

1. Error of Omission

If any entry is not recorded in the books of original entry at all or omitted to be recorded, then the trial balance shall not be affected, e.g., furniture purchased from Ram Rs. 2,000 is not recorded in the journal at all, it means neither purchase account is debited nor Ram's account has been credited. Since neither account is debited nor credited, therefore trial balance will agree.

2. Error of Commission

If the correct amount is recorded in the wrong account but on the correct side, it is called as

error of commission. For example, goods are sold to Ram for Rs. 1,000 but Ravi's A/c is debited instead of Ram's A/c with Rs. 1,000, it is the error of commission.

3. Error of Principle

When the rules of double entry system are not followed properly then it is called error of principle. or whenever any income and expenditure is not properly allocated between capital and revenue. For example, installation charges of machinery are not debited to machinery account but debited to Wages A/c or sale of newspaper is credited to sales account, etc. the trial balance shall remain unaffected by such errors.

4. Compensating Errors

These errors compensate each other and neutralizes the fact of errors. When one error is committed which affects the total of trial balance but at the same time another error of opposite effect neutralizes the effect of earlier errors. For example, over-posting of Rs. 1,000 in the debit side of one account may be compensated if there is underposting of Rs. 1,000 on the credit side of some other account.

PROBLEMS ON TRIAL BALANCE

15. Prepare a trial balance as on 31st July 2009 from the following balances of Mr. Rajvansh.

Particulars	Amount	Particulars	Amount
Capital	10,000	Bank overdraft	8,700
Sales returns	1,000	Opening stock	15,000
Drawings	5,000	Cash	2,500
Bills payable	5,000	Purchases	9,000
Sales	15,000	Rent	1,000
Furniture	2,000	Bad debts	700
Creditors	12,000	Bills Receivable	3,500
Interest received	1,500	Debtors	14,500
Purchase returns	2,500		
Wages	500		

Sol :

Trial Balance of Mr. Rajvansh as on 31st July 2009

Particulars	Debit (₹)	Credit (₹)
Capital		10,000
Sales returns	1,000	-
Drawings	5,000	-
Bills payable	-	5,000
Sales	-	15,000
Furniture	2,000	-
Creditors	-	12,000
Interest received	-	1,500
Purchase returns	-	2,500

Wages	500	-
Bank overdraft	-	8,700
Opening stock	15,000	-
Cash	2,500	-
Purchases	9,000	-
Rent	1,000	-
Bad debts	700	-
Bills receivable	3,500	-
Debtors	14,500	-
	54,700	54,700

16. Prepare trial balance from the information given below.

Particulars	(₹)	Particulars	(₹)
Salaries account	12,000	Furniture account	25,000
Bank account	10,000	Cash account	18,000
Mahesh (prop) capital account	50,000	Prepaid insurance account	500
Insurance paid account	2000	Outstanding rent account	1,000
Goodwill account	15,000	Plant and Machinery account	20,000
Bank loan account (taken)	40,000	Sundry creditors account	28,000
Discount received account	500	Commission received account	1,000
Sundry debtors account	18,000		

Sol.:

Trial Balance

Particulars	Debit Amount (₹)	Particulars	Credit Amount (₹)
Salaries	12,000	Mahesh (proprietor) capital	50,000
Bank	10,000	Bank loan (taken)	40,000
Insurance paid	2000	Discount received	500
Goodwill	15,000	Prepaid insurance	500
Sundry debtors	18,000	Sundry creditors	28,000
Furniture	25,000	Commission received	1,000
Cash	18,000	Suspense a/c (b/f)	1,000
Outstanding rent	1,000		
Plant & Machinery	20,000		
	1,21,000		1,21,000

17. Ramya is not an expert in accountig she prepared the following trial abalance your are requested to correct it and prepare a correct trial balance of Ramya.

Particulars	Dr	Cr
Ramya Capital		25,500
Ramya drawings	500	
Promises	7,000	
Sales		50,000
Debtors		5,500
Purchases	20,000	
Purchase returns	2,000	
Loan from the bank		2,500
Creditors	6,000	
Trade and Office expenses	700	
Cash at Bank	1,500	
Bills Payable	1,000	
Salaries	1,300	
Opening stock		3,000
Rent	2,500	
Sales returns	6,000	
Machinery	39,000	
Discount allowed		1,000
Discount received	1,000	
Bills receivable		1,000
Sold old news paper	500	-
Old Furniture Sold	-	500

Sol :

Trial Balance

Particulars	Dr	Cr
Ramya Capital	-	25,500
Ramy drawings	500	-
Premises	7,000	-
Sales	-	50,000
Debtors	5,500	-
Purchases	20,000	-

Purchases returns	–	2,000
Loan from the bank	–	2,500
Creditors	–	6,000
Trade and Office Expenses	700	–
Cast at Bank	1500	–
Bills payable	–	1,000
Salaries	1,300	–
Opening Stock	3,000	–
Rent	2,500	–
Sales Returns	6,000	–
Machinery	39,000	–
Discount allowed	1,000	–
Discount received	–	1,000
Bills receivable	1,000	–
Sold old news papers	–	500
Old Furnitures	–	500
Total	89,000	89,000

Exercise Problems

1. Journalise the following transactions and prepare the necessary Ledger Accounts.

2008

- Jan 2. Purchased goods for Cash ₹ 6,000
Jan 4. Purchased goods from Sridhar on Credit ₹ 8,000
Jan 5. Cash Sales ₹ 5,000
Jan 7. Sold goods to Rakesh for Cash ₹ 8,300
Jan 8. Sold goods to Sai ₹ 6,000
Jan 9. Returned goods from Sai ₹ 1,000
Jan 10. Paid Salary ₹ 5,000
Jan 13. Paid Rent ₹ 2,000

2. Pass the necessary Journal Entries and prepare the Ledger Accounts for the following. Purchased goods on Credit for ₹ 10,000 from Kailash and settled his Account by paying ₹ 9,900 and he allowed a Discount of ₹ 100.

3. Prepare the necessary Ledger Accounts and also pass the Journal Entries for the following transactions.

2008

- Jan 1. Commenced business with Cash ₹ 50,000
Jan 3. Cash Deposited into Bank ₹ 20,000
Jan 5. Cash withdrawn for office use ₹ 4,000
Jan 7. Goods purchased for Cash ₹ 10,000
Jan 12. Purchased goods from X'Co. ₹ 5,000
Jan 15. Purchased goods for Cash ₹ 2,000
Jan 18. Purchased goods for Cash ₹ 3,000
Jan 20. Sold goods for Cash ₹ 7,000
Jan 22. Sold goods to Yasmeen ₹ 5,000
Jan 28. Sold goods for Cash ₹ 8,000

4. Prepare the Trial Balance from the following information. Capital ₹ 27,000; Cash ₹ 1,900; Bank ₹ 24,050; Stock of goods ₹ 4,000; Machinery ₹ 20,000; Furniture ₹ 4,700; Raj & Co. (Debit Balance) ₹ 950; Loan from HDFC ₹ 10,000; Ramana & Co. (Credit Balance) ₹ 2,000; Loan from SBI ₹ 20,000; Purchases ₹ 5,000; Sales ₹ 3,500; Discount Allowed ₹ 100; Profit on sale of Machinery ₹ 50; Repairs ₹ 200; Freight Inward ₹ 100; Octroi ₹ 100; Advertisement ₹ 500; Sale of newspapers ₹ 50; Rent ₹ 500; Salaries ₹ 500.

[Ans : ₹ 62,600]

5. Prepare a Trial Balance from the following information. Capital Account ₹ 80,000; Sales ₹ 90,000; Debtors ₹ 10,000; Discount Allowed ₹ 2,000; Purchases ₹ 1,00,000; Salaries ₹ 2,000; Drawings ₹ 40,000; Creditors ₹ 5,000; Cash in hand ₹ 5,000; Bank Overdraft ₹ 25,000; Furniture ₹ 50,000.

[Ans. : ₹ 2,09,000]

6. From the following information, prepare the Trial Balance. Cost of goods sold ₹ 15,000; Closing Stock ₹ 4,000; Debtors ₹ 6,000; Creditors ₹ 3,000; Fixed Assets ₹ 5,000; Opening Stock ₹ 6,000; Expenses ₹ 2,000; Sales ₹ 20,000; Capital ₹ 9,000. **Note :** As Cost of goods sold is given, Opening Stock and Purchases do not appear in Trial Balance, whereas, Closing Stock appears in Trial Balance as a debit balance.

[Ans. : ₹ 32,000]

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Short Question & Answers

1. Define single entry system.

Ans :

Single entry system is an incomplete form of recording financial transactions. It is the system, which does not record two aspects or accounts of all the financial transactions. It is the system, which has no fixed set of rules to record the financial transactions of the business.

Single entry system records only one aspect of transaction. Thus, single entry system is not a proper system of recording financial transactions, which fails to present complete information required by the management. Single entry system mainly maintains cash book and personal accounts of debtors and creditors. Single entry system ignores nominal account and real account except cash account. Hence, it is incomplete form of double entry system, which fails to disclose true profit or loss and financial position of a business organization.

2. Features of Double Entry System.

Ans :

The features of double entry system are as follows :

1. Set Rules

Every transaction is recorded as per the set rules of personal, real and nominal accounts. For this purpose every transaction is divided in two parts.

2. Entry in Two Accounts

Each transaction affects two accounts whether it is a cash or credit transaction.

3. Scientific System

Each transaction is divided in two parts which are personal and impersonal and then the rules of these accounts are applied. Since it has certain rules, it can be called as a scientific system.

4. Preparation of Trial Balance

Under double entry system, a trial balance is prepared to check the arithmetical accuracy of the accounts. If the total of debit column is equal to the total of credit column, then it means the accounts are arithmetically accurate.

5. Preparation of Final Accounts

Under double entry system, the final accounts are prepared through which one can know the profit and loss earned during the year. It also tells the final position of the business on the date of preparation of final accounts.

3. Accounting equation .

Ans :

Every business transaction has two aspects. One aspect is debited other aspect is credited. Both the aspects have to be recorded in accounts appropriately. American Accountants have derived the rules of debit and credit through a 'novel' medium, i.e., accounting equation. The equation is as follows:

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

The equation is based on the principle that accounting deals with property and rights to property and the sum of the properties owned is equal to the sum of the rights to the properties. The properties owned by a business are called assets and the rights to properties are known as liabilities or equities of the business. Equities can be subdivided into equity of the owners which is known as capital and equity of creditors who represent the debts of the business known as liabilities. These equities may also be called internal equity and external equity. Internal equity represents the owner's equity in the assets and external represents the outsider's interest in the asset. Based on the bifurcation of equity, the accounting equation can be restated as follows:

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

(Or)

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

4. Define journal.*Ans :*

A journal is known as a primary book of accounts or a book of original entry. With the increase in the size of business, the number of business transactions also increases. It is very difficult for a human-being to remember all those transactions. Therefore, to overcome this drawback, journal is prepared. Although, as stated above, the transactions can be recorded directly in the ledger. But such procedure will be cumbersome and confusing. Under this process, it will be very difficult to locate a transaction after several recordings. But in journal, the transactions can easily be located as it provides chronological record of transactions.

Definitions

- i) **According to Carter says,** "The journal or daily record as originally used, is a book of prime entry in which transactions are copied in order of date from a memorandum or a waste book. The entries as they are copied, classified into debit and credit, so as to facilitate their being correctly posted afterwards in the ledger."
- ii) **According to L.C. Cropper,** "A journal is a book employed to classify or sort out transactions in a form convenient for their subsequent entry in the ledger."
- iii) **According to Roland,** "Journal means a day book, diary or a log book. It is called prime subsidiary book of double entry system."

5. Objectives of Journal.*Ans :*

The following are the objectives and importance of journal:

1. Complete Record of Each Transaction

Date-wise complete record of each business transaction is recorded in the journal. Summary of each transaction is also written which is known as narration. This narration is helpful in getting full information about the transaction.

2. As a Proof

Journal is treated as a proof in the eye of the court for settling down the disputes among two or more parties. In some countries like France, Italy, Germany, etc. it is mandatory to prepare ledger.

3. Ledger Hosting

To prepare ledger from the journal is easier than preparing directly from vouchers or memorandum book. Chances of mistakes or errors are very less when we post the entries in the ledger from journal.

4. Correct Knowledge

Each and every transaction is recorded by debiting and crediting two accounts. This helps in knowing which two accounts are affected by the transaction.

6. Define ledger.*Ans :*

Ledger is a book where the journalized transactions are being classified. Ledger is a set of accounts and includes all the accounts of business i.e., personal, nominal or real.

A company can maintain ledger in two forms i.e., Bound Ledger and Loose-leaf Ledger. The process of transferring the debit and credit items from the journal to the ledger in their respective accounts is known as posting. Posting must be made/done before the preparation of final accounts. The accounts which are active in nature must be updated on the timely basis.

Definitions of Ledger

- i) **According to J.R.Batliboi,** "The Ledger is the chief book of accounts and it is in this book that all the business transactions would ultimately find their place under their accounts in a duly classified form".
- ii) **According to L.C.Cropper,** The book which contains a classified and permanent record of all the transactions of a business is called a ledger'.

iii) **According to O.P. Gupta**, "Ledger is that principal book of accounts in which all the business transactions find their ultimate place in the shape of accounts in a classified form. This book supplies all the information regarding the working of a business."

7. Define trial balance.

Ans :

Trial balance is a worksheet in which the balances of all ledgers are compiled into debit and credit columns. Under the double entry system, the total of debits must be equal to total of credits. This worksheet helps in evaluating whether or not the total debits for the period are equal to total number of credits generated for the same period.

Every businessman prepares the trial balance after journal and ledger. It is a tradition to prepare the trial balance before the preparation of the final accounts. It serves as a tool to detect errors. If the trial balance is balanced, it means there are no mathematical errors in the ledgers. However this does not mean that there are no errors in a company's accounting system. By preparing a trial balance on a regular basis makes it possible to quickly identify a specific accounting period where the imbalance took place and correct it quickly. Therefore many businessman choose to prepare a trial balance on monthly basis.

Definitions of Trial Balance

- i) **According to Carter**, "Trial Balance is a statement of debit and credit balances derived from the ledger, including cash and bank balances."
- ii) **According to William Pickles**, "The statement prepared with the help of ledger balances, at the end of financial year or at any other date, to find out whether debit total agrees with credit total, is called a Trial Balance."
- iii) **According to J. R. Battiboi**, "Trial Balance is a statement prepared with the help of debit and credit balances derived from the ledger, the objective of which is to check the arithmetical accuracy of the ledger."

iv) **According to M.S. Gosar**, "Trial Balance is a statement containing the balances of all ledger accounts, as at any given date, arranged in the form of debit and credit columns placed side by side and prepared with the object of checking the arithmetical accuracy of ledger posting."

8. What are the features of Trial Balance?

Ans :

Following are the essential features of trial balance:

- It is a statement and not a part of the double entry system of book-entry.
- It can be prepared at regular interval.
- It contains the summary of all ledger accounts.
- Its purpose is to find out the arithmetical accuracy of the books of accounts.
- It shows the debit balances and the credit balances in two separate columns.
- In the trial balance the ledger folio number of each ledger account is noted beside its name, to facilitate easy reference.

Choose the Correct Answer

1. The amount brought in by the proprietor in the business should be credited to [b]
(a) Cash Account (b) Capital Account
(c) Drawing Account (d) All of the above
2. The amount of salary paid to Suresh should be debited to [b]
(a) The account of Suresh (b) Salaries Account
(c) Cash Account (d) All of the above
3. The return of goods by a customer should be debited to [b]
(a) Customer's Account (b) Sales Returns Account
(c) Goods Account (d) All of the above
4. Sales made to Mahesh for cash should be debited to [a]
(a) Cash Account (b) Mahesh
(c) Sales Account (d) All of the above
5. The rent paid to the landlord be credited to [c]
(a) Landlord's Account (b) Rent Account
(c) Cash Account (d) All of the above
6. The Cash Discount allowed to a debtor should be credited to [b]
(a) Discount Account (b) Customer's Account
(c) Sales Account (d) All of the above
7. In case of a debt becoming bad, the amount should be credited to [a]
(a) Debtor's Account (b) Bad Debts Account
(c) Sales Account (d) All of the above
8. _____ is a statement in which debit side and credit side balances are verified. [b]
(a) Income statement (b) Trial balance
(c) Balance sheet (d) Trading account
9. A listing of a business entity's assets, liabilities and owner's equity as of a specific date is, [a]
(a) Balance sheet (b) Income statement
(c) Statement of owner's equity (d) Statement of cash flow

10. Type of journal entry [d]
(a) Simple entry (b) Compound entry
(c) Opening entry (d) all
11. Component of ledger [d]
(a) Date (b) Amount
(c) Particulars (d) All
12. J.F stands for [a]
(a) Journal folio (b) Junior folio
(c) Jobs folio (d) all

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Fill in the blanks

1. Purchases Journal records only _____ purchase of goods.
2. Sales Journal records all _____ sales of goods.
3. A _____ is sent to a customer when he returns the goods.
4. When the goods are returned to the supplier a _____ is sent to him.
5. _____ give item-wise information about the goods purchased, sold or returned during a particular period.
6. Total purchases are posted to the _____ at the end of a week or a month.
7. Goods Outward Journal is meant for recording all returns of goods _____ on credit.
8. The process of transferring the debit and credit items from a Journal to their respective accounts in the Ledger is termed as _____.
9. Journal is the book of _____ entry, while Ledger is the book of _____ entry.
10. The word "By" is used with an account while making posting on the _____ side of an account.
11. The technique of finding the net balance of an account after considering the totals of both debits and credits appearing in the account is known as _____.
12. The statement containing various ledger balances on a particular date is known as _____.
13. If the two sides of the trial balance tally, it is an indication of the fact that the books of accounts are _____ accurate.

ANSWERS

1. Credit
2. Credit
3. Credit Note
4. Debit Note;
5. Columnar Journals
6. Purchases Account
7. Purchased
8. Posting
9. First, Second
10. Credit
11. Balancing of an account
12. Trial Balance
13. Arithmetically

UNIT III

Preparation of Financial Statements :

Trading Account, Profit & Loss Account and Balance Sheet, Adjustment Entries, Understanding contents of financial statements of a joint stock company as per the Companies Act 2013.

3.1 PREPARATION OF FINAL ACCOUNTS

Q1. Define final accounts. What are the objectives of final accounts ?

Ans :

Introduction

One of the main objectives of maintaining accounts is to know the profit or loss made by the business organization in a particular period. This period may be a year, half year to quarter of a year for non statutory business concerns, it will be as per the convenience of the trader. But in general it is at the end of either calendar year or financial year. Further one must know that by mere preparation of trial balance one may not be able to find out the profit or loss of a business entity. Hence it is needed to prepare the final accounts.

Meaning

The term final accounts means statements which result finally from the preparation of accounts showing the profit earned or loss suffered by the firm and the financial state of affairs of the firm at the end of the period concerned. As already stated, the statement showing the profit or loss is known as Profit and Loss Account and the statement showing the financial state of affairs is called the Balance Sheet. The student must realise that in every concern, big or small, the accountant will be required to prepare these statements. Therefore, those who learn accountancy should become proficient in this. It is the trial balance that is the basis of these two statements and unless the student has mastered the preparation of the various books

and ledger accounts and also of the trial balance, he will not be able to fully grasp the significance of the profit and loss account and the balance sheet and master the technique of preparing them.

Objectives

The main objectives of preparation of final accounts are :

- The ascertain the profit or loss of the business for a particular period (By preparing Trading and Profit & Loss Account)
- To find out the financial position of the business concern on a specified date or period. (By preparing of the Balance Sheet)

Q2. What are the features of final accounts?

Ans :

1. Based on Facts

On the basis of the facts and transactions recorded in accounting books, the final accounts are usually being prepared.

2. Implements Accounting Conventions

Accounting conventions act as the basis for preparing the final accounts/statement.

For instance, closing stock valuation at the market price or cost price which ever is less.

3. Follows Accounting Assumptions

The final accounts are prepared on the basis of few accounting assumptions such as, going concern assumption, money measurement assumption.

4. Laid on Personal Opinion, Judgements and Estimates

The final accounts are laid on the personal opinion, judgements and estimates like creation of provision for doubtful debts, valuation of the closing stock either at cost price or at market price which ever is less.

Q3. Explain the uses of final accounts?

Ans :

1. It is used in evaluating approximately the organisation's earning ability.
2. It facilitates the investors to take appropriate investment decisions.
3. It assists in giving complete information about the cash inflows and outflows of the organisation to the financial institutions.
4. It helps in ascertaining the true and fair financial position of the organisation and helps in deciding about the credit worthiness of the organisation.
5. It also helps in making various fiscal policies for the organisation.

Q4. State the advantages and disadvantages of final accounts?

Ans :

Advantages

1. Business profit or loss can be known to the trader through the trading account and profit and loss account (Income statements).
2. Financial position can be revealed by the preparation of Balance Sheet.
3. Final accounts are important source of finance information and this help the trader or management to plan the financial activities of the business concern for any period or time.
4. Financial statement help the trader to take business decisions by comparing current year results with the results of the previous year statements.

5. As the profit & loss account discloses either profit or loss, based on which a trader prepare himself to pay the taxes correctly.
6. Tax authorities also needs financial statements to determine the amount of tax exactly.
7. As financial statements reveals the solvency position of the organization, the banks and other lending organizations may consider for extending the lona facility.

Disadvantages

1. Do not reflect the current prices as they are based on the historical costs.
2. Do not consider qualitative data, such as, quality, efficiency of workforce, employee and employer relationship, motivation level of employees, value of human resources etc.
3. Do not reveal the accurate picture of the business, as certain values of assets and some expenses and income items are based on the judgement of the management, who may have prejudice.

3.1.1 Trading Account

Q5. Define trading account ? What are the advantages of trading account.

Ans :

Preparation of trading account is the first stage in final accounts. It is prepared to ascertain the 'Gross Profit or Gross Loss'. In other words, it is prepared to find out the difference between the actual cost of goods sold and sale proceeds. Generally the business organization purchases goods from others and incur certain expenditure and sell the same to earn profit. This process is known as trading activity. Hence trading account is prepared to know the results of trading activities carried during any specified accounting period.

Trading Account is a 'nominal account ' in nature. All the trading expenses should be debited and trading incomes should be credited to this trading account. The balance in the trading account is either gross profit or gross loss.

Cost of Goods Sold = Purchase price of the goods + Expenses incurred on purchases

If opening stock of goods and closing stock of goods are given,

**Cost of Goods Sold = Opening Stock + Net Purchases (Cash + Credit – Returns)
+ Direct expenses – Closing stock of goods**

Gross Profit / Loss = Net Sales – Cost of Goods Sold

If the selling price of goods is more than cost price, it is known as gross profit. If the selling price of goods is less than cost price, it is known as gross loss. The gross profit or gross loss of trading account will be transferred to profit & loss account.

Advantages

1. It reveals either Gross Profit or Gross Loss
2. It helps in computing the Gross Profit / Loss Ratio
3. Trading expenses and incomes of the current year can be compared with that of the previous year or with any other year. This helps the trader in estimating his trade revenue for future years.

Q6. Explain the proforma of trading account.

Ans :

Trading Account for the year ending

Dr.			Cr.		
Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Opening stock		xx	By Sales	xxx	
To Purchases	xx		Less: Sales Returns	xx	xx
Less: Purchase returns	xx	xxx	By Closing stock		xx
Purchase expenses:		xx			
To Carriage		xx			
To Cartage		xx			
To Freight		xx			
To Customs duties		xx			
To Import duties		xx			
To Clearing charges		xx			
To Octroi		xx			
To Excise duties		xx			
Direct Expenses:		xx			
To Wages		xx			
To Factory Rent		xx			

To Factory Insurance		xx			
To Gas and Coal		xx			
To Water Charges		xx			
To Factory Manager's Salary		xx			
To Works Manager's Salary		xx			
To Oil & fuel		xx			
To Manufacturing Expenses		xx			
To Heating and lighting		xx			
To Gross Profit			By Gross loss		
(Balancing figure)			(Balancing figure)		
(Transferred to Profit and Loss account)		xx	(Transferred to Profit & Loss a/c)		xx
		xxx			xxx

Items Appearing in Trading Account

1. Opening Stock

The stock which remains unsold at the end of previous year becomes the opening stock of next year. There will be no opening stock in the first year. In a manufacturing concern, there may be opening stock of raw material, work-in-progress and finished goods. All are shown on the debit side of the trading account.

2. Purchases and Purchase Returns

Net purchases are shown on the debit side of the trading account. Net purchases mean the purchases less returns outward (if any). Purchases include both cash as well as credit purchases.

3. Sales less Returns Inward

Net sales of goods are shown on the credit side the trading account. Net sales are arrived by deducting sales return from the gross sales.

4. Closing Stock

The unsold stock at the end of the year is known as closing stock. It appears on the credit side of the trading account. Like opening stock, it may be of raw-material, work-in-progress and finished goods. It is calculated at the end of the year and therefore no account is maintained for it in the ledger. If it is valued before the preparation of trial balance, then it appears in trial balance. When it is given in trial balance, it is shown in the balance-sheet only.

If it is valued after the preparation of trial balance, then it appears in adjustments. When it appears in adjustments, then it appears on the credit side of trading account and asset side of balance sheet. Different methods are followed for the valuation of closing stock, like FIFO, LIFO, average price, etc. Whatever may be the method adopted, it must be followed consistently. A principle should be kept in mind while showing it in the books. That principle is cost price or market price whichever is less. This principle is based on the convention that prospective profits should not be shown in the books of accounts while prospective losses are to be provided for in the books.

5. Power, Coal, Gas, Water, Fuel, etc.

These expenses are incurred on the conversion of raw-material into finished goods. They are shown on the debit side of trading account.

6. Royalty

These expenses are paid for using the rights of a property. For example, royalty paid to the owner of mine for extracting minerals, coal, etc. It is also debited to trading account.

7. Custom Duty, Dock-Charges

These are paid for bringing the raw-material from another country to our country. These are also debited to trading account.

8. Other Expenses

Other expenses, which are paid for manufacturing or upgrading the raw-material into saleable condition, are also shown on the debit side of trading account. These may be wages, freight, carriage inward, factory rent and factory lighting, etc.

PROBLEMS**Problems on Trading Account****1. Ascertain gross profit from the following :**

Particulars	Rs.
Opening Stock	5,570
Purchases	13,816
Sales	15,284
Purchases Returns	390
Returns Inwards	524
Warehouse Wages Paid	1,400
Import Charges	252
Closing Stock	8,880

Sol :

Dr

Trading Account

Cr

Particulars	Rs.	Particulars	Rs.
To Opening Stock	5,570	By Sales	15,284
To Purchases	13,816	Less : Returns	524
Less: Returns	390	By Closing Stock	8,880
To Warehouse Wages	1,400		
To Import Charges	252		
To Gross profit (transferred to profit and loss account)	2,992		
	23,640		23,640

2. Prepare Trading Account of Raji & Co. for the year ended 31 st March. 1989

Particulars	Rs.	Particulars	Rs.
Purchases	42,500	Wages	5,000
Manufacturing expenses	1,950	Opening stock	10,000
Carriage inwards	100	Sales returns	50
Sales	67,500	Purchase returns	200
Freight and duty	5,000	Stores consumed	200
Power	300	Closing stock	12,000

*Sol.:*Dr. **Trading Account for the year ending 31 st March, 1989.** Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	10,000	By Sales	67,500
To Purchases	42,500	Less : Returns	50
Less: Returns	200	By Closing Stock	12,000
	42,300		
To Wages	5,000		
To Stores consumed	200		
To Manufacturing expenses	1,950		
To Carriage inwards	100		
To Freight and duty	5,000		
To Power	300		
To Gross profit (transferred to P & L Account)	14,600		
	79,450		79,450

3. Prepare the Trading Account from the following balances.

Particulars	Rs.
Stock 1-1-1986	
Raw Materials	5,000
Partly finished goods	14,000
Finished goods	30,000
Purchases	50,000
Sales	1,55,000
Sales returns	2,500
Purchases Returns	2,000
Carriage & cartage	1,000
Productive wages	1,000
Coal & coke	1,000
Freight	1,000
Factory lighting & heating	2,000
Dock charges	1,000

Factory rent, rates and taxes	500
Marine Insurance	500
Stock 31-12-1986	
Raw materials	5,000
Partly finished goods	9,000
Finished goods	14,000

*Sol :*Dr **Trading Account for the year ending 31-12-1986** Cr

Particulars	Rs.	Particulars	Rs.
To Opening stock		By Sales	1,55,000
Raw Materials	5,000	Less : Sales returns	2,500
Partly-finished goods	14,000		1,52,500
Finished goods	30,000	By Closing stock (31-12-'86)	
	49,000	Raw Materials	5,000
To Purchase returns	50,000	Partly finished' goods	9,000
Less : Purchases		Finished goods	14,000
returns	2,000		28,000
	48,000		
To Productive Wages	1,000		
To Freight	1,000		
To Carriage & cartage	1,000		
To Coal & Coke	1,000		
To Factory lighting and heating	2,000		
To Factory rent, rates and taxes	500		
To Marine Insurance	500		
To Dock charges	1,000		
To Gross profit	75,500		
(Transferred to profit and loss Account)			
	1,80,500		1,80,500

4. From the following information prepare trading account of Shylaja Traders for the year ending 31.12.2018:

Opening Stock	40,000
Purchases	85,000
Sales	1,80,000
Purchase Returns	3,000
Sales Returns	5,000
Wages	8,000
Carriage	2,000
Coal & Gas and Fuel	7,000
Factory Rent	4,000
Closing Stock	9,000

Sol.:

Trading account of Shylaja Traders
for the year ended 31.12.2018

Dr.

Cr.

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Opening Stock		40,000	By Sales	1,80,000	
To Purchases	85,000		Less: Sales Returns	5,000	1,75,000
Less: Purchase Returns	3,000	82,000	By Closing Stock		9,000
To Wages		8,000			
To Carriage		2,000			
To Coal ,Gas& Fuel		7,000			
To Factory Rent		4,000			
To Gross Profit		41,000			
(Transferred to Profit & Loss A/C)					
		1,84,000			1,84,000

5. From the following information, prepare Trading Account of Swamy as on 31.12.2018:

Opening Stock	8,000
Purchases	20,000
Sales	35,000
Carriage on Purchases	2,000
Factory Insurance	1,000
Gas & Water Charges	3,000
Return Inwards	2,000
Return Outwards	4,000
Wages	5,000
Import Duties	1,000
Closing Stock	6,000

*Sol :***Trading account of Mr. Swamy for the year ended 31.12.2018**

Dr.

Cr.

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Opening Stock		8,000	By Sales	35,000	
To Purchases	20,000		Less: Sales Returns	2,000	33,000
Less: Purchase Returns	4,000	16,000	By Closing Stock		6,000
To Carriage		2,000			
To Factory Insurance		1,000			
To Gas and Water		3,000			
To Wages		5,000			
To Import Duties		1,000			
To Gross Profit (Transferred to Profit & loss A/c		3,000			
		39,000			39,000

3.1.2 Profit & Loss Account**Q7. What is Profit & Loss Account? What are the advantages of Profit & Loss Account?***Ans :***(Dec.-19)**

After trading account, the second stage of the preparation of final account is the preparation of Profit & Loss account. It is prepared to find out the Net Profit or Net Loss of the business. This is also a nominal Account, so all the revenue expenses and losses should be debited and all the revenue incomes and gains are to be credited to this Profit & Loss a/c. The balance of Profit & Loss Account is either net profit or net loss, which will be transferred to balance sheet. The net profit will be added to the capital account in the balance sheet at liabilities side and the net loss will be deducted from Capital Account.

$$\text{Net Profit / Loss} = \text{Gross Profit} + \text{Incomes and Gains} - \text{Expenses and Losses}$$

Advantages

1. It Reveals net profit or net loss.
2. It helps to find out net profit ratio.
3. It assists in comparison of Current year's administrative, selling and other expenses with the previous year's amounts.
4. It facilitates for the preparation of balance sheet.

Q8. Explain the proforma of Profit & Loss Account.

Ans :

Profit & Loss A/c of XXX for the year ending xx, xx, xxxx

Dr.

Cr.

Particulars	Amount ()	Amount ()	Particulars	Amount ()	Amount ()
To Gross Loss b/d		XXX	By Gross Profit b/d		XXX
To Administrative Expenses			By Discount received	XXX	
To Salaries	XXX		By Interest received	XXX	
To Rent	XXX		By Commission received	XXX	
To Rates & Taxes	XXX		By Rent received	XXX	
To Insurance	XXX		By Interest on Drawings	XXX	
To Printing & Stationary	XXX		By Apprentice Premium	XXX	
To Audit Expenses	XXX		By Profit on sale of assets	XXX	
To Legal Expenses	XXX		By Bad Debt recovered	XXX	
					XXX
To General Expenses	XXX				
To Repairs	XXX	XXX			
To Selling & Distribution Expenses					
To Carriage Outwards	XXX				
To Advertisements	XXX				
To Bank Charges	XXX				
To Commission	XXX				
To Bad Debts	XXX				
To Travelling Expenses	XXX				
To Packing Expenses	XXX	XXX			
To Financial Expenses:					
To Discount Allowed	XXX				
To Interest on Capital	XXX				
To Interest on Loans	XXX	XXX			
To Losses:					
To Loss on sale of assets	XXX				
To Depreciation	XXX				
To Loss due to Fire Accident	XXX				
To Net Profit (transferred to Capital Account)	XXX	XXX	By Net Loss (Transferred to Capital Account)		XXX
(Balance figure)			(Balance figure)		
		XXXX			XXXX

PROBLEMS ON PROFIT & LOSS ACCOUNT

6. From the following balances prepare a profit and loss account for the year ending 31-12-1995.

Particulars	Rs.
Salaries	3,000
Carriage outwards	1,000
Discount allowed	500
Commission allowed	1,500
Bad debts	1,000
Repairs	1,000
Advertisements	1,000
Audit fee	500
General charges	1,000
Postage	1,000
Printing and stationery	1,500
Commission received	1,000
Rents received	1,000
Insurance premium paid	1,000
Office electricity charges	500
Gross profit	24,000

Sol.:

Dr Profit and Loss Account for the year ending 31-12-1995 Cr			
Particulars	Rs.	Particulars	Rs.
To Salaries	3,000	By Gross profit b/d	24,000
To Carriage outwards	1,000	By Commission Received	1,000
To Discount allowed	500	By Rent Received	1,000
To Commission allowed	1,500		
To Bad debts	1,000		
To Repairs	1,000		
To Advertisements	1,000		
To Audit fee	500		
To General charges	1,000		
To Postage	1,000		
To Printing and Stationery	1,500		
To Insurance Premium Paid	1,000		
To Office Electricity Charges	500		
To Net profit (Transferred to capital account & of Balance Sheet)	11,500		
	26,000		26,000

7. From the following ledger balances prepare a profit and loss account of Genetic sports company for the year ending 31-12-1995

Particulars	Rs.
Rent paid	3,000
Salaries	4,000
Commission paid	1,000
Discount paid	1,000
Advertisements	1,000
Telephone charges	1,000
Interest paid on loans	2,000
Bad debts	1,000
Telephone charges paid	1,000
Printing and Stationery	1,000
Office Insurance	1,000
Postage	500
Repairs	500
The Gross profit was 40% of sales and sales amounted to Rs. 1,00,000	

Sol :

Genetic Sports Company

Dr **Profit and Loss Account for the year ending 31 -12-1995** Cr

Particulars	Rs.	Particulars	Rs.
To Rent Paid	3,000	By Gross Profit b/d	40,000
To Salaries	4,000	$\left(1,00,000 \times \frac{40}{100}\right)$	
To Commission Paid	1,000		
To Discount Paid	1,000		
To Advertisements	1,000		
To Telephone charges	1,000		
To Interest Paid on Loans	2,000		
To Bad debts	1,000		
To Telephone charges paid	1,000		
To Printing and Stationery	1,000		
To Office Insurance	1,000		
To Postage	500		
To Repairs	500		
To Net Profit	22,000		
(transferred to capital account & of Balance Sheet)			
	40,000		40,000

8. Prepare Profit & Loss A/c of Naveen Kumar Traders as on 31.03.2018

Particulars		Particulars	
Rent	1,500	Discount paid	3,500
Printing & Stationary	2,000	Telephone charges	1,500
Salaries & Wages	8,000	Interest	2,000
Interest received	3,000	Insurance	1,800
Bad Debts recovered	2,000	Repairs	800
Advertisements	5,000	Postage	1,200
Gross profit	39,500	Bad debts	3,200

*Sol.:***Profit & Loss A/c of Naveen Kumar Traders as on 31.12.2018****Dr.****Cr.**

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Rent		1,500	By Gross Profit b/d		39,500
To Discount Paid		3,500	By Interest received		3,000
To Telephone Charges		1,500	By Bad Debts recovered		2,000
To Interest		2,000			
To Insurance		1,800			
To Repairs		800			
To Postage		1,200			
To Bad Debts		3,200			
To Printing & Stationary		2,000			
To Salaries & Wages		8,000			
To Advertisements		5,000			
To Net Profit		14,000			
(Transferred to Capital Account of B/S)					
		44,500			44,500

9. From the following balances, prepare Profit & Loss a/c of Harini for the year ended 31-12-2018

Particulars		Particulars	
General Charges	475	Discount received	950
Insurance	300	Profit on Sale of Investments	1200
Rent & Taxes	250	Gross loss	500
Commission	125		
Discount	275		
Depreciation	325		
Bad Debts	450		
Carriage on sales	250		
Interest on Capital	325		

Sol :

Profit & Loss A/c of Harini for the year ended 31st Dec., 2018

Dr.

Cr.

Particulars	Amount ()	Amount ()	Particulars	Amount ()	Amount ()
To Gross Loss b/d		500	By Discount Received		950
To General Charges		475	By Profit on sale of investments		1200
To Insurance		300	By Net Loss		1125
To Rent and Taxes		250	(Transferred to capital a/c of balance sheet)		
To Commission		125			
To Discount		275			
To Depreciation		325			
To Bad debts		450			
To Carriage on Sales		250			
To Interest on Capital		325			
		<u>3,275</u>			<u>3,275</u>

3.1.3 Preparation of Balance Sheet

Q9. What do you understand by balance sheet?

Ans :

A Balance Sheet is a statement prepared with a view to measure the financial position of a business on a certain fixed date. The financial position of a concern is indicated by its assets on a given date and its liabilities on that date. Excess of assets over liabilities represent the capital and is indicative of the financial soundness of a company. A Balance Sheet is also described as a 'statement showing the sources and applications of capital'. It is a statement and not an account and prepared from real and personal accounts. The left hand side of the balance sheet may be viewed as a description of the sources from which the business has obtained the capital with which it currently operates and the right hand side as a description of the form in which that capital is invested on a specified date.

On the left hand side of the Balance Sheet, the several liability items describe how much capital was obtained from trade creditors, from banks, from bill holders and other outside parties. The owner's equity section shows the capital supplied by the owner.

Capital obtained from various sources has been invested according to management's best judgement of the optimum mix or combination of assets for the business. A certain fraction is invested in buildings, another fraction in stock, another fraction is retained as cash for current needs of the business and so on. The assets side of the Balance Sheet, therefore, shows the result of these management judgements as on the date of the Balance Sheet.

A properly drawn up Balance Sheet gives information relating to (i) the nature and value of assets (ii) the nature and extent of liabilities, (iii) whether the firm is solvent, (iv) whether the firm is overtrading.

If assets exceed the liabilities, the firm is solvent i.e., able to pay its debts in full. A business is, therefore, solvent by the amount of ownership

capital in it, as it is the excess of assets over liabilities. The last point i.e., (iv) concerns the stability of the business. If the total of the debts due to creditors (including bank overdraft) is greater than the liquid assets (i.e., cash, investments, bills etc.) the position of the firm may be financially unsound. Where the debts are being incurred without sufficient means of payment, the firm is said to be overtrading. For the position to be quite sound, there should be some working capital i.e., some spare liquid assets available for current expenditure. It is not a wise policy to lock up the entire capital in fixed assets. The concern may be solvent without being sound.

Q10. Explain the Characteristics of a Balance Sheet.

Ans :

(Imp.)

Following are the main characteristics :

1. It is prepared on a particular date and not for a particular period.
2. It is prepared after the preparation of Trading and Profit & Loss Account.
3. As assets must be equal to total liabilities, the two sides of the Balance Sheet must have the same total.
4. It shows the financial position of a business as a going concern.
5. It is a statement of assets (debit balances) and liability (credit balances) and not an account. Information that Balance Sheet Convey to Outsiders

Following are the main items of information that the Balance Sheet convey to an outsider:

1. The nature and the value of assets.
2. It shows the nature and extent of liabilities.
3. It shows the owners' equity (i.e., assets - liabilities = capital)
4. It tells about creditworthiness and solvency of the firm.
5. It reflects the liquidity of a firm.
6. It reveals the financial position of a firm at a particular point of time.

Q11. Explain the Classification of various Assets and Liabilities.

Ans : (Imp.)

A) Assets

Assets are property and possession of a business. Stock, land, buildings, books debts, cash, bills receivable are some examples of assets. The classification of assets depends on their nature. The various types of assets are:

- (i) **Fixed Assets** : Those assets which are acquired and held permanently in the business and are used for the purpose of earning profits are called fixed assets. Land and buildings, machinery, furniture and fixtures are some examples of these assets.
- (ii) **Current (or Floating) Assets** : Those assets such as cash, debtors and stock that can be realised and readily available to discharge liabilities within an operating cycle of one year or are meant to be converted into cash as soon as possible are called current assets.
- (iii) **Tangible Assets** : These are definite assets which can be seen, touched and have volume such as machinery, cash, stock, etc.
- (iv) **Fictitious Assets** : These assets are fictitious in nature i.e., they are virtually not assets are valueless but shown in financial statements. These are either the past accumulated losses or expenses which are incurred once in the life of a business and are capitalized for the time being. Profit and Loss Account (debit balance), organisation expenses, discount on the issue of shares and advertisement expenses capitalized for the time being are examples of such assets.
- (v) **Intangible Assets** : Those assets which cannot be seen, touched and have no volume but have value are called intangible assets. Goodwill, patents, licences and trade marks are examples of such assets but quite valuable to the undertaking. An intangible asset may not be fictitious. If on account of the past goodwill purchased along with an existing concern, sales are readily effected and profit is readily earned, the asset is certainly

not fictitious though it is intangible. However, if the amount of goodwill was paid in respect of a losing concern, the asset would be fictitious.

- (vi) **Wasting Assets** : Those fixed assets which have a fixed contact like mines, quarries etc. that become exhausted or reduce in value by their working are called wasting assets.
- (vii) **Liquid Assets** : These current assets which are already in the form of cash or such items as marketable securities which can be converted into cash quickly.
- (viii) **Contingent Asset** : It is an asset the existence, value and ownership of which is dependent on the occurrence or non-occurrence of a specified act. Suppose a firm has filed a suit for some specified property now in possession of someone else. If the suit is decided in firm's favour, the firm will get the property. At the moment it is a contingent asset. Similar would be the position of a patent applied for arising of a firm's own research effort. Contingent liability in respect of a contract for capital expenditure already entered into will give rise to an asset on payment, at present it is only a contingent asset.
- (ix) Working Capital is the difference between current assets and current liabilities.
- (x) Accounts Receivable will include sundry debtors and bills receivable.

B) Liabilities

A liability is an amount which a business is legally bound to pay. It is a claim by an outsider on the assets of a business. Liabilities may be classified into four categories :

- (i) **Fixed Liabilities** : These are those liabilities which are payable only on the termination of the business such as capital which is a liability to the owner.
- (ii) **Long term Liabilities** : Those liabilities which are not payable within the next accounting period but will be payable within next five to ten years are called long term liabilities such as debentures.

(iii) **Current Liabilities** : Those liabilities which are payable out of current assets within the next accounting period usually year or already due are called current liabilities. Sundry creditors, bills payable, short term bank overdraft are examples of such liabilities.

(iv) **Contingent Liabilities** : A contingent liability is one which is not an actual liability but which will become an actual one on the happening of some event which is uncertain. Thus such liabilities have two characteristics : (a) uncertainty as to whether the amount will be payable at all, and (b) uncertainty about the amount involved. It is sufficient if the amount of such liability is stated on the face of the Balance Sheet by way of a note unless there is a probability that a loss will materialise. In that event it is no more a contingent liability and a specific provision should be made therefor. Examples of such liabilities are:

- (a) Claims against the firm not acknowledged as debts.
- (b) Uncalled liability on partly paid up shares.
- (c) Arrears of fixed cumulative dividend.
- (d) Estimated amount of contracts remaining to be executed on capital account and not provided for.
- (e) Liability of a case pending in the court.
- (f) Bills of exchange, guarantees given against a particular firm or person.

Owners' Equity (or net worth) is the difference between assets and outside liabilities. It includes both capital and retained earnings.

Q12. Explain the uses of the Balance Sheet.

Ans :

The Balance Sheet is regarded as a prominent accounting report. The different interested parties may derive different information for their own use. Generally the following information can be derived from the Balance Sheet:

1. It enables us to ascertain the proprietary interest of a person or business organization.
2. It enables us to calculate the actual capital employed in the business.
3. The lender can ascertain the financial position of the business.

4. It may serve as the basis for determining purchase consideration of the business.
5. The trends of working capital of the business can be determined by comparison of Balance Sheet of successive years and corrective measures can be taken, where necessary.
6. Different ratios can be calculated from the Balance Sheet and these ratios can be utilised for better management of the business.

Q13. Explain Limitations of the Balance Sheet.

Ans :

Though the Balance Sheet is prepared by every organisation for disclosing its financial position, yet it is suffering from the following limitations :

1. Fixed assets are shown in the Balance Sheet at historical cost less depreciation upto date. A conventional Balance Sheet cannot reflect the true value of these assets. Again intangible assets are shown in the Balance Sheet at book values which may bear no relationship to market values.
2. Sometimes, Balance Sheet contains some assets which command no market value such as preliminary expenses, debenture discount, etc. The inclusion of these fictitious assets unduly inflate the total value of assets.
3. The Balance Sheet cannot reflect the value of certain factors such as skill and loyalty of staff.
4. A conventional Balance Sheet may mislead untrained readers in inflationary situations.
5. The value of majority number of current assets depend upon some estimates, so it cannot reflect the true financial position of the business.

Q14. Distinction between Profit and Loss Account and Balance Sheet.

Ans :

The main points of differences between a Profit and Loss Account and a Balance Sheet are as follows:

1. Profit and Loss Account is an account prepared with balances of nominal accounts whereas a Balance Sheet is a statement of assets and liabilities.
2. Profit and Loss Account discloses the profits earned or losses incurred for the accounting period usually a year whereas a Balance Sheet shows the financial position of the business on the last day of the accounting period.
3. Balances of nominal accounts are transferred to the Profit and Loss Account. Personal accounts and real accounts are shown in the Balance Sheet. Balance of Profit and Loss Account (i.e., net profit) is also shown on the liabilities side of the Balance Sheet.
4. Nominal accounts are closed by transferring them to the Profit and Loss Account. But the accounts that are shown in the Balance Sheet do not close and become the opening balances for the next accounting period.

Q15. Explain the various forms of balance sheets.

Ans. :

Form of Balance Sheet

Assets Accounts show debit balances, where as liabilities show credit balances. All Assets are shown on the Assets side and all liabilities are shown on the Liabilities side. It is customary to show the assets and liabilities in a specific order. Arrangement of Assets and Liabilities in the Balance Sheet is called *Marshalling*. There are two methods of arranging the assets and liabilities.

1. The order of liquidity or releasability
2. The order of performance.

1. Balance Sheet under order of Liquidity

Generally Sole Trading Concerns and partnership firms follow the order of liquidity or realisability. The principle followed in this case is that those assets which can be easily converted into cash come first and then the assets which are more difficult to realise. Liabilities will be shown in the order in which they are payable, the most pressing liabilities being placed first and follows the less pressing liabilities. Following is the specimen of Balance Sheet where assets are arranged in the order of liquidity. Specimen Balance Sheet is given below.

Balance Sheet Under Order of Liquidity

Balance Sheet as at

Capital and Liabilities	Rs.	Assets	Rs.
Current Liabilities		Current Assets	
Sundry Creditors	xxx	Cash in hand	xxx
Bills payable	xxx	Cash at bank	xxx
Bank overdraft	xxx	Bills receivable	xxx
Mortgage	xxx	Sundry debtors	xxx
Outstanding expenses	xxx	Investments	xxx
Income received in advance	xxx	Closing stock	xxx
Loans		Unexpired expenses	xxx
Short term loans	xxx	Accrued income	xxx
Long term loans	xxx	Fixed Assets	
Reserve Fund		Furniture and Fittings	xxx
Capital	xxx	Plant and Machinery	xxx
Opening Balance	xxx	Land and Buildings	xxx

Add : Additional		Leasehold property	xxx
Capital introduced	xxx	Freehold property	xxx
Interest on capital	xxx	Motor vehicles	xxx
Net Profit	xxx	Intangible or Invisible Assets	
	xxx	Patents	xxx
Less : Drawings	xxx	Trade Marks	xxx
Interest on Drawings	xxx	Copy rights	xxx
Income tax	xxx	Goodwill	xxx
Insurance premium of			
Proprietor	xxx		
	xxx		xxx

2. Balance Sheet under Order of Performance

Under the second method i.e., where the order of performance is followed, the Balance Sheet appears as given below.

Balance Sheet as at

Capital and Liabilities	Rs.	Assets	Rs.
<i>Capital</i>		<i>Intangible or Invisible Assets</i>	
Opening Balance	xxx	Goodwill	xxx
Add : Additional		Copy rights	
Capital introduced	xxx	Trade marks	xxx
Interest on capital	xxx	Patents	xxx
Net Profit	xxx	<i>Fixed Assets</i>	
	xxx	Motor vehicles	xxx
Less : Drawings	xxx	Freehold property	xxx
Interest on		Leasehold property	xxx
Drawing	xxx	Land & Buildings	xxx
Income Tax	xxx	Plant and Machinery	xxx
Insurance	xxx	Furniture and Fittings	xxx
Premium of		<i>Current Assets</i>	
properties	xxx	Accrued Income	xxx
<i>Reserve Fund</i>	xxx	Unexpired expenses	xxx
<i>Loans</i>		Closing stock	xxx
Long term loans	xxx	Investments	xxx
Short term loans	xxx	Sundry debtors	xxx
<i>Current Liabilities</i>		Bills Receivable	xxx
Income received in advance	xxx	Cash at bank	xxx
Outstanding expenses	xxx	Cash in hand	xxx
Mortgage	xxx		
Bank overdraft	xxx		
Bills payable	xxx		
Sundry creditors	xxx		
	xxx		xxx

PROBLEMS ON BALANCE SHEET

10. From the following particulars, prepare a Balance Sheet as on 31st March, 2013:

Particulars	₹	Particulars	₹
Capital	50,000	Loan to Smith	5,000
Business Premises	55,000	Investments	3,000
Furniture & Fixtures	2,500	Cash in Hand	200
Bills Receivable	3,500	Cash at Bank	3,500
Bills Payable	2,500	Proprietor's withdrawals	3,000
Sundry Debtors	20,000	Net Profit	38,900
Sundry Creditors	15,800	Closing Stock	7,000
Packing Machinery	4,500		

Sol :

BALANCE SHEET
as on 31st March, 2013

Liabilities	₹	Assets	₹
Sundry Creditors	15,800	Cash in Hand	200
Bills Payable	2,500	Cash at Bank	3,500
Capital	50,000	Investments	3,000
Add: Net Profit	38,900	Sundry Debtors	20,000
	88,900	Bills Receivable	3,500
Less: Drawings	3,000	Closing Stock	7,000
	85,900	Loan to Smith	5,000
		Packing Machinery	4,500
		Furniture & Fixtures	2,500
		Business Premises	55,000
	1,04,200		1,04,200

11. Following balances are extracted from the books of Kautilya & Co. on 31st March, 2013. You are required to make the necessary closing entries and to prepare the Trading and Profit and Loss Account and a Balance Sheet as on that date :

Particulars	₹	Particulars	₹
Opening Stock	500	Commission (Cr.)	200
Bills Receivable	2,250	Returns Outward	250
Purchases	19,500	Trade Expenses	100
Wages	1,400	Office Fixtures	500

Insurance	550	Cash in Hand	250
Sundry Debtors	15,000	Cash at Bank	2,375
Carriage Inward	400	Rent & taxes	550
Commission (Dr.)	400	Carriage Outward	725
Interest on Capital	350	Sales	25,000
Stationery	225	Bills Payable	1,500
Returns Inward	650	Creditors	9,825
		Capital	8,950

The Closing Stock was valued at ₹ 12,500.

Sol :

TRADING & PROFIT & LOSS A/C OF MESSERS KAUTILYA & CO.
for the year ended 31st March, 2013

Particulars			Particulars		
To Opening Stock		500	By Sales	25,000	
To Purchases	19,500		Less: Returns Inward	650	
Less: Returns Outward	250				24,350
		19,250	By Closing Stock		12,500
To Wages		1,400			
To Carriage Inward		400			
To Gross Profit c/d		15,300			
		36,850			36,850
To Insurance		550	By Gross Profit b/d		15,300
To Commission		400	By Commission		200
To Interest on Capital		350			
To Stationery		225			
To Trade Expenses		100			
To Rent and Taxes		550			
To Carriage Outward		725			
To Net Profit transferred to Capital A/c		12,600			
		15,500			15,500

BALANCE SHEET OF MESSERS KAUTILYA & CO.
as on March 31, 2013

Liabilities			Assets	
Creditors		9,825	Cash in Hand	250
Bills Payable		1,500	Cash at Bank	2,375
Capital			Bill Receivable	2,250
April 1,2012	8,950		Stock	12,500
Add: Net Profit	<u>12,600</u>		Sundry Debtors	15,000
		21,550	Office Fixtures	500
		<u>32,875</u>		<u>32,875</u>

12. From the following balances of Ramesh, prepare trading and profit and loss account for the year ending 31st March, 2004 and a balance sheet as on that date.

Particulars	Amount	Particulars	Amount
Capital	70,000	Cash in hand	3,600
Buildings	37,500	S. Creditors	20,000
Returns Inwards	900	Debtors	14,000
Salaries	2,220	General Expenses	1,600
Discount allowed	400	Rent Paid	7,420
Stock (1.4.2003)	33,000	Drawings	1,300
Bills Payable	10,000	Electricity charges	380
Sales	1,27,000	Carriage Inwards	1,700
Purchases	93,700	Cash at Bank	6,000
Wages	5,000	Machinery	18,500
Returns Outwards	220		

Closing stock was valued at 36,420.

Sol.:

Trading and Profit and Loss Account of Ramesh as on 31.03.2004

Particulars	Amount	Particulars	Amount
To Opening Stock	33,000	By Sales	1,27,000
To Purchases	93,700	Less: Returns	<u>900</u>
Less: Returns Outward	<u>220</u>	By Closing Stock	36,420
To Wages	5,000		
To Carriage Inward	1,700		
To Gross Profit c/d	29,340		
	<u>1,62,520</u>		<u>1,62,520</u>

To Salaries	2,220	By Gross Profit b/d	29,340
To Discount allowed	400		
To General Expenses	1,600		
To Rent	7,420		
To Electricity charges	380		
To Net Profit (carried to Capital)A/c	17,320		
	<u>29,340</u>		<u>29,340</u>

Balance Sheet of Ramesh as on 31.03.2004

Liabilities	Amount	Assets	Amount
Sundry Creditors	20,000	Cash in hand	3,600
Bills Payable	10,000	Cash at Bank	6,000
Capital	70,000	Debtors	14,000
Add: Net Profit	17,320	Closing Stock	36,420
	<u>87,320</u>	Machinery	18,500
Less: Drawings	1,300	Buildings	37,500
	<u>86,020</u>		<u>37,500</u>
	<u>1,16,020</u>		<u>1,16,020</u>

13. From the following trial balance of Kerala Sons prepare trading and profit and loss account and balance sheet.

Trial Balance as on 31.03.2003

Debit Balances	Amount	Credit Balances	Amount
Stock at the end	19,270	Capital	90,000
Purchases less Returns	24,720	Creditors	59,160
Investments	20,000	Loans	19,500
Wages & Salaries	15,965	Reserve	2,000
Furniture	9,840	Income from Investment	453
Carriage (Inward)	2,150	Sales	94,500
Premises	25,000		
Goodwill	30,000		
Taxes & Insurance	4,175		
Trade Expenses	8,142		
Debtors	88,140		
Horses and Carts	5,165		
Stable Expenses	2,473		
Discount	928		
Bad Debts	1,485		
Bank Charges	475		
Cash in hand and at bank	7,685		
	<u>2,65,613</u>		<u>2,65,613</u>

Dr. Trading and Profit and Loss Account Kerala Sons as on 31.03.2003 Cr.

Particulars	Amount	Particulars	Amount
To Purchase less returns	24,720	By Sales	94,500
To Wages and Salaries	15,965		
To Carriage Inward	2,150		
To Gross Profit c/d	51,665		
	94,500		94,500
To Stable Expenses	2,473	By Gross Profit b/d	51,665
To Taxes and Insurance	4,175	By Income from investments	453
To Trade Expenses	8,142		
To Discount	928		
To Bad Debts	1,485		
To Bank Charges	475		
To Net Profit	34,440		
	52,118		52,118

Balance Sheet of Kerala Sons as on 31.02.2003

Liabilities	Amount	Assets	Amount
Creditors	59,160	Cash in hand and at bank	7,685
Loan	19,500	Debtors	88,140
Reserve	2,000	Investments	20,000
Capital 90,000		Closing Stock	19,270
Add. Net Profit 34,440	1,24,440	Furniture	9,840
		Horses and Carts	5,165
		Premises	25,000
		Goodwill	30,000
	2,05,100		2,05,100

14. The following trial balance is extracted from the books of Vinit on 31st March, 2003. Stock is valued at Rs 11,360. Prepare Trading and Profit and Loss Account for the year ending 31st March, 2003 and a balance sheet as on that date :

Particulars	Dr. Amount	Cr. Amount
Sundry Debtors and Creditors	9,000	8,800
Cash at Bank	3,040	—
Furniture	10,000	—
Stock	9,180	—
Purchases and Sales	44,500	67,200
Returns	860	1,500
Salaries	9,000	—
Rent	1,000	—
Advertisement	400	—
Drawings	5,000	—
Printing and Stationary	100	—
Freight on Sales	180	—
Trade Expenses	1,600	—
Capital	—	16,000
Discount Received	—	360
	93,860	93,860

Sol :

Dr. Trading and Profit and Loss Account of Vinit as on 31st March, 2003 Cr.

Particulars	Amount	Particulars	Amount
To Opening Stock	9,180	By Sales	67,200
To Purchases	44,500	Less : Returns	860
Less : Returns	1,500	By Closing Stock	11,360
To Gross Profit c/d	25,520		
	77,700		77,700
To Salaries	9,000	By Gross Profit b/d	25,520
To Rent	1,000	By Discount Received	360
To Advertisement	400		
To Printing and Stationery	100		
To Trade Expenses	1,600		
To Freight on Sales	180		
To Net Profit c/d	13,600		
	25,880		25,880

Balance Sheet of Vinit as on 31.03.2003

Liabilities		Amount	Assets	Amount
Creditors		8,800	Cash at Bank	3,040
Capital	16,000		Sundry Debtors	9,000
Add. Net Profit	13,600		Closing Stock	11,360
	29,600		Furniture	10,000
Less: Drawings	5,000	24,600		
		33,400		33,400

3.2 ADJUSTMENTS ENTRIES

Q16. What do you mean by Adjustments? Explain the objectives of Adjustments.

Ans :

(Jan.-21, June-18)

Every adjustment has two fold effect according to the principle of double entry system. Hence, every item given as adjustment is to be shown two times i.e., one time either in Trading Account or in Profit and Loss Account and second time, it should be shown in the Balance Sheet. However, the items given in the Trial Balance should be shown only one time while preparing the final accounts.

Objective of Adjustments

1. To rectify the errors done in the recording of transactions in the books of accounts.
2. To record those transactions which are omitted to be recorded.
3. To record such expenses and incomes which have accrued but have not been paid or received.
4. To find out the correct profit or loss and financial position of the business.

Q17. Explain the various adjustments in the treatment of final accounts.

Ans :

Some of the important adjustments are explained as follows :

These adjustments will be recorded at two places because these are not recorded or wrongly recorded in the books. These are :

1. Closing Stock

These are the goods which remain unsold at the end of the year. It is valued at cost price or market price whichever is less. Since it is not valued at the time of preparing trial balance, therefore it appears outside the trial balance. The following entry is passed for it.

Entry : Closing Stock A/c Dr.

To Trading A/c

Treatment : (i) Once it will appear on the Credit side of Trading A/c and secondly on the Assets side of Balance Sheet, (ii) If the Closing Stock is given in Trial balance, then only in Assets side of Balance Sheet.

2. Outstanding Expenses or Unpaid Expenses or Expenses due but not paid

The expenses which have become due but have not been paid at the end of the accounting year are called as outstanding expenses.

Entry: Expenses A/c Dr.
To Outstanding Expenses
(being expenses due)

Treatment: (i) If they are appearing outside the trial balance, once they will be added to particular related expenses in trading or profit & loss account and secondly they will appear on the liability side of balance sheet, (ii) If they are appearing inside the trial balance, They will appear on the liability side of balance sheet.

3. Prepaid Expenses or Unexpired Expenses or Expenses Paid in Advance

Such expenses are the reverse of outstanding expenses. It means the expenses which have been paid but the benefit of which is not taken are called prepaid expenses.

Entry: Prepaid Expenses A/c Dr.
To Expenses A/c
(being expenses paid in advance)

Treatment: (i) If they are appearing as adjustments, once they will be deducted from the particular related expenses appearing on the debit side of trading or profit & loss account and will appear on the assets side of balance sheet, (ii) If they are given in Trial Balance, they will appear only on the asset side of balance sheet.

4. Depreciation

It is the decrease in the value of fixed assets due to use, accident or passage of time.

Entry: Depreciation A/c Dr.
To Asset A/c
(being depreciation charged on particular asset)

Treatment: (i) If it is given as adjustment, it will appear on the debit side of profit & loss account and will be subtracted from the particular asset in the balance sheet, (ii) If it is given in trial balance, then only on the debit side of profit and loss account.

5. Outstanding Income or Accrued Income

The income which is earned but not received during the year is called accrued income.

Entry: Accrued Income A/c Dr.
To Income A/c
(being income receivable)

Treatment: (i) Outside the Trial Balance: It will be added to particular income on the credit side of profit and loss account and will be shown on the asset side of balance sheet, (ii) Given in the Trial Balance: In this case, it will appear on the asset side of balance sheet only.

6. Unearned Income or Income Received in Advance

It is the reverse of accrued income. It is the income which is received during the year but no services have been rendered for it in the year. This income is related for the next year.

Entry : Income A/c Dr.
To Unearned Income A/c
(being income received in advance)

Treatment : (i) Outside the Trial Balance: If these are given as adjustment, once these are to be deducted from particular income appearing on the credit side of profit & loss account and on the liability side of balance sheet, (ii) In the Trial Balance: If it is given in the trial balance, it will appear on the liability side of balance sheet.

7. Interest on Capital

The amount which is to be given to owner for interest on the amount invested by him in the business is called interest on capital.

Entry : Interest on Capital A/c Dr.

To Capital A/c

(being interest on capital allowed)

Treatment: It will be shown on the debit side of profit & loss account and will be added in capital on the liability side of balance sheet.

8. Interest on Drawings

The amount or the goods withdrawn by proprietor for personal use are called drawings. The business charges interest on these drawings from him. This is called as interest on drawings.

Entry: Drawings A/c Dr.

To Interest on Drawings A/c

(being interest charged on drawings)

Treatment: (i) It will appear on the credit side of profit & loss account and will be subtracted from the capital on the liability side of balance sheet.

9. Interest on Loan

If any amount is borrowed from the outside source, then the interest is to be paid on that amount. This is called as interest on loan. If this is not paid, then it will become outstanding interest.

Entry: Interest on Loan A/c Dr.

To Loan A/c

(Being interest due on loan)

Treatment: Since they are the expenses, they will be shown on the debit side of profit and loss account and will be added in the amount of loan on the liability side of the balance sheet.

10. Bad Debts

These are the amounts which are not received from the debtors or there is no possibility of realising them:

Entry: Bad Debts A/c Dr.

To Debtors A/c

(being bad-debts written off)

Treatment: (i) Outside the Trial Balance: If they are given outside the trial balance once they will be shown on the debit side of profit & loss account and secondly will be subtracted from the debtors on the assets side of balance sheet.

(ii) In the Trial Balance: If they are given in trial balance, then it will be shown on debit side of profit & loss account only.

11. Provision for Bad and Doubtful Debts

Doubtful debts are those debts about which there is an uncertainty and their recovery is doubtful. It is only anticipation of future loss. Therefore, it cannot be treated as bad debts. For such type of amounts, we create a reserve or provision which is called as provision for bad and doubtful debts.

Entry : Profit and Loss A/c Dr.

To Provision for Bad and

Doubtful Debts A/c

(Being provision for doubtful debts created)

Treatment: It will be debited to profit and loss account and will be subtracted from the amount of debtors on the asset side of the balance sheet.

Both Bad Debts and Provision for Doubtful Debts are given in Adjustments as well as in Trial Balance.

In this case, the following equation should be made

$$\begin{array}{ccccccc} \text{Bad Debts} & + & \text{Further Bad Debts} & + & \text{New Provision} & - & \text{Old Provision} \\ (\text{T.B.}) & & (\text{Adjustment}) & & (\text{Adjustment}) & & (\text{T.B.}) \end{array}$$

If this equation comes +ve, then it will appear on the debit side of profit and loss account.

If this equation comes -ve, then after taking -ve sign common and it will become as follows and will appear on the credit side of the profit and loss account.

Old Provision - Bad Debts - Further Bad Debts - New Provision (T.B.) (T.B.) (Adjustments) (Adjustment)

Note: Only the amount of Bad Debts and Provision for Doubtful Debts given in adjustment will be subtracted from Debtors in the balance sheet. Firstly, the amount of bad debts will be subtracted from debtors and on the balance amount, the provision will be created.

12. Provision for Discount on Debtors

It is the amount which is allowed to debtors for making a prompt payment. It is a probable loss for the business.

Entry: Profit and Loss A/c Dr.

To Provision for Discount on Debtors A/c

(Being provision for discount on debtors created)

Treatment: It will be shown on the debit side of profit and loss account and will be subtracted from the amount of debtors on the asset side of balance sheet.

The following sequence should be kept in mind.

Particulars	Rs.
Amount of Debtors as per T.B.	xxx
Less : Further Bad Debts (Adjustment)	xxx
Less : Provision for Doubtful Debts (Adjustment)	xxx
on the amount (a)	
Less : Provision for Discount on Debtors	xxx
(Adjustment) on (b)	
Amount to be shown in Balance Sheet	xxx

13. Provision for Discount on Creditors

Just like we allow discount to our debtors, similarly our creditors allow us the discount. It is the profit for the firm.

Entry: Provision for Discount on Creditors A/c Dr.

To Profit and Loss A/c

(Being provision for discount on creditors created)

Treatment: It is the income for the business, therefore it will appear on the credit side of profit and loss account and will be subtracted from the amount of creditors on the liability side of balance sheet.

14. Implied Interest

If the amount of loan is appearing in trial balance and the rate of interest is also mentioned there, then the interest on that amount is to be paid as per time period. Now it should be ascertained whether the full amount of interest is given in trial balance or not. If the full amount is not included in trial balance, then the left out amount should be treated as outstanding interest. Since nothing will be mentioned in adjustments in this regard, therefore it is called as implied interest.

15. Sales Tax

Sales tax is the amount which is to be paid by seller to the government. Seller collects this amount from the buyers.

Treatment :

- (i) If 'Sales Tax Collected' or 'Sales Tax' is mentioned and the amount is given on the credit side of trial balance, it will be shown on the liability side of the balance sheet.
- (ii) If 'Advance Sales Tax' is mentioned on the debit side of trial balance, it will be shown on the asset side of balance sheet.
- (iii) If 'Sales Tax Paid' is mentioned on the debit side of Trial Balance, it will be written on the debit side of Profit and Loss Account.
- (iv) If 'Sales Tax Paid' and 'Sales Tax Collected' both are given, and collected amount is more than paid, the balance amount after subtracting paid amount from collected amount will be shown on the liability side of balance sheet. But if the amount paid is more than the amount collected, the balance amount after their adjustment will be shown on the asset side of balance sheet.

16. Drawings in the Form of Goods

If the proprietor has withdrawn the goods for personal use, it is called as drawings :

Entry : Drawings A/c Dr.

To Purchases A/c

(Being goods withdrawn for personal use)

Treatment: The amount of goods withdrawn will be deducted out of purchases in the trading account and will also be deducted from capital on the liabilities side of balance sheet.

17. Use of Goods in Business

If the proprietor has used a part of goods in business, it becomes asset of the business.

Entry: Assets A/c Dr.

To Purchases A/c

(Being goods taken for business use)

Treatment: The goods withdrawn will be subtracted from purchases in the trading account and will be added or shown separately on the assets side of balance sheet.

Sometimes proprietor distributes the goods as free samples for the purpose of advertisement or for increasing the sales.

(Being goods distributed as free samples)

Treatment: The goods distributed as free samples will be deducted from purchases in the trading account and will appear on debit side of profit and loss account.

Sometimes proprietor uses the goods for charity purposes. For example, proprietor of electric goods shop gives the fans to dharamshala for the sale of charity.

(Being goods given away as charity)

Treatment: Goods given as charity will be subtracted from the purchases in the trading account and will appear on the debit side of profit and loss account.

Sometimes commission on net profit is paid to manager in addition to his salary for making extra efforts to increasing the profitability of the firm.

(Being commission to be paid to manager)

Treatment: It is a business expense, therefore, it will appear on the debit side of profit and loss account and since it is yet to be paid, it will also appear on the liability side of balance sheet.

i) On net profit before charging such commission :

$$\text{Commission} = \text{Net Profit before Commission} \times$$

ii) On net profit after charging such commission:

$$= \text{Net Profit after Commission} \times$$

i) Make all other adjustments in P/L A/c.

ii) Make total of credit side of P/L A/c and write it in working notes.

iii) Make a rough total of debit side of P/L A/c and write it in working notes.

iv) Deduct their total of debit from the total of credit. The difference is used for calculating commission.

v) Apply formula as per condition given and write down the calculated commission on the debit side of profit and loss account.

vi) Now calculate the net profit.

21. Contingent Liability

The liability which is not a liability yet, but can become a liability on the happening of a certain event, e.g.,

- i) Pending cases in the court;
- ii) Guarantee of a loan of friend;
- iii) B/R discounted but not matured;
- iv) Liability for contracts undertaken till they are completed.

Treatment: These are shown as footnotes below the balance sheet only.

22. Deferred Revenue Expenditure

Sometimes an expenditure is made, the benefit of which is likely to be derived over next few years also, this is called as deferred revenue expenditure. Therefore, the amount of expenditure is spread over the period for which benefit will accrue. Every year the amount written off is transferred to profit and loss account.

Entry: Profit and Loss A/c Dr.
 To Particular Expenditure A/c
 (Being expenses written off)

Treatment: The amount calculated after dividing the total amount by number of years will be shown to debit of profit and loss account and the balance amount will be shown on the debit side of balance sheet.

23. Goods Sold and Despatched but Omitted to be Recorded

If the goods are sold to a customer but omitted to be recorded in the books, the following journal entry will be passed. This generally happens when the sales are made on credit basis.

Entry: Debtors A/c Dr.
 To Sales A/c
 (Being goods sold on credit)

Treatment: Once the amount is added to sales on the credit side of trading account and secondly it is added to debtors on the assets side of balance sheet.

24. Goods Sold on 'Sales or Return Basis

When the goods are sold on sales or return basis and if this is treated as sales it is an error and has to be rectified.

Entry: Sales A/c Dr.
 To Debtors A/c
 (Being error of goods sold on sales or return basis rectified)

Treatment: Once it will be deducted from sales in trading account and debtors in assets in balance sheet and secondly it will be added to closing stock in trading account and in balance sheet. The selling price is to be deducted from debtors and sales and cost price of goods is to be added in closing stock at both places.

25. Dishonour of Bills of Exchange

If the payment against the bills receivable is not received on maturity date, it is called as dishonour of bills of exchange.

Entry: Debtors A/c Dr.
 To Bills Receivable A/c
 (Being B/R dishonoured)

Treatment: The amount will be subtracted from bills receivable on the asset side of balance sheet and will be added in the amount of debtors in balance sheet.

26. Capital Expenditure treated as Revenue Expenditure or vice-versa

Sometimes capital expenditure is treated as revenue expenditure or revenue expenditure is treated as capital expenditure, it is error of principal and hence has to be rectified.

Treatment:

- i) If the capital expenditure is treated as revenue expenditure, then the amount will be subtracted from the particular expenses appearing in the debit or trading or profit and loss account and will be added in particular asset in the balance sheet.
- ii) If the revenue expenditure is treated as capital expenditure, the amount will be deducted from the particular asset and will be added to the debit side of trading or profit and loss account.

PROBLEMS ON FINAL ACCOUNTS WITH ADJUSTMENTS

15. From the following trial balance of Mahindra Traders, prepare final accounts for the year ended 31.12.2018:

Trial Balance

Particulars	Debit Bal.	Credit Bal.
Capital		32,000
Salaries	1,000	
Purchases	20,000	
Purchase Returns		400
Sales		25,000
Cash	5,000	
Wages	1,200	
Factory Rent	200	
Insurance	750	
Carriage	400	
Office Expenses	800	
Carriage Outwards	200	
Machinery	10,000	
Furniture	7,000	
Discount allowed	450	
Discount received		1,600
Goodwill	5,000	
Opening stock	2,000	
Debtors	9,000	
Creditors		4,000
Total	63,000	63,000

Adjustments:

- (1) Value of Closing Stock 2,500
- (2) Prepaid Insurance 250
- (3) Outstanding Salaries 300

Sol.:

**Trading and Profit & Loss Account of Mahindra Trader's
for the year ended 31.12.2018**

Dr.

Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
To Opening Stock		2,000	By Sales		25,000
To Purchases	20,000		By Closing Stock		2,500
Less: Returns	400	19,600			
To Wages		1,200			
To Factory Rent		200			
To Carriage		400			
To Gross Profit c/d		4,100			
		27,500			27,500
To Salaries	1,000		By Gross Profit b/d		4,100
Add: Outstanding Salaries	300	1,300	By Discount Received		1,600
To Insurance	750				
Less: Prepaid Insurance	250	500			
To Office Expenses		800			
To Carriage outwards		200			
To Discount allowed		450			
To Net Profit (Transferred to Capital A/c)		2,450			
		5,700			5,700

Balance Sheet of Mahindra Trader's as on 31.12.2018

Liabilities	Amount	Amount	Assets	Amount	Amount
Capital	32,000		Cash		5,000
Add: Net Profit	2,450	34,450	Machinery		10,000
Creditors		4,000	Furniture		7,000
Outstanding Salaries		300	Goodwill		5,000
			Debtors		9,000
			Prepaid Insurance		250
			Closing Stock		2,500
		38,750			38,750

16. Prepare Final Accounts of Telangana Traders for the year ended 31.12.2018.**Trial Balance**

Debit Balances	Amount	Credit Balances	Amount
Opening Stock	7,000	Capital	1,00,000
Purchases	9,000	Interest	1,500
Rent	1,200	Return Outwards	500
Salaries	1,500	Sales	16,000
Wages	1,000	Commission	1,000
Carnage Inwards	1,050	Creditors	6,000
Carriage Outwards	450		
Land & Buildings	50,000		
Investments	20,000		
Loose Tools	12,000		
Discount	1,500		
Interest	500		
Telephone Charges	700		
Printing & Stationary	900		
Furniture	18,000		
Return Inwards	200		
	1,25,000		1,25,000

Adjustments

Closing Stock: 12000, Outstanding Wages: 500, Interest Received in Advance: 600, Commission Receivable: 400.

Sol :

**Trading and Profit & Loss Account of Telangana Trader's
for the year ended 31.12.2018**

Dr

Cr

Particulars	Amount	Amount	Particulars	Amount	Amount
To Opening Stock		7,000	By Sales	16,000	
To Purchases	9,000		Less: Returns	200	15,800
Less: Returns	500	8,500	By Closing Stock		12,000
To Wages	1,000				
Add: Outstanding Wages	500	1,500			
To Carriage		1,050			
To Gross Profit c/d		9,750			
		27,800			27,800
To Salaries		1,500	By Gross Profit b/d		9,750
To Rent		1,200	By Interest Received	1,500	
			Less: Int. Reed in		
To Carriage outwards		450	advance	600	900

To Discount		1,500	By Commission	1,000	
To Interest		500	Add: Commission. Receivable	400	1,400
To Telephone charges		700			
To Printing & Stationary		900			
To Net Profit					
(Transferred to Capital A/c)		5,300			
		12,050			12,050

Balance Sheet of Telangana Trader's as on 31.12.2018

Liabilities	Amount	Amount	Assets	Amount	Amount
Capital	1,00,000		Land & Buildings		50,000
Add: Net Profit	5,300	1,05,300	Investments		20,000
Creditors		6,000	Loose tools		12,000
Interest Received in Advance		600	Furniture		18,000
Outstanding wages		500	Commission Receivable		400
			Closing stock		12,000
		1,12,400			1,12,400

17. From the following trial balance, prepare Mahesh Trader's final accounts for the year ended 31.03.2018:

Trial Balance

Debit Balances	Amount	Credit Balances	Amount
Opening stock	5,000	Capital	22,000
Purchases	4,700	Creditors	3,000
Wages	800	Bills Payable	5,400
Carriage	500	Discount	2,400
Rent	1,000	Sales	9,000
Salaries	1,200	Overdraft	2,000
Discount	400		
Advertisement Expenses	800		
Customs Duty	600		
Factory Insurance	300		
Machinery	12,000		
Debtors	6,000		
Furniture	9,000		
Speed post charges	700		
Bad Debts	800		
	43,800		43,800

Adjustments

- Value of Closing Stock: 5,400
- Prepaid Wages: 300
- Outstanding Rent: 400
- Depreciation on Machinery: 5%, Depreciation on Furniture: 10%

Sol :

**Trading and Profit & Loss Account of Mahesh Trader's
for the year ended 31.03.2018**

Dr.

Cr.

Particulars	Amount	Amount	Particulars	Amount	Amount
To Opening Stock		5,000	By Sales		9,000
To Purchases		4,700	By Closing Stock		5,400
To Wages	800				
Less: Prepaid Wages	300	500			
To Carriage		500			
To Customs duty		600			
To Factory insurance		300			
To Gross Profit c/d		2,800			
		14,400			14,400
To Salaries		1,200	By Gross Profit b/d		2,800
To Rent	1,000		By Discount		2,400
Add: Outstanding Rent	400	1,400			
To Discount		400			
To Advertisement Expenses		800			
To Speed Post charges		700			
To Depreciation on Machinery		600			
To Depreciation on Furniture		900			
To Bad Debts		800	By Net Loss (Transferred to Capital A/c)		1,600
		6,800			6,800

Balance Sheet of Mahesh Trader's as on 31.12.2018

Liabilities	Amount	Amount	Assets	Amount	Amount
Capital	22,000		Machinery	12,000	
Less: Net loss	1,600	20,400	Less: Depreciation	600	11,400
Creditors		3,000	Furniture	9,000	
Bills Payable		5,400	Less: Depreciation	900	8,100
Overdraft		2,000	Debtors		6,000
Outstanding Rent		400	Prepaid Wages		300
		31,200	Closing Stock		5,400
					31,200

18. From the following trial balance of Arun Goyal, prepare trading and profit & loss account for the year ended on 31st March, 2006 and a balance sheet as on that date :

Name of Accounts	Dr.	Cr.
Capital	—	3,00,000
Drawings	22,000	—
Fixed Assets	2,90,000	—
Purchases and Sales	3,40,000	6,50,000
Returns Inwards	8,000	—
Returns Outwards	—	6,000
Carriage	15,600	—
Wages	36,000	—
Salaries	20,000	—
Rent	—	13,000
Insurance	1,200	—
Audit Fees	500	—
Debtors and Creditors	1,68,000	47,500
Bills Receivable and Bills Payable	4,800	3,600
Printing and Stationery	1,500	—
Commission	—	400
Opening Stock	45,000	—
Cash in hand	14,300	—
Cash at bank	62,250	—
Bank Loan	—	10,000
Interest on Loan	1,350	—
	10,30,500	10,30,500

Adjustments

1. Stock at the end Rs. 51,700.
2. Depreciate fixed assets by 10%.
3. Allow 7% p.a. interest on capital and charge Rs. 2,600 as interest on drawings.
4. Rent received in advance Rs. 1,000.
5. Commission earned but not received amounted to Rs. 150.
6. Interest on bank loan @ 18% p.a. is unpaid for the last 3 months.

Sol.:

**Trading and Profit and Loss Account for the
year ending 31st March, 2006**

Dr.

Cr.

Particulars	Amount	Particulars	Amount
To Opening Stock	45,000	By Sales	6,50,000
To Purchases	3,40,000	Less: Returns	8,000
			6,42,000
Less: Returns	6,000		
	3,34,000	By Closing Stock	51,700
To Carriage	15,600		
To Wages	36,000		
To Gross Profit c/d	2,63,100		
	6,93,700		6,93,700
To Salaries	20,000	By Gross Profit b/d	2,63,100
To Insurance	1,200	By Rent	13,000
To Audit Fees	500	Less: Received in Advance	1,000
			12,000
To Printing and Advertising	1,500	By Commission	400
To Interest on Loan	1,350	Add: Accrued Commission	150
			550
Add: Outstanding Interest	450	By Interest on Drawings	2,600
	1,800		
To Depreciation on Fixed Assets	29,000		
To Interest on Capital	21,000		
To Net Profit c/d	2,03,250		
	2,78,250		2,78,250

Balance Sheet as on 31-03-2006

Liabilities	Amount	Assets	Amount
Bills Payable	3,600	Cash in hand	14,300
Creditors	47,500	Cash at Bank	62,250
Bank Loan	10,000	Bills Receivable	4,800
Add: Outstanding Interest	450	Debtors	1,68,000
	10,450		
Rent Received in Advance	1,000	Closing Stock	51,700
Capital	3,00,000	Accrued Commission	150
Add: Interest on Capital	21,000	Fixed Assets	2,90,000
Add: Net Profit	2,03,250	Less: Depreciation	29,000
			2,61,000
	5,24,250		
Less: Drawings	22,000		
Less: Interest on Drawings	2,600		
	4,99,650		
	5,62,200		5,62,200

19. From the following figures, prepare the trading and profit and loss account for the year ended on 31 st December, 2008 and the balance sheet as on that date :

Particulars	Rs.
Stock on 1-1-2008	2,000
Book Debts	2,000
Plant and Machinery	1,000
Wages	500
Salaries	200
Capital	5,000
Land and Building	3,000
Creditors	1,000
Bad Debts	100
Trading Expenses	250
Provision for Bad Debts	950
Discount Received	50
Purchases	10,000
Sales	15,000
Cash	2,000
Drawings	1,050

The following adjustments are to be made :

- Stock on 31st December, 2008 was of Rs. 2,500.
- Make a provision of 5% on debtors.
- Bad debts Rs. 200.
- Write off 10% depreciation on plant and machinery.
- Due to salesman for salary Rs. 50.
- Wages paid in advance for Rs. 20
- Make a provision for discount on debtors and creditors @2%.

Sol.:

Trading and Profit & Loss A/c as on 31-12-2008

Dr		Cr	
Particulars	Amount	Particulars	Amount
To Opening Stock	2,000	By Sales	15,000
To Purchases	10,000	By Closing Stock	2,500
To Wages 500			
Less: Prepaid Wages 20	480		
To Gross Profit c/d	5,020		
	17,500		17,500
To Salaries 200		By Gross Profit b/d	5,020
Add: Outstanding Salary 50	250	By Discount Received	50
To Trading Expenses	250	By Old Provision 950	
To Depreciation on Machinery 100	100	Less: Bad Debts 100	

To Provision for Discount on Debtors	34.20	850	
To Net Profit c/d	5115.80	Less: Further Bad Debts	200
			650
		Less: New Provision	90
		By Provision for Discount on Creditors	560
			20
	5,650		5,650

Balance Sheet as on 31-12-2003

Liabilities		Amount	Assets		Amount
Creditors	1,000		Cash		2,000
Less: Provision for Discount on creditors	20	980	Book Debts	2,000	
Capital	5000		Less: Further Bad debts	200	
Add: New Profit	5115.80			1,800	
	10115.80		Less: New Provision for Doubtful Debts on 1800 @ 5%	90	
Less: Drawings	1050.00	9,065.80		1710	
Outstanding Salary		50	Less: Provision for Discount on Debtors @ 2%	34.20	1,675.80
			Plant and Machinery	1,000	
			Less: Depreciation	100	900
			Land and Building		3,000
			Prepaid Wages		20
			Closing Stock		2,500
		10,095.80			10,095.80

20. From the following balances of Ramesh, prepare trading and profit and loss account for the year ending 31st March, 2004 and a balance sheet as on that date.

Particulars	Amount	Particulars	Amount
Capital	70,000	Cash in hand	3,600
Buildings	37,500	S. Creditors	20,000
Returns Inwards	900	Debtors	14,000
Salaries	2,220	General Expenses	1,600
Discount allowed	400	Rent Paid	7,420
Stock (1.4.2003)	33,000	Drawings	1,300
Bills Payable	10,000	Electricity charges	380
Sales	1,27,000	Carriage Inwards	1,700
Purchases	93,700	Cash at Bank	6,000
Wages	5,000	Machinery	18,500
Returns Outwards	220		
Closing stock was valued at	36,420		

Sol.:

Dr Trading and Profit and Loss Account of Ramesh as on 31.03.2004 Cr

Particulars	Amount	Particulars	Amount
To Opening Stock	33,000	By Sales	1,27,000
To Purchases	93,700	Less: Returns	900
Less: Returns Outward	220	By Closing Stock	36,420
To Wages	5,000		
To Carriage Inward	1,700		
To Gross Profit c/d	29,340		
	1,62,520		1,62,520
To Salaries	2,220	By Gross Profit b/d	29,340
To Discount allowed	400		
To General Expenses	1,600		
To Rent	7,420		
To Electricity charges	380		
To Net Profit (carried to Capital)A/c	17,320		
	29,340		29,340

Balance Sheet of Ramesh as on 31.03.2004

Liabilities	Amount	Assets	Amount
Sundry Creditors	20,000	Cash in hand	3,600
Bills Payable	10,000	Cash at Bank	6,000
Capital	70,000	Debtors	14,000
Add: Net Profit	17,320	Closing Stock	36,420
	87,320	Machinery	18,500
Less: Drawings	1,300	Buildings	37,500
	86,020		1,16,020
	1,16,020		

21. From the following trial balance of Arun Goyal, prepare trading and profit & loss account for the year ended on 31st March, 2006 and a balance sheet as on that date:

Name of Accounts	Dr.	Cr.
Capital	—	3,00,000
Drawings	22,000	—
Fixed Assets	2,90,000	—
Purchases and Sales	3,40,000	6,50,000
Returns Inwards	8,000	—
Returns Outwards	—	6,000
Carriage	15,600	—
Wages	36,000	—
Salaries	20,000	—
Rent	—	13,000
Insurance	1,200	—
Audit Fees	500	—
Debtors and Creditors	1,68,000	47,500

Bills Receivable and Bills Payable	4,800	3,600
Printing and Stationery	1,500	—
Commission	—	400
Opening Stock	45,000	—
Cash in hand	14,300	—
Cash at bank	62,250	—
Bank Loan	—	10,000
Interest on Loan	1,350	—
	10,30,500	10,30,500

Adjustments

1. Stock at the end Rs. 51,700.
2. Depreciate fixed assets by 10%.
3. Allow 7% p.a. interest on capital and charge Rs. 2,600 as interest on drawings.
4. Rent received in advance Rs. 1,000.
5. Commission earned but not received amounted to Rs. 150.
6. Interest on bank loan @ 18% p.a. is unpaid for the last 3 months.

*Sol :***Dr Trading and Profit and Loss Account for the year ending 31st March, 2006 Cr**

Particulars	Amount	Particulars	Amount
To Opening Stock	45,000	By Sales	6,50,000
To Purchases	3,40,000	Less: Returns	8,000
			6,42,000
Less: Returns	6,000	By Closing Stock	51,700
	3,34,000		
To Carriage	15,600		
To Wages	36,000		
To Gross Profit c/d	2,63,100		
	6,93,700		6,93,700
To Salaries	20,000	By Gross Profit b/d	2,63,100
To Insurance	1,200	By Rent	13,000
To Audit Fees	500	Less: Received in Advance	1,000
			12,000
To Printing and Advertising	1,500	By Commission	400
To Interest on Loan	1,350	Add: Accured Commission	150
			550
Add: Outstanding Interest	450	By Interest on Drawings	2,600
	1,800		
To Depreciation on Fixed Assets	29,000		
To Interest on Capital	21,000		
To Net Profit c/d	2,03,250		
	2,78,250		2,78,250

Balance Sheet as on 31-03-2006

Liabilities		Amount	Assets		Amount
Bills Payable		3,600	Cash in hand		14,300
Creditors		47,500	Cash at Bank		62,250
Bank Loan	10,000		Bills Receivable		4,800
Add: Outstanding Interest	450	10,450	Debtors		1,68,000
Rent Received in Advance		1,000	Closing Stock		51,700
Capital	3,00,000		Accrued Commission		150
Add: Interest on Capital	21,000		Fixed Assets	2,90,000	
Add: Net Profit	2,03,250		Less: Depreciation	29,000	2,61,000
	5,24,250				
Less: Drawings	22,000				
Less: Interest on Drawings	2,600	4,99,650			
		5,62,200			5,62,200

22. From the following balances and additional information you are required to prepare final accounts of Preethi & co. for the year ending 31st March, 2008.

Trial Balance

Dr.

Cr.

Particulars		Particulars	
Plant and machinery	2,50,000	Capital	5,00,000
Stock on 1-4-2007	12,000	Sales	3,53,000
Furniture	18,000	Purchase returns	5,000
Purchases	1,75,000	Sundry creditors	20,000
Bad debts	2,000	Discounts	4,000
Carriage inwards	3,000	Bills payable	10,000
Carriage outwards	2,500	Commission	16,000
Sundry debtors	25,000		
Salaries	17,000		
Wages	4500		
Advertising	6000		
Sales returns	13,000		
Buildings	3,80,000		
	9,08,000		9,08,000

Additional information:

- (i) Closing stock on 31-3-2008 was ₹ 38,000.
- (ii) Salaries outstanding ₹ 3000 and commission received in advance ₹ 2000
- (iii) Provide depreciation on plant and machinery at 10% and on buildings at 5% p.a.

*Sol.:***Trading and Profit and Loss a/c for the year ending 31st March 2008.**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Opening stock	12,000	By Closing stock	38,000
To Purchase 1,75,000		By Sales 3,53,000	
(-) Purchase return 5,000	1,70,000	(-) Sales return 13,000	3,40,000
To Wages	4,500		
To Carriage inward	3,000		
To Gross profit c/d	1,88,500		
	3,78,000		3,78,000
To Carriage outwards	2,500	By Gross profit c/d	1,88,500
To Salaries 17,000		By Commission 16,000	
(+) O/S 3,000	20,000	(-) Prepaid exp 2,000	14,000
To Advertising	6,000	By Discount	4,000
To Depreciation on p & m (10% on 2,50,000)	25,000		
To Depreciation on buildings (5% on 3,80,000)	19,000		
To Bad debts	2,000		
To Net profit c/d	1,32,000		
	2,06,500		2,06,500

Balance Sheet as on 31-3-08

Liabilities		Amount (₹)	Assets		Amount (₹)
Capital	5,00,000	6,32,000	Plant and machinery	2,50,000	2,25,000
(+) Net profit	<u>1,32,000</u>		(-) Depreciation	<u>25,000</u>	
Sundry Creditors		20,000	Furniture		18,000
Bills Payable		10,000	Buildings	3,80,000	3,61,000
Outstanding salaries		3,000	(-) Depreciation	<u>19,000</u>	
Prepaid commissions		2,000	Sundry debtors		25,000
		<u>6,67,000</u>	Closing stock		38,000
					<u>6,67,000</u>

23. From the following Trial Balance of Warangal Trader's, prepare final accounts for the year ended 31-12-2018.

Trial Balance

Debit Balances	Amount (₹)	Credit Balances	Amount (₹)
Purchases	60,000	Sales	1,20,000
Salaries	4,500	Purchase Returns	2,000
Opening Stock	16,000	Sundry Creditors	20,000
Sales Returns	1,500	Bills Payable	12,000
Carriage	800	Bank Overdraft	9,000
Commission paid	300	Capital	70,000
Advertisement	1,800	Discount	3,000
Bad Debts	600	Interest Received	4,000
Discount	400	Provision for Bad & Doubtful Debts	1,000
Investments	25,000		
Plant & Machinery	30,000		
Buildings	50,000		
Factory Expenses	500		
Wages	1,000		
Insurance	700		
Sundry Debtors	40,000		
Cash in Hand	2,000		
Drawings	2,500		
General Expenses	3,400		
	<u>2,41,000</u>		<u>2,41,000</u>

Adjustments

1. Closing Stock ₹ 15,000
2. Outstanding Wages ₹ 600; Accrued Interest ₹ 1,000
3. Unexpired Insurance ₹ 200.

4. Depreciation on Plant & Machinery is 10%.
5. Bad Debts to be written off 1000 and provide 5% for Bad and Doubtful Debts.
6. Create 2% Provision for Discount on Debtors and on Creditors.

Sol.:

**Trading and Profit & Loss Account of Warangal Trader's
for the year ended 31.12.2018**

Dr.			Cr.		
Particulars	Amount	Amount	Particulars	Amount	Amount
To Opening Stock		16000	By Sales	120000	
To Purchases	60000		Less: Returns	1500	118500
Less: Returns	2000	58000	By Closing Stock		15000
To Wages	1000				
Add: Outstanding Wages	600	1600			
To Carriage		800			
To Factory Expenses		500			
To Gross Profit c/d		56600			
		1,33,500			1,33,500
To Salaries		4500	By Gross Profit b/d		56600
To Commission		300	By Discount		3000
To Advertisement Expenses		1800	By Interest Received	4000	
To Bad Debts	600		Add: Accrued Interest	1000	5000
Add: Further Bad Debts	1000	1600	By Reserve for Discount on Creditors (20000 × 2/100)		400
To Discount		400			
To Insurance	700				
Less: Unexpired Insurance	200	500			
To General Expenses		3,400			
To Depr. on Plant & Machinery (30000 × 10/100)		3,000			
To Prove. for Bad & Doubtful Debts (40000 – 1000 = 39000 × 5/100)	1,950				
Less: Old Provision for BCD	1,000	950			
To Reserve for Discount on Debtors (39000 – 1950 = 37050 × 2/100)		741			
To Net Profit (Transferred to Capital A/c)		47,809			
		65,000			65,000

**Balance Sheet of Warangal Trader's
as on 31.12.2018**

Liabilities	Amount	Amount	Assets	Amount	Amount
Capital	70,000		Plant & Machinery	30,000	
Add: Net Profit	47,809		Less: Depreciation	3,000	27,000
	1,17,809		Buildings		50,000
Less: Drawings	2,500	1,15,309	Investments		25,000
Sundry Creditors	20,000		Sundry Debtors	40,000	
Less : Reserve for Discount			Less : Further Bad debts	1,000	
on Creditors	400	19,600		39,000	
Bills Payable		12,000			
			Less: Prov. for Bad debts	1,950	
				37,050	
			Less: Prov. for Disc. on		
Bank Overdraft		9,000	Debtors	741	36,309
Outstanding Wages		600	Cash in Hand		2,000
			Closing Stock		15,000
			Unexpired Insurance		200
			Accrued Interest		1,000
		1,56,509			1,56,509

**3.3 UNDERSTANDING CONTENTS OF FINANCIAL STATEMENTS OF A JOINT STOCK COMPANY
AS PER THE COMPANIES ACT 2013**

Q18. Who is responsible for maintenance of books of accounts ?

Ans :

(June-18, June-17)

Section 128 of the Companies Act, 2013 requires that every company shall prepare and keep at its registered office books of accounts and other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books will be kept on accrual basis and according to the double entry system of accounting.

The company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

Rule 3 of the Companies (Accounts) Rules, 2014 prescribes the manner of books of account to be kept in an electronic mode. As per the Rule :

- (1) The books of account and other relevant books and papers maintained in an electronic mode shall remain accessible in India so as to be usable for subsequent reference.
- (2) The books of account and other relevant books and papers referred to in Sub-Rule (1) shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.
- (3) The information received from the branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.
- (4) The information in the electronic record of the document shall be capable of being displayed in a legible form.
- (5) There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee, if any, or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law, provided that the back-up of the books of account and other books and papers of the company maintained in an electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis.
- (6) The company shall intimate to the Registrar on an annual basis at the time of filing of the financial statement:
 - (a) the name of the service provider;
 - (b) the internet protocol address of service provider;
 - (c) the location of the service provider (wherever applicable);

The books of account and other books and papers maintained by the company within India

shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours and in the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as may be prescribed. The officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

The books of account of every company relating to a period of not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years together with the vouchers relevant to any entry in such books of account shall be kept in good order.

Section 129 of the Companies Act, 2013 requires that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards under Section 133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.

At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

Where a company has one or more subsidiaries, it shall in addition to its financial statements, prepare a consolidated financial statements of the company and of all the subsidiaries in the same form and manner as that of its own which shall also be laid before the annual general meeting of the company along with the laying of its financial statements.

If a company contravenes the provisions of Section 129 of the Companies Act, 2013, the managing director, the whole-time director in charge of finance, the chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this Section and in the absence of any of the officers mentioned above, all the directors shall be punishable with

imprisonment for a term, which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

It is further stated that the books of accounts should be maintained on accrual basis and according to the double entry system of accounting to ensure that these represent true and fair view of the affairs of the company or branch office, as the case may be.

The Act requires that proper stock records should form a necessary part of proper books of accounts and also that the books of accounts and the relevant vouchers must be preserved for a minimum period of eight years in good order.

Q19. Define the term financial statement.

Ans :

As per Section 2(40) of the Companies Act, 2013 "Financial Statement" in relation to a company, includes-

- (i) a Balance Sheet (i.e. Position Statement) as at the end of the financial year;
- (ii) a Statement of Profit and Loss Account (i.e. Income Statement), or in the case of a company carrying on any activity not for profit, an Income and Expenditure Account for the financial year;
- (iii) cash flow statement for the financial year;
- (iv) a statement of changes in equity, if applicable; and
- (v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv):

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

As per Section 2(41) of the Companies Act, 2013 "financial year" in relation to any company or body corporate, means the period ending on 31st March every year and where it has been incorporated on or after 1st January of a year, the period ending on 31st March of the following year in respect whereof the financial statement of the

company or body corporate is made up. All existing companies not having their financial year ending on 31st March have to follow the financial year ending on 31st March latest by 31st March, 2016.

Q20. State the general instructions for the preparation of balance sheet and profit and loss account of a company.

Ans :

1. Where compliance with the requirements at the Act including Accounting Standards as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head/sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made and the requirements of this Schedule shall stand modified accordingly.
2. The disclosure requirements specified in Part I and Part II of this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 2013. Additional disclosures specified in the Accounting Standards shall be made in the notes to accounts or by way of additional statement unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act shall be made in the notes to accounts in addition to the requirements set out in this Schedule.
3. Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required (a) narrative descriptions or disaggregations of items recognized in those statements and (b) information about items that do not qualify for recognition in those statements.

Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements including the notes to accounts, a balance shall be maintained between providing excessive detail that may not assist users of financial statements and not

providing important information as a result of too much aggregation.

4. Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as below:

Turnover	Rounding off
(i) less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
(ii) one hundred crore rupees or more	To the nearest, lakhs, millions or crores, or decimals thereof.

5. Except in the case of the first Financial Statements laid before the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including notes shall also be given.
6. For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards.

Q21. Prepare a specimen form of balance sheet according to the companies act 2013.

Ans :

Form of BALANCE SHEET

Name of the Company

Balance Sheet as at

(Rupees in)

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of the previous reporting period
1	2	3	4
I. EQUITY AND LIABILITIES			
(1) Shareholders' funds			
(a) Share capital			
(b) Reserves and surplus			
(c) Money received against share warrants			
(2) Share application money pending allotment			
(3) Non-current liabilities			
(a) Long-term borrowings			
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long-term provisions			

<p>(4) Current liabilities</p> <p>(a) Short-term borrowings</p> <p>(b) Trade payables</p> <p>(c) Other current liabilities</p> <p>(d) Short-term provisions</p> <p style="text-align: center;">Total</p> <p>II. Assets</p> <p>Non-current assets</p> <p>(1) (a) Fixed asseys</p> <p style="padding-left: 20px;">(i) Trangible assets</p> <p style="padding-left: 20px;">(ii) Intangible assets</p> <p style="padding-left: 20px;">(iii) Capital work-in-progress</p> <p style="padding-left: 20px;">(iv) Intangible assets under development</p> <p>(b) Non-current investments</p> <p>(c) Deferred tax assets (net)</p> <p>(d) Long-term loans and advances</p> <p>(e) Other non-current assets</p> <p>(2) Current assets</p> <p>(a) Current investments</p> <p>(b) Inventories</p> <p>(c) Trade receivables</p> <p>(d) Cash and cash equivalents</p> <p>(e) Short-term loans and advances</p> <p>(f) Other current assets</p> <p style="text-align: center;">Total</p>			
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A company shall disclose the following in the notes to accounts:

A. Share Capital

For each class of share capital (different classes of preference shares to be treated separately):

- (a) the number and amount of shares authorized;
- (b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
- (c) par value per share;
- (d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;
- (e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;

- (f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
- (g) shares in the company held by each shareholder holding more than 5 per cent shares specifying the number of shares held;
- (h) shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;
- (i) for the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
 - Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
 - Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
 - Aggregate number and class of shares bought back.
- (f) terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date.
- (k) calls unpaid (showing aggregate value of calls unpaid by directors and officers)
- (l) forfeited shares (amount originally paid up)

B. Reserves and Surplus

- (i) Reserves and Surplus shall be classified as:
 - (a) Capital Reserves ;
 - (b) Capital Redemption Reserve;
 - (c) Securities Premium Reserve;
 - (d) Debenture Redemption Reserve;

- (e) Revaluation Reserve;
- (f) Share Options Outstanding Account;
- (g) Other Reserves - (specify the nature and purpose of each reserve and the amount in respect thereof);
- (h) Surplus i.e. balance in Statement of Profit & Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc. (Additions and deductions since last balance sheet to be shown under each of the specified heads)
- (ii) A reserve specifically represented by earmarked investments shall be termed as a 'fund'.
- (iii) Debit balance of statement of profit and loss shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

C. Long-Term Borrowings

- (i) Longterm borrowings shall be classified as:
 - (a) Bonds/debentures.
 - (b) Term loans from banks and from other parties.
 - (c) Deferred payment liabilities.
 - (d) Deposits.
 - (e) Loans and advances from related parties.
 - (f) Long-term maturities of finance lease obligations.
 - (g) Other loans and advances (specify nature).
- (ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

- (iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
- (iv) Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due.
- (v) Particulars of any redeemed bonds/debentures which the company has power to reissue shall be disclosed.
- (vi) Terms of repayment of term loans and other loans shall be stated.
- (vii) Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

D. Other Long-term Liabilities

Other Long-term Liabilities shall be classified as:

- (a) Trade payables
- (b) Others

E. Long-term provisions

The amounts shall be classified as:

- (a) Provision for employee benefits.
- (b) Others (specify nature).

F. Short-term borrowings

- (i) Short-term borrowings shall be classified as:
 - (a) Loans repayable on demand from banks and from other parties.

- (b) Loans and advances from related parties.
- (c) Deposits.
- (d) Other loans and advances (specify nature).
- (ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.
- (iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.
- (iv) Period and amount of default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

G. Other current liabilities

The amounts shall be classified as:

- (a) Current maturities of long-term debt;
- (b) Current maturities of finance lease obligations;
- (c) Interest accrued but not due on borrowings;
- (d) Interest accrued and due on borrowings;
- (e) Income received in advance;
- (f) Unpaid dividends;
- (g) Application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms and conditions including the number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether the company has sufficient authorized capital to cover the share capital amount resulting from

allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under other current liabilities'

- (h) Unpaid matured deposits and interest accrued thereon
- (i) Unpaid matured debentures and interest accrued thereon
- (j) Other payables (specify nature).

H. Short-term provisions

The amounts shall be classified as:

- (a) Provision for employee benefits.
- (b) Others (specify nature).

I. Tangible assets

- (i) Classification shall be given as:
 - (a) Land.
 - (b) Buildings.
 - (c) Plant and Equipment.
 - (d) Furniture and Fixtures.
 - (e) Vehicles.
 - (f) Office equipment.
 - (g) Others (specify nature)

- (ii) Assets under lease shall be separately specified under each class of asset.
- (iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.
- (iv) Where sums have been written off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

J. Intangible assets

- (i) Classification shall be given as:
 - (a) Goodwill.
 - (b) Brands /trademarks.
 - (c) Computer software.
 - (d) Mastheads and publishing titles.
 - (e) Mining rights.
 - (i) Copyrights, and patents and other intellectual property rights, services and operating rights.
 - (g) Recipes, formulae, models, designs and prototypes.
 - (h) Licenses and franchise.
 - (i) Others (specify nature).
- (ii) A reconciliation of the gross and net carrying amounts of each class of assets

at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related amortization and impairment losses/reversals shall be disclosed separately.

- (iii) Where sums have been written off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

K. Non-current investments

- (i) Non-current investments shall be classified as trade investments and other investments and further classified as:
- (a) Investment property;
 - (b) Investments in Equity Instruments;
 - (c) Investments in preference shares;
 - (d) Investments in Government or trust securities;
 - (e) Investments in debentures or bonds';
 - (f) Investments in Mutual Funds;
 - (g) Investments in partnership firms;
 - (h) Other non-current investments (specify nature).
- (ii) Investments carried at other than at cost should be separately stated specifying the basis for valuation thereof.
- (iii) **Following shall also be disclosed:**
- (a) Aggregate amount of quoted investments and market value thereof;
 - (b) Aggregate amount of unquoted investments;

- (c) Aggregate provision for diminution in value of investments.

L. Long-term loans and advances

- (i) Long-term loans and advances shall be classified as:
- (a) Capital Advances;
 - (b) Security Deposits;
 - (c) Loans and advances to related parties (giving details thereof);
 - (d) Other loans and advances (specify nature).
- (ii) The above shall also be separately sub-classified as:
- (a) Secured, considered good;
 - (b) Unsecured, considered good;
 - (c) Doubtful.
- (iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.
- (iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

M. Other non-current assets

Other non-current assets shall be classified as:

- (i) Long-term Trade Receivables (including trade receivables on deferred credit terms);
- (ii) Others (specify nature);
- (iii) Long-term Trade Receivables, shall be sub-classified as:
 - (i) (a) Secured, considered good;
 - (b) Unsecured considered good;
 - (c) Doubtful
 - (ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

- (iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

N. Current Investments

- (i) Current investments shall be classified as:
 - (a) Investments in Equity Instruments;
 - (b) Investment in Preference Shares;
 - (c) Investments in government or trust securities;
 - (d) Investments in debentures or bonds;
 - (e) Investments in Mutual Funds;
 - (f) Investments in partnership firms;
 - (g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities) in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms

(with the names of all their partners, total capital and the shares of each partner) shall be given.

- (ii) Following shall also be disclosed:
 - (a) The basis of valuation of individual investments;

- (b) Aggregate amount of quoted investments and market value thereof;
- (c) Aggregate amount of unquoted investments;
- (d) Aggregate provision made for diminution in value of investments.

O. Inventories

- (i) Inventories shall be classified as:
 - (a) Raw materials;
 - (b) Work-in-progress;
 - (c) Finished goods;
 - (d) Stock-in-trade (in respect of goods acquired for trading);
 - (e) Stores and spares;
 - (f) Loose tools;
 - (g) Others (specify nature).
- (ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.
- (iii) Mode of valuation shall be stated.

P. Trade Receivables

- (i) Aggregate amount of Trade Receivables outstanding for a period exceeding six months from the date they are due for payment should be separately stated.
- (ii) Trade receivables shall be sub-classified as:
 - (a) Secured, considered good;
 - (b) Unsecured, considered good;
 - (c) Doubtful.
- (iii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

- (iv) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Q. Cash and cash equivalents

- (i) Cash and cash equivalents shall be classified as:
 - (a) Balances with banks;
 - (b) Cheques, drafts on hand;
 - (c) Cash on hand;
 - (d) Others (specify nature).
- (ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
- (iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
- (iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
- (v) Bank deposits with more than 12 months maturity shall be disclosed separately.

R. Short-term loans and advances

- (i) Short-term loans and advances shall be classified as:
 - (a) Loans and advances to related parties (giving details thereof);
 - (b) Others (specify nature).
- (ii) The above shall also be sub-classified as:
 - (a) Secured, considered good;
 - (b) Unsecured, considered good;
 - (c) Doubtful.
- (iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.
- (iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

S. Other current assets (specify nature).

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

Q22. Prepare a specimen form of profit and loss account according to the companies act 2013.

Ans :

Form of Statement of Profit & Loss

Name of the Company.....

Profit and loss statement for the year ended.....

(Rupees in.....)

S.No.	Particulars	Note No.	Figures for the current reporting period		Figures for the previous reporting period
I.	Revenue from operations		xxx		xxx
II.	Other income		xxx		xxx
III.	Total Revenue (I + II)		xxx		xxx
IV.	Expenses:				
	Cost of materials consumed		xxx		xxx
	Purchases of Stock-in-Trade		xxx		xxx
	Changes in inventories of finished goods work- in-progress and Stock-in-Trade		xxx		xxx
	Employee benefits expense Finance costs				
	Depreciation and amortization expense				
	Other expenses				
	Total expenses		xxx		xxx
V.	Profit before exceptional and extraordinary items and tax (III-IV)		xxx		xxx
VI.	Exceptional items		xxx		xxx
VII.	Profit before extraordinary items and tax (V -VI)		xxx		xxx
IX.	Extraordinary Items Profit before tax (VII-VIII)		xxx		xxx
X.	Tax expense:				
	(1) Current tax	xxx		xxx	
	(2) Deferred tax	xxx		xxx	
XI.	Profit (Loss) for the period from continuing operations (VII-VIII)		xxx		xxx
XII.	Profit/(loss) from discontinuing operations		xxx		xxx
XIII.	Tax expense of discontinuing operations		xxx		xxx
XIV.	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)		xxx		xxx
XV.	Profit (Loss) for the period (XI + XIV)		xxx		xxx
XVI.	Earnings per equity share:		xxx		xxx
	(1) Basic		xxx		xxx
	(2) Diluted		xxx		xxx

Q23. What is divisible profits ?*Ans :*

The term "Divisible Profit" is a very complicated term because all profits are not divisible profits. Only those profits are divisible profits which are legally available for dividend to shareholders. Dividends cannot be declared except out of profits, i.e., excess of income over expenditure ; ordinarily capital profits are not available for distribution amongst shareholders because such profits are not trading profits. Thus, profits arising from revaluation or sale of fixed assets or redemption of fixed liabilities should not be available for distribution as dividend amongst shareholders.

The principles of determination of the divisible profits are governed by Section 123 of the Companies Act, 2013 which is reproduced below :

- (1) No dividend shall be declared or paid by a company for any financial year except out of the profit of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section
- (2) or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with those provisions and remaining undistributed or out of both or out of money provided by the Central Government or a State Government for the payment of dividend in pursuance of a guarantee given by that Government.

Provided that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company (transfer to reserves is not compulsory ; it is at the option of the company)

Provided further that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in that behalf :

Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves.

Depreciation stated above shall be provided in accordance with the provisions of Schedule II of the Companies Act, 2013.

The amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within 5 days from the date of declaration of dividend.

From Section 123 of the Companies Act, 2013 it is clear that dividends cannot be declared unless :

- (i) depreciation has been provided for in respect of the current financial year for which dividend is to be declared :
- (ii) there are free reserves i.e. out of reserves available for dividend.

Q24. What do you understand by provision for taxation.*Ans :* (Imp.)

Statement of Profit and Loss of a company must set out the amount of charge for Indian income- tax and other Indian taxation on profits, including where practicable, with Indian Income-tax, any taxation imposed elsewhere to the extent of the relief, if any, from Indian Income-tax and distinguishing, where practicable, between income-tax and other taxation.

A company is liable to pay income-tax or tax on profits under the Income-tax Act, 1961 and such tax is treated as charge against the profits of the accounting year, although the profits are assessed and actual liability for tax is determined in the following year. Moreover, the assessable profits (taxable profits) are seldom the same as accounting profits. As such it is not possible to determine the actual amount of tax payable at the time the financial statements are prepared. Therefore, liability for tax is estimated and provided for while preparing the final statements. Such provision is a charge against profit in the Statement of Profit and Loss and credited to Provision for Taxation Account.

While making the estimate of provision for taxation, due consideration should be given to the following points :

- (i) Whether the net profit has been determined after deducting depreciation according to Income-tax Act and managerial remuneration.

- (ii) Whether income-tax has been computed at the rates prescribed.
- (iii) Whether profit sur-tax is payable or not.
- (iv) Whether capital gains tax is payable or not.
- (v) Whether penalty is payable under any tax laws.
- (vi) Whether rebate is available for double taxation.
- (vii) Whether investment allowance, extra shift allowance, etc., if any, have been duly deducted or not in estimating the tax liability.
- (viii) Whether adjustment has been made for the last year's actual tax liability or not.

PROBLEMS

24. Prepare Balance Sheet as at 31st March, 2017 from the particulars furnished by Vision Ltd., as per Schedule III of the Companies Act, 2013.

Particulars		
Equity Share Capital (10 each, fully paid)		8,00,000
Call in arrear		800
Land		1,70,640
Building		2,80,000
Plant & Machinery		4,20,000
Furniture		40,000
General Reserve		1,68,000
Loan from IDBI		1,20,000
Loans (Unsecured)		96,800
Provision for Taxation		54,400
Sundry Debtors		1,60,000
Advances (Dr.)		34,160
Proposed Dividend		48,000
Surplus A/c		80,000
Cash Balance		24,000
Cash at Bank		1,97,600
Sundry Creditors (For Goods & Expenses)		
Stock:		
Finished Goods	1,60,000	
Raw Material	40,000	
		2,00,000

Adjustments :

- (i) 1,500 equity shares were issued for consideration other than cash. 1,60,000 2,00,000
- (ii) Loan of ` 1,20,000 from IDBI is inclusive of ` 6,000 for interest accrued but not due. The loan is hypothecated by plant and machinery.

- (iii) Debtors of ₹ 50,000 are due for more than six months.
- (iv) The cost of assets :
- | | |
|-------------------|----------|
| Building | 3,20,000 |
| Plant & Machinery | 5,60,000 |
| Furniture | 50,000 |
- (v) Bank balance includes ₹ 2,000 with Trust Bank Ltd. which is not a scheduled Bank.
- (vi) Bills receivable for ₹ 2,20,000 maturing on 30th June, 2017 have been discounted.
- (vii) The company had contract for the erection of machinery at ₹ 1,50,000 which is still incomplete.

Sol :

Vision Ltd. Balance Sheet as at 31 st March, 2017

Particulars	Note No.	
I. Equity and Liabilities		
(1) Shareholders ' Funds		
(a) Share Capital	A	7,99,200
(b) Reserves and Surplus	B	2,48,000
(2) Non-current Liabilities		
Long-term Borrowings	C	2,10,800
(3) Current Liabilities		
Trade Payables (For Goods & Expenses)		1,60,000
Other Current Liabilities	D	6,000
Short-term Provisions	E	1,02,400
Total Equity and Liabilities		15,26,400
II. Assets		
(1) Non-current Assets		
Fixed Assets :		
Tangible Assets	F	9,10,640
(2) Current Assets		
Inventories	G	2,00,000
Trade Receivables	H	1,60,000
Cash and Cash Equivalents	I	2,21,600
Short-term Loans & Advances	J	34,160
Total Assets		15,26,400
Contingent Liabilities and Commitments	K	3,70,000

Working Notes :**A. Share Capital**

Particulars	
Authorised Capital	
Issued, Subscribed and Paid-up Capital :	
80,000 Equity Shares of ₹ 10 each	8,00,000
(Of the above shares, 1,500 equity share are allotted as fully paid up pursuant to a contract without payment being received in cash)	
Less : Calls in arrear	800
	<u>7,99,200</u>

B. Reserves and Surplus

Particulars	
General Reserve	1,68,000
Surplus Account	80,000
	<u>2,48,000</u>

C. Long-term Borrowings

Particulars	
Secured Loans	
Loan from IDBI (Secured by hypothecation of Plant and Machinery)	1,14,000
Unsecured Loans	96,800
	<u>2,10,800</u>

D. Other Current Liabilities

Interest accrued but not due on Secured Loan	6,000

E. Short-term Provisions

Particulars	
Provision for Tax	54,400
Proposed Dividend	48,000
	<u>1,02,400</u>

F. Tangible Assets

Particulars		
Land at Cost		1,70,640
Building at Cost	3,20,000	
Less : Depreciation up to date	40,000	
		2,80,000
Plant and Machinery at Cost	5,60,000	
Less : Depreciation up-to-date	1,40,000	
		4,20,000
Furniture at Cost	50,000	
Less : Depreciation to date	10,000	
		40,000
		<u>9,10,640</u>

G. Inventories

Particulars	
Finished Goods	1,60,000
Raw Materials	40,000
	2,00,000

H. Trade Receivables

Particulars		
Sundry Debtors		
(a) Debts Outstanding over 6 months	50,000	
(b) Other Debts	1,10,000	1,60,000
		1,60,000

I. Cash and Cash Equivalents

Particulars		
Bank Balances :		
(a) With Scheduled Banks	1,95,600	
(b) With Trust Bank (Non-scheduled Bank)	2,000	1,97,600
Cash Balance		24,000
		2,21,600

J. Short-term Loans and Advances

Particulars	
Advances	34,160

K. Contingent Liabilities and Commitments (to the extent not provided for)

Particulars	
1. Bills Receivable Discounted but maturing on 30th June, 2017	2,20,000
2. Contract for Erection of Machinery still incomplete	1,50,000
	3,70,000

25. Following balances are extracted on 31st March, 2017 from the books of CEE BEE Ltd.:

Particulars		Particulars	
Factory Premises at cost	4,50,000	Share Capital:	
Plant and Machinery at cost	3,49,160	30,000,7% Preference Shares of	
Motor Lorries at cost	73,000	10 each	3,00,000
Sundry Debtors	1,21,780	60,000 Equity Shares of	
Bad Debts written off	2,850	10 each	6,00,000
Rent, Rates and Taxes	28,400	Surplus A/c	16,240
Advertisement	19,500	Gross Profit for the year	2,46,640
Cash in hand and at Bank	68,500	Provision for Doubtful Debts	9,000
Directors' Fees	3,600	Sundry Creditors	1,29,640
Audit Fees	10,000	Transfer Fees	110
Stock on 31-3-2017	1,14,600	Accrued Wages	12,840
Rent and Taxes paid in advance	7,980	Staff Benevolent Fund	17,900

Salaries and Wages	32,000		
Dividends paid on :			
On Preference Shares	21,000		
On Equity Shares (Interim)	15,000		
Patents	15,000		
	13,32,370		13,32,370

The provision for doubtful debts is to be made upto ` 10,200. The Factory Premises, Plant and Machinery and Motor Lorries are to be depreciated by 3%, 15% and 20% respectively. The Authorised Capital of the company is ` 10,00,000 divided into 1,00,000 shares of ` 10 each. You are required to prepare :

- (i) Statement of Profit and Loss for the year ended 31st March, 2017.
- (ii) a Balance Sheet as at 31st March, 2017 in the form prescribed under the Companies Act, 2013. Previous year's figures are not required and also ignore taxation. You need not provide corporate dividend tax.

Sol.:

**CEE BEE Ltd. Statement of Profit and Loss
for the year ending 31st March, 2017**

Particulars	Note No.	
I. Revenue from Operations (Gross Profit)		
II. Other Income (Transfer Fees)		2,46,640
III. Total Revenue (I + II)		110
IV. Expenses:		2,46,750
Employee Benefits Expense (Salaries & Wages)		32,000
Finance Costs		Nil
Depreciation and Amortisation Expense		80,474
Other Expenses	1	65,550
Total Expenses		1,78,024
V. Profit for the year (III - IV)		68,726

Accompanying Note to The Statement of Profit & Loss

1. Other Expenses

Particulars		
Rent, Rates and Taxes		28,400
Audit Fees		10,000
Advertisement		19,500
Directors' Fees		3,600
Bad Debts		2,850
Provision for Doubtful Debts :		
Required	10,200	
Less : Old Provision	9,000	
		1,200
		65,550

CEE BEE Ltd. Balance Sheet
as at 31st March, 2017

Particulars	Note No.	
I. Equity and Liabilities		
(1) Shareholders Funds		
(a) Share Capital	A	9,00,000
(b) Reserves and Surplus	B	66,866
Total		9,66,866
(2) Non-Current Liabilities		Nil
(3) Current Liabilities		
Trade Payables (Creditors)		1,29,640
Other Current Liabilities (Accrued Wages) (3)		12,840
		1,42,480
Total of Equity and Liabilities (1) + (2) + (3)		11,09,346
II. Assets		
(1) Non-Current Assets		
(i) Tangible Assets	C	7,91,686
(ii) Intangible Assets	D	15,000
		8,06,686
(2) Current Assets		
Inventories	E	1,14,600
Trade Receivables	F	1,11,580
Cash and Cash Equivalents	G	68,500
Short-term Loans and Advances	H	7,980
		3,02,660
Total of All Assets (1) + (2)		11,09,346

Working Notes :**Accompanying Notes To The Balance Sheet****A. Share Capital**

Particulars	
Authorised	
1,00,000 Shares of ₹ 10 each	10,00,000
Issued, Subscribed and Paid-up Capital	
30,000, 7% Preference Shares of ₹ 10 each, fully paid up	3,00,000
60,000 Equity Shares of ₹ 10 each, fully paid up	6,00,000
	9,00,000

B. Reserves and Surplus

Particulars			
Staff Benevolent Fund			17,900
Surplus Account:			
As at 1-4-2016		16,240	
Profit for the year	68,726		
Less : Dividend paid on :			
Preference Shares	21,000		
Equity Shares (Interim)	15,000		
	<u>36,000</u>		
		<u>32,726</u>	
			48,966
			<u>66,866</u>

C. Tangible Assets

Particulars			
Factory Premises (at Cost)			4,50,000
Less : Depreciation @ 3%			13,500
Plant and Machinery (at Cost)			3,49,160
Less : Depreciation @ 15%			52,374
Motor Lorries (at Cost)			73,000
Less : Depreciation @ 20%			14,600
			<u>58,400</u>
			7,91,686

D. Intangible Assets

Particulars			
Patents			15,000

E. Inventories

Particulars			
Stock (at Cost Assumed)			1,14,600

F. Trade Receivables

Particulars			
Sundry Debtors (exceeding 6 months assumed)			10,000
Sundry Debtors (less than 6 months)			1,11,780
		<u>1,21,780</u>	
Less : Provision for Doubtful Debts			10,200
(All debtors are assumed to be unsecured)			
			<u>1,11,580</u>

G. Cash and Cash Equivalents

Particulars			
Cash in hand and at Bank			68,500

H. Loans and Advances

Particulars			
Rent and Taxes paid in Advance			7,980

26. The authorised capital of Inter State Distributors Ltd. is ₹ 7,50,000 consisting of 3,000 6% cumulative preference shares of ₹ 100 each and 4,500 equity shares of ₹ 100 each. Following is the Trial Balance drawn up on March 31, 2017 :

Particulars	₹	Particulars	₹
Paid-up Capital:			
3,000 6% cumulative preference shares	3,00,000	General expenses	21,000
3,000 equity shares (₹ 75 per share called up)	2,25,000	Furniture at cost	75,000
Goodwill	1,00,000	Sales	9,18,600
5% first mortgage debentures (secured on freehold properties)	2,10,000	Purchases	4,76,500
Trade debtors	1,67,500	Bills receivable	6,000
Trade creditors	1,25,520	Freight and carriage inward	3,750
Freehold properties at cost	3,90,000	Investments :	
Stock on 1st April, 2016	2,41,500	600 shares of ₹ 100 each in Sunrise Limited	60,000
General Reserve	82,725	Debenture interest (half-year to September, 2016)	5,250
Salaries	1,03,500	Final dividend for 2015-16	20,250
Surplus Account (Cr.)	58,500	Preference dividend (half-year to 30th September, 2016)	9,000
Reserve for taxation	8,800	Balance at bank in current account	97,500
Delivery expenses	1,02,000	Cash in hand	14,145
Rent and rates	38,250	Shares forfeited account	2,000

- (a) The value of stock on March 31, 2017 was ₹ 2,15,000 ; (ft) Depreciation on freehold properties is to be provided at 25% and on furniture at 6% ; (c) The directors propose to pay the second half-year's dividend on preference shares and a 10% dividend on equity shares ; and
- (d) Shares were forfeited on non-payment of ₹ 35 per share, (e) Corporate dividend tax need not be provided.

You are required to prepare final accounts of the company.

Sol :

Inter State Distributors Ltd.
PART II—STATEMENT OF PROFIT AND LOSS
for the year ending 31st March, 2017

(₹ in '000)

Particulars	Note No.	Year Ending 31-3-2017	Year Ending 31-3-2016
I. Revenue from Operations	1	918.600	
II. Other Income		Nil	
III. Total Revenue (I + II)		918.600	
IV. Expenses :			
Cost of Goods Sold :	2	506.750	
Employee Benefits Expense	3	103.500	
Finance Costs	4	10.500	
Depreciation and Amortisation Expense	5	14.250	
Other Expenses	6	161.250	
Total Expenses		796.250	
V. Profit before Tax (III - IV)		122.350	

Note Forming Part of Statement of Profit and Loss**1. Revenue From Operations**

(₹ in '000)

Particulars	Year Ending 31-3-2017	Year Ending 31-3-2016
Sales	918.600	

2. Cost of Goods Sold

(₹ in '000)

Particulars	Year Ending 31-3-2017	Year Ending 31-3-2016
Opening Stock	241.500	
Purchases	478.500	
Add : Freight & Carriage	3.785	
	480.250	
	721.750	
Less : Closing Stock	215.000	
	506.750	

3. Employee Benefits Expense (₹ in '000)

Particulars	Year Ending 31-3-2017	Year Ending 31-3-2016
Salaries	103.500	

4. Finance Cost (₹ in '000)

Particulars	Year Ending 31-3-2017	Year Ending 31-3-2016
Debenture Interest 5.250		
Add : Interest Outstanding for 1/2 year 5.250		
	10.500	

5. Finance Cost (₹ in '000)

Particulars	Year Ending 31-3-2017	Year Ending 31-3-2016
Depreciation @ 2½% on Freehold Property 9.750		
Depreciation @ 6% on Furniture 4.500		
	14.250	

6. Other Expenses (₹ in '000)

Particulars	Year Ending 31-3-2017	Year Ending 31-3-2016
Rent and Rate 38.250		
Delivery Expenses 102.000		
General Expenses 21.000		
	161.250	

Inter State Distributors Ltd. Balance Sheet

as at 31-3-2017

Particulars	Note No.	Year Ending 31-3-2017	(₹ in '000) Year Ending 31-3-2016
I. Equity and Liabilities			
(1) Shareholders Funds			
(a) Share Capital	A	527.000	
(b) Reserves & Surplus	B	211.625	
		738.625	
(2) Non-Current Liabilities			
Long-term Borrowings	C	210.00	

(3) Current Liabilities			
Trade Payables (Creditors)		125.520	
Other Current Liabilities	D	5.250	
Short-term Provisions	E	31.500	
		372.270	
Total of Equity and Liabilities (1) + (2) + (3)		1110.895	
II. Assets			
(1) Non-Current Assets			
Fixed Assets			
(i) Tangible Assets	F	450.750	
(ii) Intangible Assets	G	100.000	
Non-Current Investment	H	60.000	
(2) Current Assets			
Inventories	I	215.000	
Trade Receivables	J	173.500	
Cash and Cash Equivalents	K	111.645	
Total of All Assets (1) + (2)		1110.895	

Working Notes to the Balance Sheet

A. Share Capital		(` in '000)	
Particulars		31-3-2017	31-3-2016
Authorised 3,000 6% Cumulative Preference Shares of ` 100 each		300.000	
4,500 Equity Shares of ` 100 each		450.00	
		750.00	
Issued, Subscribed & Paid-up Capital			
3,000 6% Preference Shares of ` 100 each, fully called up and paid up		300.00	
Equity Shares of ` 100 each, ` 75 per share called up and paid up		225.000	
Shares Forfeited Account		2.000	
		527.00	
B. Reserves and Surplus		(` in '000)	
		31-3-2017	31-3-2016
General Reserve		82.725	
Reserves for Taxation		8.800	
Surplus : Balance as on 1-4-2016	58.500		
Add : Profit for the year	122.350		
	180.850		
Less : Final Dividend for 2015-1	20.250		
Preference Dividend for $\frac{1}{2}$ year to 30.9.201	9.000		
Proposed Dividend :			
On Preference Shares for the second $\frac{1}{2}$ year to 31-3-2017	9.000		
On Equity Shares @ 10% on ` 2,25,000	22.500		
	60.750		
		120.100	
		211.625	

C. Long-Term Borrowings (₹ in '000)		
Particulars	31-3-2017	31-3-2016
5% First Mortgage Debentures (Secured on Freehold Properties)	210.00	
D. Other Current Liabilities (₹ in '000)		
Particulars	31-3-2017	31-3-2016
Interest on Debentures Outstanding	5.250	
E. Short-Term Provisions (₹ in '000)		
Particulars	31-3-2017	31-3-2016
Proposed Dividend on Preference Shares @ 6% p.a. for $\frac{1}{2}$ year on ₹ 3,00,000	9.000	
Proposed Dividend on Equity Shares @ 10% on ₹ 2,25,000	22.500	
	31.500	
F. Tangible Assets (₹ in '000)		
Particulars	31-3-2017	31-3-2016
Freehold Properties at Cost 390.000		
Less : Depreciation @ 2.5% 9.750		
	380.250	
Furniture at Cost 75.000		
Less : Depreciation @ 6% 4.5000		
	70.500	
	460.750	
G. Intangibles Assets (₹ in '000)		
Particulars	31-3-2017	31-3-2016
Goodwill	100.000	
H. Non-Current Investment (₹ in '000)		
Particulars	31-3-2017	31-3-2016
600 shares of ₹ 100 each in Sunrise Ltd.	60.000	
I. Inventories (₹ in '000)		
Particulars	31-3-2017	31-3-2016
Stock	215.000	
J. Trade Receivables (₹ in '000)		
Particulars	31-3-2017	31-3-2016
Trade Debtors (assumed to be less than 6 months)	167.500	
Bills receivable	6.000	
	173.500	
K. Cash and Cash Equivalents (₹ in '000)		
Particulars	31-3-2017	31-3-2016
Cash in hand	141.145	
Balance at Bank in Current A/c	97.500	
	111.645	

Exercise Problems

1. Prepare Trading Account from the following Trial Balance.

Trial Balance as on 31st March 2008

Particulars	Dr (₹)	Cr (₹)
Ram's Capital	–	25,000
Ram's Drawings	700	–
Purchases & Sales	9,000	15,000
Sales Return & Purchase Return	500	200
Stock (1-4-2007)	2,000	–
Wages	1,000	–
Building	15,000	–
Freight & Carriage	1,500	–
Advertisement	200	–
Taxes & Insurance	100	–
Debtors & Creditors	10,000	1,000
Cash at Bank	1,000	–
Cash in Hand	200	–
	41,200	41,200

Adjustments : Stock on 31st March 2008 was valued at ₹ 1,500.

[Ans : Gross Profit : ₹ 1,700]

2. Prepare Profit & Loss Account from the following Trial Balance.

Particulars	Dr (₹)	Cr (₹)
Capital	–	8,000
Cash in Hand	50	–
Purchases	7,500	–
Sales	–	10,000
Furniture	1,000	–
Lighting & Heating	100	–
Bills Receivable	850	–
Salaries	2,000	–
Creditors	–	1,800
Debtors	6,200	–

Stock on April 1, 2009	3,500	–
Printing	250	–
Bills Payable	–	1,500
Rates, Taxes & Insurance	200	–
Discount Received	–	500
Discount Allowed	150	–
	21,800	21,800

Adjustments : Stock on 31st March 2010 was valued at ` 2,000; Gross Profit ` 1,000.

[Ans : Net Loss : ` 1,200]

3. Following is the Trial Balance of Varma Corporations as on 31st March 2010. Prepare the Trading and Profit & Loss Account for the year ended 31st March 2010 and the Balance Sheet as on that date. Trial Balance of Varma Corporations as on 31st March 2010

Particulars	Dr (₹)	Cr (₹)
Capital		2,00,000
Stock on (1/4/2009)	20,000	
Purchases	64,000	
Sales		1,20,000
Sales Returns	2,000	
Wages	15,000	
Manufacturing Expenses	19,000	
Salaries	5,000	
Insurance	1,500	
Postage	300	
Advertisement	1,500	
Bad Debts	500	
Bills Payable		14,000
Discount		800
Land & Buildings	80,000	
Plant & Machinery	90,000	
Furniture	2,000	
Sundry Debtors	23,000	
Sundry Creditors		45,000
Drawings	5,000	
Cash in Hand	1,000	
Cash at Bank	50,000	
	3,79,800	3,79,800

Adjustments :

1. Closing Stock as on 31st March 2010, was Rs 30,000
2. Provide depreciation on Land & Buildings @ 10%, on Furniture @ 5%, and on Plant & Machinery @10%
3. Outstanding expenses : Salaries Rs 2,000, Wages ` 1,600.
4. Insurance paid for 15 months upto March 2010.

[Ans : Gross Profit: ` 28,400; Net Profit: ` 1,600; Balance Sheet Total: ` 2,59,200]

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Short Question & Answers

1. Define final accounts.

Ans :

One of the main objectives of maintaining accounts is to know the profit or loss made by the business organization in a particular period. This period may be a year, half year to quarter of a year. for non statutory business concerns, it will be as per the convenience of the trader. But in general it is at the end of either calender year or financial year. Further one must know that by mere preparation of trial balance one may not be able to find out the profit or loss of a business entity. Hence it is needed to prepare the final accounts.

Meaning

The term final accounts means statements which result finally from the preparation of accounts showing the profit earned or loss suffered by the firm and the financial state of affairs of the firm at the end of the period concerned. As already stated, the statement showing the profit or loss is known as Profit and Loss Account and the statement showing the financial state of affairs is called the Balance Sheets. The student must realise that in every concern, big or small, the accountant will be required to prepare these statements. Therefore, those who learn accountancy should become proficient in this. It is the trial balance that is the basis of these two statements and unless the student has mastered the preparation of the various books and ledger accounts and also of the trial balance, he will not be able to fully grasp the significance of the profit and loss account and the balance sheet and master the technique of preparing them.

Objectives

The main objectives of preparation of final accounts are :

- The ascertain the profit or loss of the business for a particular period (By preparing Trading and Profit & Loss Account)

- To find out the financial position of the business concern on a specified date or period.

2. State the advantages and disadvantages of final accounts?

Ans :

Advantages

1. Business profit or loss can be known to the trader through the trading account and profit and loss account (Income statements).
2. Financial position can be revealed by the preparation of Balance Sheet.
3. Final accounts are important source of finance information and this help the trader or management to plan the financial activities of the business concern for any period or time.
4. Financial statement help the trader to take business decisions by comparing current year results with the results of the previous year statements.
5. As the profit & loss account discloses either profit or loss, based on which a trader prepare himself to pay the taxes correctly.
6. Tax authorities also needs financial statements to determine the amount of tax exactly.
7. As financial statements reveals the solvency position of the organization, the banks and other lending organizations may consider for extending the lona facility.

Disadvantages

1. Do not reflect the current prices as they are based on the historical costs.
2. Do not consider qualitative data, such as, quality, efficiency of workforce, employee and employer relationship, motivation level of employees, value of human resources etc.

3. Do not reveal the accurate picture of the business, as certain values of assets and some expenses and income items are based on the judgement of the management, who may have prejudice.

3. What is Profit & Loss Account?

Ans :

After trading account, the second stage of the preparation of final account is the preparation of Profit & Loss account. It is prepared to find out the Net Profit or Net Loss of the business. This is also a nominal Account, so all the revenue expenses and losses should be debited and all the revenue incomes and gains are to be credited to this Profit & Loss a/c. The balance of Profit & Loss Account is either net profit or net loss, which will be transferred to balance sheet. The net profit will be added to the capital account in the balance sheet at liabilities side and the net loss will be deducted from Capital Account.

$$\text{Net Profit / Loss} = \text{Gross Profit} + \text{Incomes and Gains} - \text{Expenses and Losses}$$

Advantages

1. It Reveals net profit or net loss.
2. It helps to find out net profit ratio.
3. It assists in comparison of Current year's administrative, selling and other expenses with the previous year's amounts.
4. It facilitates for the preparation of balance sheet.

4. Characteristics of a Balance Sheet.

Ans :

Following are the main characteristics :

1. It is prepared on a particular date and not for a particular period.
2. It is prepared after the preparation of Trading and Profit & Loss Account.
3. As assets must be equal to total liabilities, the two sides of the Balance Sheet must have the same total.
4. It shows the financial position of a business as a going concern.
5. It is a statement of assets (debit balances) and liability (credit balances) and not an account. Information that Balance Sheet Convey to Outsiders

5. Explain the uses of the Balance Sheet.

Ans :

The Balance Sheet is regarded as a prominent accounting report. The different interested parties may derive different information for their own use. Generally the following information can be derived from the Balance Sheet:

1. It enables us to ascertain the proprietary interest of a person or business organization.
2. It enables us to calculate the actual capital employed in the business.
3. The lender can ascertain the financial position of the business.
4. It may serve as the basis for determining purchase consideration of the business.

5. The trends of working capital of the business can be determined by comparison of Balance Sheet of successive years and corrective measures can be taken, where necessary.
6. Different ratios can be calculated from the Balance Sheet and these ratios can be utilised for better management of the business.

6. Limitations of Balance Sheet.

Ans :

Though the Balance Sheet is prepared by every organisation for disclosing its financial position, yet it is suffering from the following limitations :

1. Fixed assets are shown in the Balance Sheet at historical cost less depreciation upto date. A conventional Balance Sheet cannot reflect the true value of these assets. Again intangible assets are shown in the Balance Sheet at book values which may bear no relationship to market values.
2. Sometimes, Balance Sheet contains some assets which command no market value such as preliminary expenses, debenture discount, etc. The inclusion of these fictitious assets unduly inflate the total value of assets.
3. The Balance Sheet cannot reflect the value of certain factors such as skill and loyalty of staff.
4. A conventional Balance Sheet may mislead untrained readers in inflationary situations.
5. The value of majority number of current assets depend upon some estimates, so it cannot reflect the true financial position of the business.

7. Define the term financial statement.

Ans :

As per Section 2(40) of the Companies Act, 2013 "Financial Statement" in relation to a company, includes-

- (i) a Balance Sheet (i.e. Position Statement) as at the end of the financial year;
- (ii) a Statement of Profit and Loss Account (i.e. Income Statement), or in the case of a company carrying on any activity not for

profit, an Income and Expenditure Account for the financial year;

- (iii) cash flow statement for the financial year;
- (iv) a statement of changes in equity, if applicable; and
- (v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv):

Provided that the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

8. What is divisible profits ?

Ans :

The term "Divisible Profit" is a very complicated term because all profits are not divisible profits. Only those profits are divisible profits which are legally available for dividend to shareholders. Dividends cannot be declared except out of profits, i.e., excess of income over expenditure ; ordinarily capital profits are not available for distribution amongst shareholders because such profits are not trading profits. Thus, profits arising from revaluation or sale of fixed assets or redemption of fixed liabilities should not be available for distribution as dividend amongst shareholders.

The principles of determination of the divisible profits are governed by Section 123 of the Companies Act, 2013 which is reproduced below :

- (1) No dividend shall be declared or paid by a company for any financial year except out of the profit of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section
- (2) or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with those provisions and remaining undistributed or out of both or out of money provided by the Central Government or a State Government for the payment of dividend in pursuance of a guarantee given by that Government.

9. Provision for taxation.*Ans :*

Statement of Profit and Loss of a company must set out the amount of charge for Indian income-tax and other Indian taxation on profits, including where practicable, with Indian Income-tax, any taxation imposed elsewhere to the extent of the relief, if any, from Indian Income-tax and distinguishing, where practicable, between income-tax and other taxation.

A company is liable to pay income-tax or tax on profits under the Income-tax Act, 1961 and such tax is treated as charge against the profits of the accounting year, although the profits are assessed and actual liability for tax is determined in the following year. Moreover, the assessable profits (taxable profits) are seldom the same as accounting profits. As such it is not possible to determine the actual amount of tax payable at the time the financial statements are prepared. Therefore, liability for tax is estimated and provided for while preparing the final statements. Such provision is a charge against profit in the Statement of Profit and Loss and credited to Provision for Taxation Account.

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Choose the Correct Answer

1. _____ is a statement in which debit side and credit side balances are verified. [b]
(a) Income statement (b) Trial balance
(c) Balance sheet (d) Trading account
2. _____ helps in providing accounting information to the management for taking effective decisions [a]
(a) Management accounting (b) Financial accounting
(c) Cost accounting (d) None
3. The end users of accounting information are, [c]
(a) Creditors (b) Managers
(c) Both A and B (d) None
4. Which of the following is not included in a balance sheet ? [b]
(a) Accounts receivable (b) Sales
(c) Accounts payable (d) Cash
5. The process of transferring transaction effects into the appropriate accounts is referred to as, [d]
(a) Closing (b) Journalizing
(c) Recording (d) Posting
6. A listing of a business entity's assets, liabilities and owner's equity as of a specific date is, [a]
(a) Balance sheet (b) Income statement
(c) Statement of owner's equity (d) Statement of cash flow
7. Net income is _____. [a]
(a) Total revenue - Total expenses
(b) Total expenses - Total revenues
(c) Revenues + Expenses
(d) Assets - Liabilities.
8. Component of final accounts [a]
(a) Trading account (b) Current account
(c) Nominal account (d) All

9. Preparation of final statements are made compulsory under Sec, [c]
(a) 209 (b) 207
(c) 210 (d) 211.
10. Parties who are interested in knowing the financial position of a business are, [d]
(a) Owners (b) Employees
(c) Financial institutions (d) All the above
11. In financial accounting, we consider only [d]
(a) Assets the value of which can be expressed in terms of money
(b) Liabilities the value of which can be expressed in terms of money
(c) Assets and liabilities the value of which can be expressed in terms of money's worth
(d) Assets and liabilities which can be expressed in terms of money or money's worth

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Fill in the blanks

1. Gross Profit + Opening stock + Purchases + Direct expenses – Sales = ?
2. Income received in advance is debited to income account and credited to _____ while making adjustment entries.
3. If outstanding salaries appear in the trial balance, it is taken only to the _____.
4. A claim of ₹ 600 was accepted in respect of stock worth ₹ 800 which was destroyed by fire. The amount of abnormal loss of ₹ 200 will be debited to _____ and credited to _____.
5. The claim admitted in respect of stock destroyed by fire will be credited to and will go to _____ the side of Balance Sheet.
6. A commission of 10% on net profits after charging such commission will be calculated _____.
7. If adjustment related to bad debts is given outside the trial balance, then they are adjusted by debiting _____ and crediting _____.
8. Medicines given to the office staff by a manufacturer of medicines will be debited to _____.
9. The cost of furniture purchased for sale is a _____ expenditure.
10. Current assets in _____.
11. Goodwill is a _____.
12. Return outward is also known as _____.
13. Return inward is also known as _____.
14. There are _____ types of accounts.

ANSWERS

1. Closing Stock
2. Income received in advance account
3. Balance Sheet
4. Profit and Loss Account, Trading Account
5. Trading Account, assets
6. 1/10 of residual i.e., crediting all incomes and gross profit and debiting all expenses except commission
7. Bad Debts Account; Sundry Debtors
8. Salaries Account
9. Revenue
10. Balance sheet
11. Intangible
12. Purchase return
13. Sales return
14. Three

UNIT IV

Financial Statement Analysis using Ratios

Objective of financial statement analysis, sources of information, Techniques of financial statement analysis: Horizontal analysis, Vertical analysis and Ratio Analysis; Financial Ratios: Meaning and Usefulness of Financial Ratios. Analysis of ratios- Liquidity Ratios, Solvency Ratios, Profitability Ratios and Turnover Ratios; Limitation of ratio analysis.

4.1 FINANCIAL STATEMENT ANALYSIS

4.1.1 Meaning

Q1. Define Financial Statement of Analysis?

Ans :

A financial statement is an organized collection of data according to logical and consistent accounting procedures. Its purpose is to convey an understanding of some financial aspects of a business firm. It may show a position at a moment of time as in the case of a balance sheet, or may reveal a series of activities over a given period of time, as in the case of an income statement.

Analysts can obtain useful information by comparing a company's most recent financial statements with its results in previous years and with the results of other companies in the same industry. Three primary types of financial statement analysis are commonly known as horizontal analysis, vertical analysis, and ratio analysis.

Definition :

"Financial statement analysis is largely a study of relationship among the various financial factors in a business as disclosed by single set-of statements, and a study of the trend of these factors as shown in a series of statements."

- Myers

'A combination of recorded facts, accounting conventions and personal judgements and the judgements and conventions applied affect them materially.' This implies that data exhibited in the financial statements are affected by recorded facts, accounting conventions and personal judgements.

- The American Institute of Certified Public Accountants

Q2. Write a note on Analysis and Interpretation and Financial Statement ?

Ans:

Analysis and interpretation of financial statements are an attempt to determine the significance and meaning of the financial statement data so that a forecast may be made of the prospects for future earnings, ability to pay interest, debt maturities, both current as well as long term, and profitability of sound dividend policy.

The main function of financial analysis is the pinpointing of the strength and weaknesses of a business undertaking by regrouping and analysis of figures contained in financial statements, by making comparisons of various components and by examining their content. The analysis and interpretation of financial statements represent the last of the four major steps of accounting. Analysis consists in breaking down a complex set of facts or figures into simple elements. Interpretation, on the other hand, consists in explaining the real significance of these simplified statements. Interpretation includes both analysis and criticism.

To interpret means to put the meaning of statement into simple terms for the benefit of a person. Interpretation is to explain in such a simple language the financial position and earning capacity of the company which may be understood even by a layman, who does not know accounting. The analysis and interpretation of financial statements requires a comprehensive and intelligent understanding of their nature and limitations as well as the determination of the monetary valuation of the items. The analyst must grasp what represent sound and unsound relationship reflected by the financial statements. Interpretation is impossible

without analysis. "Interpretation is not possible without analysis and without interpretation analysis has no value".

Analysis and interpretation act as a bridge between the art of recording and reporting financial information and the act of using this information. Analysis refers to the process of fact finding and breaking down complex set of figures into simple components while interpretation stands for explaining the real significance of these simplified components. Interpretation is a mental process based on analysis and criticism.

Q3. Explain the procedure for Analysis and Interpretation?

Ans :

Procedure for Analysis and Interpretation

To make an effective analysis and interpretation of financial statements, the following groundwork is required to be completed.

1. The objectives of financial statement analysis are the basis for the selection of techniques of analysis. Hence, the organization should decide the purpose of financial statement analysis.
2. The extent of interpretation is also decided to select right type of techniques of financial statement analysis.
3. The financial statements are prepared on certain assumptions, principles and practices which are ascertained to understand their significance.
4. Additional information required for the work of interpretation should be collected properly.
5. The collected data should be presented in a logical sequence by rearrangement of data.
6. Data should be analyzed for preparing comparative statement, common size statement, trend percentage, calculation of ratios and the like.
7. General market conditions and economic conditions are taken into consideration for analyzing and interpreting the collected facts.

8. Interpreted data and information should be presented in a suitable report form.

Q4. Explain the Nature of Financial Statement Analysis?

Ans :

Nature of Financial Statement Analysis

(i) Recorded Facts

The term 'recorded facts' means facts, which have been recorded in the accounting books. Facts which have not been recorded in the financial books are not depicted in the financial statements, however material they might be. For example, fixed assets are shown at cost irrespective of their market or replacement price since such price is not recorded in the books.

(ii) Accounting Conventions

Accounting conventions imply certain fundamental accounting principles which have been sanctified by long usage. For example, on account of the convention of 'conservatism', provision is made of expected losses but expected profits are ignored. This means that the real financial position of the business may be much better than what has been shown by the financial statements.

(iii) Personal Judgements

Personal judgements also have an important bearing on the financial statements. For example, the choice of selecting a method of depreciation lies on the accountant. Similarly, the mode of amortization of fictitious assets also depends on the personal judgement of the accountant.

4.1.2 Objective of Financial Statement Analysis

Q5. What are the objectives of Financial Statement Analysis ?

Ans :

1. Reviewing the performance of a company over the past periods

To predict the future prospects of the company, past performance is analyzed. Past

performance is analyzed by reviewing the trend of past sales, profitability, cash flows, return on investment, debt-equity structure and operating expenses, etc.

2. Assessing the current position & operational efficiency

Examining the current profitability & operational efficiency of the enterprise so that the financial health of the company can be determined. For long-term decision making, assets & liabilities of the company are reviewed. Analysis helps in finding out the earning capacity & operating performance of the company.

3. Predicting growth & profitability prospects

The top management is concerned with future prospects of the company. Financial analysis helps them in reviewing the investment alternatives for judging the earning potential of the enterprise. With the help of financial statement analysis, assessment and prediction of the bankruptcy and probability of business failure can be done.

4. Loan Decision by Financial Institutions and Banks

Financial analysis helps the financial institutions, loan agencies & banks to decide whether a loan can be given to the company or not. It helps them in determining the credit risk, deciding the terms and conditions of a loan if sanctioned, interest rate, and maturity date etc.

Q6. Explain the importance of Financial Statement Analysis

(or)

What are the significance of Financial statement analysis

(or)

What are the purposes of financial statement analysis?

Ans :

(Dec.-19)

The financial statements are important in many ways. Some of the advantages of using financial statements are as follows :

1. Helps in Measuring the Profitability

The main objective of a business is to earn a satisfactory return on the funds invested in it. Financial analysis helps in ascertaining whether adequate profits are being earned on the capital invested in the business or not. It also helps in knowing the capacity to pay the interest and dividend.

2. Indicates the Trend of Achievements

Financial statements of the previous years can be compared and the trend regarding various expenses, purchases, sales, gross profits and net profit etc. can be ascertained. Value of assets and liabilities can be compared and the future prospects of the business can be envisaged.

3. Assesses the Growth Potential of the Business

The trend and other analysis of the business provides sufficient information indicating the growth potential of the business.

4. Comparative Position in Relation to other firms

The purpose of financial statements analysis is to help the management to make a comparative study of the profitability of various firms engaged in similar businesses. Such comparison also helps the management to study the position of their firm in respect of sales, expenses, profitability and utilizing capital, etc.

5. Assesses overall Financial Strength

The purpose of financial analysis is to assess the financial strength of the business. Analysis also helps in taking decisions, whether funds required for the purchase of new machines and equipments are provided from internal sources of the business or not if yes, how much? And also to assess how much funds have been received from external sources.

6. Helps in Assessing Solvency of the Firm

The different tools of an analysis tell us whether the firm has sufficient funds to meet its short term and long term liabilities or not.

Q7. What are the limitations of Financial Statement Analysis?

(or)

What are the demerits of Financial Statement Analysis?*Ans :***Limitations****(i) Manipulation or Window Dressing**

Some business enterprises resort to manipulate the information contained in the financial statements so as to cover up their bad or weak financial position. Thus, the analysis based on such financial statements may be misleading due to window dressing.

(ii) Use of Diverse Procedures

There may be more than one way of treating a particular item and when two different business enterprises adopt different accounting policies, it becomes very difficult to make a comparison between such enterprises. For example, depreciation can be charged under straight line method or written down value method. However, results provided by comparing the financial statements of such business enterprises would be misleading.

(iii) Qualitative Aspect Ignored

The financial statements incorporate the information which can be expressed in monetary terms. Thus, they fail to assimilate the transactions which cannot be converted into monetary terms. For example, a conflict between the marketing manager and sales manager cannot be recorded in the books of accounts due to its non-monetary nature, but it will certainly affect the functioning of the activities adversely and consequently, the profits may suffer.

(iv) Historical

Financial statements are historical in nature as they record past events and facts. Due to continuous changes in the demand of the product, policies of the firm or government etc, analysis based on past information does

not serve any useful purpose and gives only post-mortem report.

(v) Price Level Changes

Figures contained in financial statements do not show the effects of changes in the price level, i.e. price index in one year may differ from price index in other years. As a result, misleading picture may be obtained by making a comparison of figures of past year with current year figures.

(vi) Subjectivity & Personal Bias

Conclusions drawn from the analysis of figures given in financial statements depend upon the personal ability and knowledge of an analyst. For example, the term 'Net profit' may be interpreted by an analyst as net profit before tax, while another analyst may take it as net profit after tax.

(vii) Lack of Regular Data/Information

Analysis of financial statements of a single year has limited uses. The analysis assumes importance only when compared with financial statements, relating to different years or different firm.

Q8. Explain the various parties interested in Financial Statement Analysis.*Ans :***Parties Interested In Financial Statement Analysis**

Analysis of financial statements has become very significant due to widespread interest of various parties in the financial results of a business unit. The various parties interested in the analysis of financial statements are :

(i) Investors

Shareholders or proprietors of the business are interested in the well being of the business. They like to know the earning capacity of the business and its prospects of future growth.

(ii) Management

The management is interested in the financial position and performance of the enterprise as a whole and of its various divisions. It helps

them in preparing budgets and assessing the performance of various departmental heads.

(iii) Trade Unions

They are interested in financial statements for negotiating the wages or salaries or bonus agreement with the management.

(iv) Lenders

Lenders to the business like debenture holders, suppliers of loans and lease are interested to know short term as well as long term solvency position of the entity.

(v) Suppliers and Trade Creditors

The suppliers and other creditors are interested to know about the solvency of the business i.e. the ability of the company to meet the debts as and when they fall due.

(vi) Tax Authorities

Tax authorities are interested in financial statements for determining the tax liability.

(vii) Researchers

They are interested in financial statements in undertaking research work in business affairs and practices.

(viii) Employees

They are interested to know the growth of profit. As a result of which they can demand better remuneration and congenial working environment.

(ix) Government and their agencies

Government and their agencies need financial information to regulate the activities of the enterprises/ industries and determine taxation policy. They suggest measures to formulate policies and regulations.

(x) Stock exchange

The stock exchange members take interest in financial statements for the purpose of analysis because they provide useful financial information about companies.

4.2 TYPES OF FINANCIAL STATEMENT ANALYSIS

Q9. Explain different types of Financial Statement Analysis.

Ans : (Dec.-19)

Different types of financial statements analysis can be made on the basis of

- (i) The nature of the analyst and the material used by him,
- (ii) The objective of the analysis, and
- (iii) The modus operandi of the analysis.

These are discussed one by one.

- (i) According to the nature of the analyst and the material used by him. On this basis, the financial analysis can be external and internal analysis :

(a) External Analysis

It is made by those persons who are not connected with the enterprise. They do not have access to the enterprise. They do not have access to the detailed record of the company and have to depend mostly on published statements. Such type of analysis is made by investors, credit agencies, governmental agencies and research scholars.

(b) Internal Analysis

The internal analysis is made by those persons who have access to the books of accounts. They are members of the organization. Analysis of financial statements or other financial data for managerial purpose is the internal type of analysis. The internal analyst can give more reliable result than the external analyst because every type of information is at his disposal.

(iii) According to the objectives of the analysis

On this basis the analysis can be long-term and short-term analysis.

(a) Long-term Analysis

This analysis is made in order to study the long-term financial stability, solvency and liquidity as well as profitability and earning capacity of a business concern. The purpose of making such type of analysis is to know whether in the long-run the concern will be able to earn a minimum amount which will be sufficient to maintain a reasonable rate of return on the investment so as to provide the funds required for modernization, growth and development of the business and to meet its costs of capital. This type of analysis helps the long-term financial planning which is essential for the continued success of a business.

(b) Short-term Analysis

This is made to determine the short-term solvency, stability and liquidity as well as earning capacity of the business. The purpose of this analysis is to know whether in the short run a business concern will have adequate funds readily available to meet its short-term requirements and sufficient borrowing capacity to meet contingencies in the near future. This analysis is made with reference to items of current assets and current liabilities (working capital analysis) to have fairly sufficient knowledge about the company's current position which may be helpful for short-term financial planning and long-term planning.

(iii) According to the modus operandi of the analysis

On this basis, the analysis may be horizontal analysis and vertical analysis.

(a) Horizontal (or Dynamic) Analysis

This analysis is made to review and analyze financial statements of a number of years and is, therefore, based on financial data taken from several years. This is very useful for long-term trend analysis and planning. Comparative financial statement is an example of this type of analysis.

(b) Vertical (or Static) Analysis

This analysis is made to review and analyze the financial statements of one particular year only. Ratio analysis of the financial performance relating to a particular accounting year is an example of this type of analysis.

4.2.1 Horizontal Analysis and Vertical Analysis**Q10. Define****(a) Horizontal Analysis****(b) Vertical Analysis**

Ans.

(a) Horizontal Analysis

Horizontal analysis of financial statements involves comparison of a financial ratio, a benchmark, or a line item over a number of accounting periods. This method of analysis is also known as trend analysis. Horizontal analysis allows the assessment of relative changes in different items over time. It also indicates the behavior of revenues, expenses, and other line items of financial statements over the course of time.

Accounting periods can be two or more than two periods. Accounting period can be a month, a quarter or a year. It will depend on the analyst's discretion when choosing an appropriate number of accounting periods. During the investment appraisal, the number of accounting periods for analysis is based on the time horizon under consideration.

Horizontal analysis of financial statements can be performed on any of the item in the income statement, balance sheet and statement of cash flows. For example, this

analysis can be performed on revenues, cost of sales, expenses, assets, cash, equity and liabilities. It can also be performed on ratios such as earnings per share (EPS), price earning ratio, dividend payout, and other similar ratio.

(b) Vertical Analysis

Vertical analysis of financial statements is a technique in which the relationship between items in the same financial statement is identified by expressing all amounts as a percentage a total amount. This method compares different items to a single item in the same accounting period. The financial statements prepared by using this technique are known as common size financial statements.

Q11. What are the difference between horizontal and vertical analysis.

Ans :

Basis	Horizontal Analysis	Vertical Analysis
Need	Comparative Financial statement is needed to prepare horizontal analysis.	Financial statements of one accounting period are needed to prepare vertical analysis.
Items	It includes same items of different periods	It includes different items of same period.
Calculation	In this analysis, both absolute and percentage changes are computed.	In this analysis, only percentage change is computed.
Application	It is applicable to time series analysis.	It is applicable to cross-section analysis.

4.3 TECHNIQUES OF FINANCIAL STATEMENT ANALYSIS

Q12. Explain the various tools of Financial Statement Analysis.

(or)

What are the various methods of financial statement analysis?

(or)

Explain the various techniques of Financial Statement Analysis

Ans :

(July-17)

Tools / Methods / Techniques of Financial Statement Analysis

1. Comparative financial statements
2. Common size statements
3. Trend analysis
4. Ratio analysis
5. Funds flow analysis
6. Cash flow analysis

1. Comparative Financial Statements

Comparative study of financial statements is the comparison of the financial statements of the business with the previous year's financial statements. It enables identification of weak points and applying corrective measures. Practically, two financial statements (balance sheet and income statement) are prepared in comparative form for analysis purposes.

(a) Comparative Balance Sheet

The comparative balance sheet shows the different assets and liabilities of the firm on different dates to make comparison of balances from one date to another. The comparative balance sheet has two columns for the data of original balance sheets. A third column is used to show change (increase/decrease) in figures. The fourth column may be added for giving percentages of increase or decrease. While interpreting comparative Balance sheet the interpreter is expected to study the following aspects :

(i) Current financial position and Liquidity position

For studying current financial position or liquidity position of a concern one should examine the working capital in both the years. Working capital is the excess of current assets over current liabilities.

(ii) Long-term financial position :

For studying the long-term financial position of the concern, one should examine the changes in fixed assets, long-term liabilities and capital.

(iii) Profitability of the concern

The next aspect to be studied in a comparative balance sheet is the profitability of the concern. The study of increase or decrease in profit will help the interpreter to observe whether the profitability

has improved or not. After studying various assets and liabilities, an opinion should be formed about the financial position of the concern.

(b) Comparative Income statement

The income statement provides the results of the operations of a business. This statement traditionally is known as trading and profit and loss Account. Important components of income statement are net sales, cost of goods sold, selling expenses, office expenses etc. The figures of the above components are matched with their corresponding figures of previous years individually and changes are noted. The comparative income statement gives an idea of the progress of a business over a period of time. The changes in money value and percentage can be determined to analyze the profitability of the business. Like comparative balance sheet, income statement also has four columns. The first two columns are shown figures of various items for two years. Third and fourth columns are used to show increase or decrease in figures in absolute amount and percentages respectively. The analysis and interpretation of income statement will involve the following :

- The increase or decrease in sales should be compared with the increase or decrease in cost of goods sold.
- To study the operating profits
- The increase or decrease in net profit is calculated that will give an idea about the overall profitability of the concern.

2. Common Size Statement

The common size statements (Balance Sheet and Income Statement) are shown in analytical percentages. The figures of these statements are shown as percentages of total assets, total liabilities and total sales

respectively. Take the example of Balance Sheet. The total assets are taken as 100 and different assets are expressed as a percentage of the total. Similarly, various liabilities are taken as a part of total liabilities.

(a) Common Size Balance Sheet

A statement where balance sheet items are expressed in the ratio of each asset to total assets and the ratio of each liability is expressed in the ratio of total liabilities is called common size balance sheet. Thus the common size statement may be prepared in the following way.

- The total assets or liabilities are taken as 100
- The individual assets are expressed as a percentage of total assets i.e. 100 and different liabilities are calculated in relation to total liabilities.

(b) Common Size Income Statement

The items in income statement can be shown as percentages of sales to show the relations of each item to sales.

3. Trend Percentage Analysis

Trend percentage analysis (TPA) The trend analysis is a technique of studying several financial statements over a series of years. In this analysis the trend percentages are calculated for each item by taking the figure of that item for the base year taken as 100. Generally the first year is taken as a base year. The analyst is able to see the trend of figures, whether moving upward or downward.

4. Ratio Analysis

Two individual items on the statements can be compared with one another and the relationship is expressed as a ratio. Ratios are computed for items on the same financial statement or on different statements. These ratios are compared with those of prior years and with those of other companies to make them more meaningful. A ratio is a simple mathematical expression. Ratio may be expressed by a number of ways. It is a number

expressed in terms of another number. It is a statistical yard stick that provides a measure of relationship between two figures.

5. Fund Flow Analysis

Funds Flow Analysis has been the salient feature of the evolution of accounting theory and practice. The financial statement of a business provides only some information about financial activities of a business in a limited manner. The income statement deals solely with operations and the balance sheet shows the changes in the assets and liabilities. In fact, these statements are substantially an analysis of static aspects of financial statements. Under this context, it is imperative to study and to analyze the fund movements in the business concern. Such a study or analysis may be undertaken by using another tool of financial analysis, which is called 'Statement of Sources, and Uses of Funds' or simply 'Fund Statement' or Fund Flow Analysis.

6. Cash Flow Analysis

Fund Flow Statement fails to convey the quantum of inflow of cash and outflow of cash. When we say cash, we refer to the cash as well as the bank balances of the company at the end of the accounting period as reflected in the Balance Sheet of the company. Cash is a current asset like inventory and Accounts Receivables. Cash reflects its liquidity position. Cash flow statement is a statement of cash flow and cash flow signifies the movements of cash in and out of a business concern. Inflow of cash is known as sources of cash and outflow of cash is called uses of cash. This statement also depicts factors for such inflow and outflow of cash.

Thus cash flow statement is a statement designed to highlight upon the causes which bring changes in cash position between two Balance Sheets dates. It virtually takes the nature and character of cash receipts and cash payments though the basic information used in the preparation of this statement differs from that which is used in recording cash receipts and cash payments.

Q13. Explain the format of comparative balance sheet.

Ans :

Format of Comparative Balance Sheet

Particular	Note No.	Current Year	Previous Year	Absolute Change (Increase / Decrease)	Percentage Change (Increases / Decrease) %
(1)	(2)	(A)	(B)	C = A – B	$\left(D = \frac{C}{B} \times 100 \right)$
1. Equity and Liabilities					
1. Shareholder's Funds					
(a) Share Capital					
(i) Equity Share Capital	-	-	-	-	-
(ii) Preference Share Capital	-	-	-	-	-
(b) Preference and Surplus	-	-	-	-	-
2. Non-Current Liabilities					
(a) Long-term Borrowings	-	-	-	-	-
(b) Long-term Provisions	-	-	-	-	-
3. Current Liabilities					
(a) Short-term Borrowings	-	-	-	-	-
(b) Trade Payables	-	-	-	-	-
(c) Other Current Liabilities	-	-	-	-	-
(d) Short-term provisions	-	-	-	-	-
Total	-	-	-	-	-
II. Assets					
1. Non-Current Assets					
(a) Fixed Assets					
(i) Tragible Assets	-	-	-	-	-
(ii) Intangible Assets	-	-	-	-	-
(b) Non-Current Investments	-	-	-	-	-
(c) Long-term Investments	-	-	-	-	-
2. Current Assets					
(a) Current-term Loans and Advances	-	-	-	-	-
(b) Inventories	-	-	-	-	-
(c) Trade receivables	-	-	-	-	-
(d) Cash and cash equivalents	-	-	-	-	-
(e) Short-term Loans and Advances	-	-	-	-	-
(f) Other Current Assets	-	-	-	-	-
Total	-	-	-	-	-

Q14. Explain the format of comparative income sheet.

Ans :

Format of Comparative Income Statement (or)

Comparative Statement of profit and Loss

Comparative Income Statement for Comparative Statement of Profit and Loss for the years ended

Particular	Note No.	Figures for Current Year	Figures for Previous Year	Absolute Change (Increase / Decrease)	Percentage Change (Increases / Decrease)
(1)	(2)	(3) A	(4) B	(5) A - B = C	(6) $\frac{C}{B} \times 100 = D$
I. Revenue from Operations		-	-	-	-
II. Other Income		-	-	-	-
III. Total Revenue (I + II)		-	-	-	-
IV. Expenses :					
Cost of Materials Consumed		-	-	-	-
Purchases of Stock-in-Hand		-	-	-	-
Changes in Inventories of Finished Goods, Work-in-Progress and Stock-in-Trade		-	-	-	-
Employees Benefit Expenses		-	-	-	-
Finance Costs		-	-	-	-
Depreciation and Amortisation Expense		-	-	-	-
Other Expenses		-	-	-	-
Total Expenses		-	-	-	-
V. Profit before tax (III - IV)		-	-	-	-
VI. Less : Tax		-	-	-	-
VII. Profit after Tax (V - VI)		-	-	-	-

Note : If Current year's figure has decreased show the Absolute change and Percentage Change in brackets so as to reflect negative item.

Q15. Discuss the format common size balance sheet.

Ans :

Format of Common Size Balance Sheet

Common Size Balance Sheet as of

Particular	Note	Absolute Amounts		Percentage of Balance Sheet Type	
		Figures as at the end of Current Year (`)	Figures as the end of Previous year (`)	Current Year (%)	Previous Year (%)
(1)	(2)	(3)	(4)	(5)	(6)
I. Equity and Liabilities					
1. Shareholder's Funds					
(a) Share Capital		-	-	-	-
(b) Reserves and Surplus		-	-	-	-
2. Non-Current Liabilities					
(a) Long-term Borrowings		-	-	-	-
(b) Trade Payables		-	-	-	-
(c) Other Current Liabilities		-	-	-	-
(d) Short-term Provisions		-	-	-	-
Total		-	-	100	100
II. Assets					
1. Non-Current Assets					
(a) Fixed Assets					
(i) Tangible Assets		-	-	-	-
(ii) Intangible Assets		-	-	-	-
(b) Non-Current Investments		-	-	-	-
(c) Long-term Loans and Advances		-	-	-	-
2. Current Assets					
(a) Current Investments		-	-	-	-
(b) Inventories		-	-	-	-
(c) Trade Receivables		-	-	-	-
(d) Cash and Cash Equivalents		-	-	-	-
(e) Short-term Loans and Advances		-	-	-	-
(f) Other Current Assets		-	-	-	-
Total		-	-	100	100

Q16. Explain the format of common size income statement

Ans :

Format of Common Size Income Sheet

Common Size Statement of profit and Loss

Common Size Income Statement for the years ended

Particular	Note	Figures for the Current Year (`)	Figures for the Previous year (`)	Percentage of Revenue from Operations	
				Current Year (%)	Previous Year (%)
(1)	(2)	(3)	(4)	(5)	(6)
I. Revenue from Operations		-	-	-	-
II. Other Income		-	-	-	-
III. Total Revenue		-	-	-	-
IV. Expenses		-	-	-	-
Cost of materials Consumed		-	-	-	-
Purchases of Stock-in-Trade		-	-	-	-
Changes in inventories of Finished Goods, Work-in-Progress and Stock-in-					
Trade Employees benefits Expenses		-	-	-	-
Finance Costs		-	-	-	-
Depreciation and Amortisation Expense	-	-	-	-	-
Other Expenses		-	-	-	-
Total Expenses		-	-	-	-
V. Profit before tax (III - IV)		-	-	-	-
VI. Less : Tax		-	-	-	-
VII. Profit after Tax (V - VI)		-	-	-	-

PROBLEMS**Problems on Comparative Balance Sheet**

1. From the following Balance Sheet, prepare a Comparative Balance Sheet and comment upon the same .

Liabilities	2012	2013	Assets	2012	2013
Equity share capital	4,00,000	3,00,000	Furniture	1,00,000	1,40,000
6% Pref. Share	3,00,000	4,00,000	Plant & Machinery	3,00,000	2,70,000
Reserves	2,00,000	2,45,000	Buildings	3,00,000	2,70,000
7% Debentures	1,00,000	1,50,000	Land	1,00,000	1,00,000
Outstanding Taxes	1,00,000	1,50,000	Stocks	2,00,000	3,00,000
Creditors	1,50,000	2,00,000	Debtors	2,00,000	3,00,000
Bills Payables	50,000	75,000	Cash	1,00,000	1,40,000
	13,00,000	15,20,000		13,00,000	5,20,000

Comparative Balance Sheet for 2012 and 2013

Particulars	2012	2013	Increase / Decrease	Change in (%)
I. Equity and Liabilities				
1. Shareholders Fund				
(a) Equity Share Capital	4,00,000	3,00,000	(1,00,000)	(25)
Pref. Share Capital	3,00,000	4,00,000	1,00,000	33.33
(b) Reserves and Surplus				
Reserves	2,00,000	2,45,000	45,000	26
Total (1)	9,00,000	9,45,000	45,000	5
2. Non-Current Liabilities				
7% Debentures	1,00,000	1,50,000	50,000	50
Total (2)	1,00,000	1,50,000	50,000	50
3. Current Liabilities				
(i) Trade Payables				
(a) Creditors	1,50,000	2,00,000	50,000	33.33
(b) Bills Payables	50,000	75,000	25,000	50
(ii) Other Current Liabilities				
Outstanding Taxes	1,00,000	1,50,000	50,000	
Total of (3)	3,00,000	4,25,000	1,25,000	41.67
Total (1+2+3)	13,00,000	15,20,000	2,20,000	16.92

II. Assets				
1. Fixed Assets				
(a) Tangible Assets				
Furniture	1,00,000	1,40,000	40,000	40
Plant & Machinery	3,00,000	2,70,000	(30,000)	(10)
Buildings	3,00,000	2,70,000	(30,000)	(10)
Land	1,00,000	1,00,000	-	-
Total of (1)	8,00,000	7,80,000	(20,000)	(2.5)
2. Current Assets				
(a) Trade Receivables	2,00,000	3,00,000	1,00,000	50
(b) Inventories	2,00,000	3,00,000	1,00,000	50
(c) Cash and Cash Equivalent	1,00,000	1,40,000	40,000	40
Total of (2)	5,00,000	7,40,000	2,40,000	48
Total (1 + 2)	13,00,000	15,20,000	2,20,000	16.92

Interpretation :

- The above comparative Balance Sheet reveals that the current assets are increased by 2,40,000. The current liabilities also increased by ` 1,25,000. So, the company is able to pay the current liabilities from current assets. Cash position is also improved. So, the financial position is good.
- Any fixed assets are purchased during the year. There is no increase in share capital. But long-term loans increased by ` 50,000. It depicts the fact that long-term loans are utilized for the current assets. So, the liquidity position is improved considerably.
- There is an increase in reserves. So, the company may issue bonus shares in future.
- So, the overall financial position is satisfactory.

2. From the following Balance Sheets, prepare Comparative Balance Sheet for Vijaya Laxmi Ltd., and give a brief report of the inferences you draw :

Particulars	31-3-2016	31-3-2015
I. Equity and Liabilities		
Shareholders Fund		
Share Capital	3,00,000	2,00,000
Reserves and Surplus	2,00,000	2,00,000
Non-Current Liabilities		
Long Term Borrowings	1,60,000	40,000
Current Liabilities		
Trade Payables (Creditors)	1,00,000	60,000
Total	7,60,000	5,00,000

II. Assets		
Non-Current Assets		
Fixed Assets	5,60,000	3,60,000
Non-Current Investments	40,000	40,000
Current Assets :		
Trade Receivables (Book Debts)	1,20,000	80,000
Cash and cash equivalent	40,000	20,000
Total	7,60,000	5,00,000

Sol:

Comparative Balance Sheet for 2012 and 2013

Particulars	2012	2013	Increase / Decrease	Change in (%)
I. Equity and Liabilities				
1. Shareholders Fund				
Share Capital	2,00,000	3,00,000	1,00,000	50
Reserves and Surplus	2,00,000	2,00,000	-	-
Total (1)	4,00,000	5,00,000	1,00,000	50
2. Non-Current Liabilities				
Long-term borrowings	40,000	1,60,000	1,20,000	300
Total (2)	40,000	1,60,000	1,20,000	300
3. Current Liabilities				
Trade Payables	60,000	1,00,000	40,000	66.67
Total (3)	60,000	1,00,000	40,000	66.67
Total (1 + 2 + 3)	5,00,000	7,60,000	2,60,000	52
II. Assets				
1. Non - Current Assets				
(a) Fixed Assets	3,60,000	5,60,000	2,00,000	55.56
(b) Non-Current Investments	40,000	40,000	-	-
Total (1)	4,00,000	6,00,000	2,00,000	50
2. Current Assets				
(a) Trade Receivables	80,000	1,20,000	40,000	50
(b) Cash and Cash Equivalent	20,000	40,000	20,000	100
Total (2)	1,00,000	1,60,000	60,000	60
Total (1 + 2)	5,00,000	7,60,000	2,60,000	52

Interpretation :

1. Comparative Balance Sheet of the company shows that there is an increase in share capital by Rs. 1,00,000 and in long-term borrowings by Rs. 1,20,000.
2. Fixed assets have been increased during 2015-16 by Rs. 2,00,000 i.e 55.56%. This fact shows that the company has utilized major portion of funds raised through issue of shares and long term borrowings for acquiring fixed assets.
3. Utilizing funds raised through long term borrowings and share capital for acquiring income earnings assets is a sound and good policy.
4. Company has to improve its short term liquidity position, because current liabilities are increased with compare to current assets.
5. The overall financial position of the company is good.

Problems on Comparative Income Statement

3. Rearrange the following in the form of a comparative Statement of Profit and Loss Showing the changes in absolute amounts and percentages and give your views briefly on the net effect of the changes :

Particulars	2016	2015
Revenue from Operations (Net Sales)	9,60,000	8,00,000
Purchases of Stock in trade	5,50,000	4,50,000
Changes in Inventories of stock in trade	30,000	50,000
Other Expenses	2,65,000	2,40,000

*Sol.:***Comparative Statement of Profit and Loss for the year ended 31st March, 2015 and 2016.**

Particulars	2012	2013	Increase / Decrease	Change in (%)
I. Revenue from Operations	8,00,000	9,60,000	1,60,000	20
Total	8,00,000	9,60,000	1,60,000	20
II. Expenses				
(a) Purchases of Stock in trade	4,50,000	5,50,000	1,00,000	22.22
(b) Changes in Inventories of Stock in trade	50,000	30,000	(20,000)	(40)
(c) Other Expenses	2,40,000	2,65,000	25,000	10.42
Total	7,40,000	8,45,000	1,05,000	14.19
Profit Before Tax (I-II)	60,000	1,15,000	55,000	91.67

Interpretation :

1. Revenue from Operations (Net Sales) has increased by 20%.
 2. Purchases of stock in trade have increased by 22.22% and Inventory of Stock-in-Trade has decreased by 40%.
 3. Expenses have increased by 14.19%
 4. The overall impact is that Profit Before Tax has increased by 91.67%.
4. **Rearrange the following data in the form of Comparative Statement or Profit and Loss and Study the profitability of the concern.**

Particulars	2016	2015
Revenue from Operations (Net Sales)	12,50,000	10,00,000
Purchases of Stock in trade	6,00,000	5,80,000
Changes in Inventories of stock in trade	40,000	50,000
Other Incomes (Interest on Investments)	30,000	30,000
Other Expenses	60,000	50,000
Rate of Income Tax	40%	40%

*Sol. :***Comparative Statement of Profit and Loss for the year ended 31st March, 2015 and 2016.**

Particulars	2012	2013	Increase / Decrease	Change in (%)
I. Revenue from Operations	10,00,000	12,50,000	2,50,000	25
II. Other Incomes	30,000	30,000	-	-
Total (I+II)	10,30,000	12,80,000	2,50,000	24.27
III. Expenses				
(a) Purchases of Stock in trade	5,80,000	6,00,000	20,000	3.45
(b) Changes in Inventories of Stock in trade	50,000	40,000	(10,000)	(20)
(c) Other Expenses	50,000	60,000	10,000	20
Total (III)	6,80,000	7,00,000	20,000	2.94
Profit Before Tax (I+II-III)	3,50,000	5,80,000	2,30,000	65.71
Less : Tax	1,40,000	2,32,000	92,000	65.71
Profit After Tax	2,10,000	3,48,000	1,38,000	65.71

Comments :

1. Revenue from operations (Net Sales) has increased by 25%.
2. Purchases of Stock in trade have increased by only 3.45%.
3. Inventories of stock in trade have decreased by 20%

4. Other expenses have increased by 20%
5. Total expenses have increased by 2.94% whereas the total revenue has increased by 24.27%.
6. The overall profit has increased by 65.71%
7. There has been remarkable increase in the profitability of the company.

Problems on Common Size Balance Sheet

5. The Balance Sheet of Nithya and Co. and Satya and Co. are given below :

Balance Sheet as at 31-3-2018.

Particulars	Nithya & Co.	Satya & Co
I. Equity and Liabilities		
Shareholders Fund		
Share Capital		
Preference Share Capital	1,20,000	1,60,000
Equity Share Capital	1,50,000	4,00,000
Reserves and Surplus	14,000	18,000
Non-Current Liabilities		
Long Term Loans	1,15,000	1,30,000
Current Liabilities		
Trade Payables		
Bills Payables	2,000	–
Sundry Creditors	12,000	4,000
Outstanding Expenses	15,000	6,000
Proposed Dividends (Short term Provisions)	10,000	90,000
	4,38,000	4,38,000
II. Assets		
Non-Current Assets		
Tangible Assets :		
Land and Buildings	80,000	1,23,000
Plant and Machinery	3,34,000	6,00,000
Current Assets :		
Temporary Investments	1,000	40,000
Inventories	10,000	25,000
Trade Receivables (Book Debts)	4,000	8,000
Prepaid Expenses (other current assets)	1,000	2,000
Cash and cash equivalent	8,000	10,000
	4,38,000	4,38,000

Prepare Common Size Balance Sheet and Comment.

Sol:

Common Size Balance Sheet Balance Sheet

Particulars	Rs. Nithya	%	Rs. Satya	%
I. Equity and Liabilities				
1. Shareholders Fund				
Equity Share Capital	1,50,000	34.25	4,00,000	49.50
Preference Share Capital	1,20,000	27.39	1,60,000	19.80
Reserves and Surplus	14,000	3.19	18,000	2.23
Total of (1)	2,84,000	64.83	5,78,000	71.53
2. Non-Current Liabilities				
Long-term loans	1,15,000	26.25	1,30,000	16.09
Total of (2)	1,15,000	26.25	1,30,000	16.09
3. Current Liabilities				
(a) Trade Payables				
Bills Payables	2,000	0.46	-	-
Sundry Creditors	12,000	2.74	4,000	0.49
(b) Other Current Liabilities				
Outstanding Expenses	15,000	3.44	6,000	0.74
(c) Short-term Provisions				
Proposed Dividend	10,000	2.28	90,000	11.15
Total of (3)	39,000	8.92	1,00,000	12.38
Total (1 + 2 + 3)	4,38,000	100	8,08,000	100
II Assets				
1. Non-Current Assets :				
Fixed Assets				
(a) Tangible Assets				
Land and Building	80,000	18.26	1,23,000	15.22
Plant and Machinery	3,34,000	76.26	6,00,000	74.62
Total of (1)	4,14,000	94.52	7,23,000	89.48
2. Current Assets				
Current Investments	1,000	0.23	40,000	4.95
Inventories	10,000	2.28	25,000	3.08
Trade Receivables	4,000	0.91	8,000	0.99
Cash and Cash Equivalent	8,000	1.83	10,000	1.25
Other Current Assets (Prepaid)	1,000	0.23	2,000	0.25
Total of (2)	24,000	5.48	85,000	10.52
Total (1 + 2)	4,38,000	100	8,08,000	100

Comments :

1. An analysis of pattern of financing of both the companies shows that Satya and Co. is more traditionally financed as compared to Nithya and Co. The former company has depended more on its funds as is shown by Balance Sheet. Out of total Investments, 71.53% of the funds are proprietor's funds and outsider's funds account only for 28.47%. In Nithya and Co. proprietor's funds are 64.83% while outsider's share is 35.17% which shows that this company has depended more on outsider's funds. In this context both the companies have good financial planning but Satya and Co. is financed more on traditional lines.
 2. Both the companies are suffering from inadequacy of working capital. the percentage of current liabilities is more than the percentage of current assets in both the companies. The first company is suffering more from working capital position than the second company because current liabilities are more than current assets by 3.44% and this percentage is 1.86% in the case of second company.
 3. A close look at the balance sheets shows that investments in fixed assets have been financed from working capital in both the companies. In Satya and Co. fixed assets account for 94.52% of total assets while long-term funds account for 91.08% of total funds. In Nithya and Co. fixed assets account for 89.48% whereas long term funds account for 87.62% of total funds instead of using long-term funds for working capital purposes the companies have used working capital for purchasing fixed assets.
 4. Both the companies face working capital problem and immediate steps should be taken to issue more capital or raise long-term loans to raise working capital position.
6. **The balance sheet of Shaheen Ltd are given for the year 2007 and 2008 convert them into common size balance sheet and interpret the changes.**

Balance Sheet

Liabilities	2007	2008	Assets	2007	2008
Equity share	1,46,800	1,91,000	Buildings	1,80,000	2,00,000
Capital reserve	50,000	70,000	Plant & machinery	40,000	55,000
General Reserve	22,000	30,000	Furniture	10,000	20,000
Trade creditors	30,000	40,000	Investments (temporary)	36,500	42,000
Bills payable	80,000	60,000	Freehold property	20,000	12,000
Outstanding Exp.	90,000	80,000	Goodwill	25,000	30,000
Provisions	30,000	20,000	Cash balance	25,000	20,000
			Sundry debtors	30,000	35,000
			Inventories	70,000	57,000
			Bills receivable	10,300	20,000
	4,46,800	4,91,000		4,46,800	4,91,000

Sol.:

Common Size Balance Sheet Balance Sheet

Particulars	Rs. 2007	%	Rs. 2008	%
I. Equity and Liabilities				
1. Shareholders Fund				
Equity Share Capital	146,800	32.86	1,91,000	38.90
Reserves and Surplus				
Capital Reserves	50,000	11.19	70,000	14.26
General Reserves	20,000	4.48	30,000	6.11
Total of (1)	2,16,800	48.53	2,91,000	59.27
2. Non-Current Liabilities	-	-	-	-
3. Current Liabilities				
(a) Trade Payables				
Bills Payables	80,000	17.91	60,000	12.22
Sundry Creditors	30,000	6.17	40,000	8.15
(b) Other Current Liabilities				
Outstanding Expenses	90,000	20.14	80,000	16.29
(c) Short-term Provisions	30,000	6.71	20,000	4.07
Total of (3)	2,30,000	51.47	2,00,000	40.73
Total (1 + 2 + 3)	4,46,800	100	4,91,000	100
II. Assets				
1. Non-Current Assets :				
Fixed Assets				
(a) Tangible Assets				
Building	1,80,000	40.29	2,00,000	40.75
Plant and Machinery	40,000	8.95	55,000	11.20
Furniture	10,000	2.24	20,000	4.07
Freehold Property	20,000	4.48	12,000	2.44
(b) Intangible Assets				
Goodwill	25,000	5.60	30,000	6.11
Total of (1)	2,75,000	61.5	3,17,000	64.57

2. Current Assets				
Current Investments	36,500	8.17	42,000	8.55
Inventories	70,000	15.71	57,000	11.60
Trade Receivables				
Bills Receivables	10,300	2.30	20,000	4.08
Debtors	30,000	6.71	35,000	7.13
Cash and Cash Equivalent	25,000	5.59	20,000	4.07
Total of (2)	1,71,800	38.44	1,74,000	35.43
Total (1 + 2)	4,46,800	100	4,91,000	100

Interpretation :

1. Out of every rupee of sales 60.72 per cent in 2007 and 63.63 per cent in 2008 account for cost of goods sold.
2. The percentage ratio of gross profit to sales was 39.28 per cent in 2007 which was reduced 36.37 percent 2008.
3. The operating expenses increased from 15.71 per cent of sales in 2007 to 16.37 per cent in 2008 All this reduced the percentage ratio of net income after tax to sales from 14.15 per cent in 2007 to 12.00 per cent in 2008.
4. The operating expenses increased from 15.71 per cent of sales in 2007 to 16.37 per cent in 2008. All this reduced to percentage ratio of net income after tax to sales from 14.15 per cent in 2008.

Problems on Common Size Income Statement

7. From the following Statement of Profit and Loss, prepare Common-Size Statement of Profit and Loss and give comments :

Particulars	2017	2016
I. Revenue from Operations (Net Sales)	12,50,000	10,00,000
II. Expenses		
Purchases of Stock in Trade	8,70,000	7,20,000
Changes in Inventories of Stock in Trade	(20,000)	30,000
Depreciation and Amortisation Expenses	30,000	20,000
Other Expenses	50,000	30,000
Total (II)	9,30,000	8,00,000
III. Profit Befor Tax (I-II)	3,20,000	2,00,000
Less : Tax	96,000	60,000
Profit After Tax	2,24,000	1,40,000

Sol.:

Particulars	2016	2017	Changes in Percentages	
			2016	2017
I. Income				
Revenue from Operations	10,00,000	12,50,000	100	100
Total	10,00,000	12,50,000	100	100
II. Expenses				
(a) Purchases of Stock in Trade	7,20,000	8,70,000	72	69.6
(b) Changes in Inventories of Stock in Trade	30,000	(20,000)	3	1.6
(c) Depreciation and Amortisation	30,000	20,000	2	2.4
(d) Other Expenses	30,000	50,000	3	4
Total Expenses	8,00,000	9,30,000	80	74.4
Profit Befor Tax (I-II)	2,00,000	3,20,000	20	25.6
Less : Tax	60,000	96,000	6	7.68
Profit After Tax	1,40,000	2,24,000	14	17.92

Comments :

- Purchases of Stock-in-Trade and Changes in inventories of Stock-in-Trade have decreased from 75% to 68%. There are two possible reasons for this change.
 - Efficient functioning of the purchase and production department.
 - Increase in the sale price of the product without corresponding increase in the cost of inputs.
 - Increase in net profit is mainly due to decrease in the percentage of cost of goods sold.
- 8. The following is the statement of profit and loss of Kulkarni Ltd. for the years ended 31st March 2018 and 2017.**

Particulars	2018	2017
I. Revenue from Operations		
Sales	8,15,000	7,25,000
Less : Returns	15,000	25,000
Total (A)	8,00,000	7,00,000
II. Other Incomes	8,050	1,200
III. Total Revenue (I + II)	8,08,050	7,01,200
IV. Expenses		
Cost of Material Consumed	6,15,000	5,95,000
Employee Benefit Expenses	12,500	12,700
Depreciation and Amortisation Expenses	1,940	1,750
Other Expenses	24,000	23,000
Total of Balance (Total of B)	6,53,440	6,32,450
V. Profit Befor Tax (A – B)	1,54,610	68,750

Sol :

Particulars	2017	2018	Changes in Percentages	
			2017	2018
I. Revenue from Operations				
Sales	7,25,000	8,15,000		
Less : Returns	25,000	15,000		
	7,00,000	8,00,000	100	100
II. Other Incomes	1,200	8,050	0.17	1.00
III. Total Revenue (I+II)	7,01,200	8,08,050	100.17	101.00
IV. Expenses				
Cost of Material Consumed	5,95,000	6,15,000	85.00	76.87
Employee Benefit Expenses	12,700	12,500	1.81	1.56
Depreciation	1,750	1,940	0.25	0.24
Other Expenses	23,000	24,000	3.29	3.00
Total Expenses	6,32,450	6,53,440	90.35	81.67
V. Profit Befor Tax (III-IV)	68,750	1,54,610	9.82	19.33

Comments :

1. Net revenue from operations have increase from Rs. 7,00,000 to Rs. 8,00,000
2. Cost of Materials Consumed has been reduced from 85% in 2017 to 76.87% in 2018. It has contributed to the increase in profitability of the company.
3. Employee benefits expenses, depreciation and other expenses have also reduced. The total expenses have declined from 90.35% to 81.67% of net revenue from operations.
4. Other income has increased from 0.17% to 1.00% of net revenue from operations.
5. The profitability of the company has sufficiently improved.

Problems on Trend values

9. Calculate the trend percentages from the following figures of Arun Ltd. The year 2010 is taken as the base year.

Year	Sales	Cost of Goods Sold	(` 000) Gross Profit
2010	2,000	1,400	600
2011	2,500	1,800	700
2012	3,000	2,200	800
2013	3,500	2,600	900
2014	4,500	3,000	1,000

Sol:

Sales			Cost of Goods Sold		(₹ '000) Gross Profit	
Year	Amount	Trend (%)	Amount	Trend (%)	Amount	Trend (%)
2010	2,000	100	1,400	100.000	600	100.000
2011	2,500	125	1,800	128.57	700	116.66
2012	3,000	150	2,200	157.14	800	133.33
2013	3,500	175	2,600	185.71	900	150.00
2014	4,000	200	3,000	214.28	1,000	166.66

Interpretation :

1. Sales has continuously increased in all the years upto 2014. The percentage in 2014 is 200 as compared to 100 in 2010. The increase in sales is, quite satisfactory.
2. The figures of cost of goods sold have also increased from 2010 to 2014. The cost of goods sold is 185.71% in 2013 and 214.28% in 2014 as compared to earlier years.
3. The gross profit has substantially increased. In five years period it has considerably increased. The comparative increase in profits is much higher in 2013 and 2014 as compared to 2010.
4. From the above analysis, it is observed that the expansion of the firm is good, because the firm has doubled its sales and profits in just five years time. The profit has increased equivalent to sales, which shows that there is a proper control over cost of goods sold. This indicates that the overall performance of the firm is good.

10. From the following data relating to the assets side of the balance sheet of ABC Ltd. for the period-ending 31st March 2003 – 06, calculate trend percentages and interpret the results thereof.

Balance Sheet of Nithya Ltd.**For the period-ending 31 March 2003 - 06****(Rs. in lakhs)**

Particulars	2003	2004	2005	2006
Cash	100	120	80	140
Debtors	200	250	325	400
Stock	300	400	350	500
Other Current Assets	50	75	125	150
Land	400	500	500	500
Buildings	800	1,000	1,200	1,500
Plant	1,000	1,000	1,200	1,500

Sol.:

Trend Percentage of Nithya Ltd.
For the period-ending 31 March 2003 - 06
(Rs. in lakhs)

Assets	2003	%	2004	%	2005	%	2006	%
Current Assets								
Cash	100	100	120	120	80	80	140	140
Debtors	200	100	250	125	325	162.5	400	400
Stock	300	100	400	133.33	350	116.67	500	166.67
Other Current Assets	50	100	75	150	125	250	150	300
Total of Current Assets	650	100	845	130	880	135.38	1,190	183.08
Fixed Assets								
Land	400	100	500	125	500	125	500	125
Buildings	800	100	1,000	125	1,200	150	1,500	187.5
Plant	1,000	100	1,000	100	1,200	120	1,500	150
Total of Fixed Assets	2,200	100	2,500	113.64	2,900	131.82	3,500	159.00
Total Assets	2,850	100	3,345	117.36	3,780	132.63	4,690	164.56

Interpretation :

1. The assets have exhibited a continuous increasing trend over the period.
2. The current assets increased much faster than the fixed assets.
3. Sundry debtors, other current assets and buildings have shown higher growth.

4.4 RATIO ANALYSIS

Q17. What is Ratio Analysis? What are the objectives of ratio analysis?

*Ans.:***(Imp.)****Definition**

According to Myers, "Ratio analysis is a study of relationship among the various financial factors in a business".

Thus, ratio analysis measures the profitability, efficiency and financial soundness of the business.

Ratio analysis is to present the figure of financial statement in simple and intangible form. Ratio analysis is to present the figure of financial statement in simple and intangible form. Ratio analysis, in this way, is the process of establishing meaningful relationship between two figures and set of financial statement.

Objectives of Ratio Analysis

The objectives of ratio analysis are as follows:

1. Measuring the Profitability

The profitability of the business can be measured by calculating gross profit, net profit, expenses ratio and other.

2. Judging the Operational Efficiency of Business

The operational efficiency of the business can be ascertained by calculating operating ratio.

3. Assessing the Solvency of the Business

It can be ascertained whether the firm is solvent or not by calculating solvency ratio. Solvency ratios show relationship between total liabilities and total assets. If total assets are lesser than the total liabilities it shows unsound position of the business.

4. Measuring Short and Long-Term Financial Position of the Company

Ratio analysis helps in knowing the short term and long term financial position of the business by calculating various ratios. Current and liquid ratio indicates short-term financial position, whereas debt equity ratio, fixed asset ratio and proprietary ratio shows long-term financial positions.

5. Facilitating Comparative Analysis of the Performance

Every firm has to compare its present performance with the previous and discover the plus and minus points. These points can be located by the calculation of different ratio. Comparison with the performance of other competitive firms can also be made.

4.4.1 Financial Ratios

4.4.1.1 Meaning and Usefulness of Financial Ratios

Q18. What do understand by meaning of financial ratio ?

Ans :

Financial ratios are one of the most common tools of managerial decision making. A ratio is a

comparison of one number to another—mathematically, a simple division problem. Financial ratios involve the comparison of various figures from the financial statements in order to gain information about a company's performance. It is the interpretation, rather than the calculation, that makes financial ratios a useful tool for business managers. Ratios may serve as indicators, clues, or red flags regarding noteworthy relationships between variables used to measure the firm's performance in terms of profitability, asset utilization, liquidity, leverage, or market valuation.

Ratio Analysis

Ratio analysis is the process of determining and presenting the relationship of items and group of items in the statements. According to Batty J. Management Accounting "Ratio can assist management in its basic functions of forecasting, planning coordination, control and communication".

Ratio analysis can represent following three methods

Ratio may be expressed in the following three ways :

1. Pure Ratio or Simple Ratio

It is expressed by the simple division of one number by another. For example , if the current assets of a business are Rs. 200000 and its current liabilities are Rs. 100000, the ratio of 'Current assets to current liabilities' will be 2:1.

2. 'Rate' or 'So Many Times

In this type , it is calculated how many times a figure is, in comparison to another figure. For example , if a firm's credit sales during the year are Rs. 200000 and its debtors at the end of the year are Rs. 40000 , its Debtors Turnover Ratio is $200000/40000 = 5$ times. It shows that the credit sales are 5 times in comparison to debtors.

3. Percentage

In this type, the relation between two figures is expressed in hundredth. For example, if a firm's capital is Rs.1000000 and its profit is Rs.200000 the ratio of profit capital, in term of percentage, is $200000/1000000 \times 100 = 20\%$.

Usefulness of Financial Ratios

- (1) Bankers and Lenders: Use profitability, liquidity and investment because they want to know the ability of the borrowing business in regular scheduled interest payments and repayments of principal loan amount.
- (2) Investors: Use profitability and investment because they are more interested in profitability performance of business and safety & security of their investment and growth potential of their investment.
- (3) Government: Use profitability because government may use profit as a basis for taxation, grants and subsidies.
- (4) Employees: Use profitability, liquidity and activity because employees will be concerned with job security, bonus and continuance of business and wage bargaining.
- (5) Customers: Use liquidity because customers will seek reassurance that the business can survive in the short term and continue to supply.
- (6) Suppliers: Use liquidity because suppliers are more interested in knowing the ability of the business to settle its short-term obligations as and when they are due.
- (7) Management: Use all ratios because management is interested in all aspects i.e., both financial performance and financial condition of the business.

Q19. Explain the nature of ratio analysis.

Ans :

In financial analysis, ratio is used as an index of yardstick for evaluating the financial position and performance of the firm. It is a technique of analysis and interpretation of financial statements. Ratio analysis helps in making decisions as it helps in establishing relationship between various ratios and interpret thereon. Ratio analysis helps analysts to make quantitative judgement about the financial position and performance of the firm. Ratio analysis involves following steps:

1. Relevant data selection from the financial statements related to the objectives of the analysis.

2. Calculation of required ratios from the data and presenting them either in pure ratio form or in percentage.
3. Comparison of derived different ratios with :
 - (i) The ratio of the same concern over a period of years to know upward or downward trend or static position to help in estimating the future, or
 - (ii) The ratios of another firm in same line, or
 - (iii) The ratios of projected financial statements, or
 - (iv) The ratios of industry average, or
 - (v) The predetermined standards, or
 - (vi) The ratios between the departments of the same concern assessing either the financial position or the profitability or both.

Q20. What are the Guidelines or Precautions for use of Ratios ?

Ans :

(Imp.)

The calculation of ratios may not be difficult task but their use is not easy. The information on which these are based, the constraints of financial statements, objective for using them, the calibre of the analyst, etc. are important factors which influence the use of ratios. Following guidelines or factors may be kept in mind while interpreting various ratios :

1. Accuracy of Financial Statements

The ratios are calculated from the data available in financial statements. The reliability of ratios is linked to the accuracy of information in these statements. Before calculating ratios one should see whether proper concepts and conventions have been used for preparing financial statements or not. These statements should also be properly audited by competent auditors. The precautions will establish the reliability of data given in financial statements.

2. Objective or Purpose of Analysis

The type of ratios to be calculated will depend upon the purpose for which these are required. If the purpose is to study current financial position then ratios relating to current assets and current liabilities will be studied. The purpose of 'user' is also important for the analysis of ratios. A creditor, a banker, an investor, a shareholder, all have different objects for studying ratios. The purpose or object for which ratios are required to be studied should always be kept in mind for studying various ratios. Different objects may require the study of different ratios.

3. Selection of Ratios

Another precaution in ratio analysis is the proper selection of appropriate ratios. The ratios should match the purpose for which these are required. Calculation of large number of ratios without determining their need in the present context may confuse the things instead of solving them. Only those ratios should be selected which can throw proper light on the matter to be discussed.

4. Use of Standards

The ratios will give an indication of financial position only when discussed with reference to certain standards. Unless otherwise these ratios are compared with certain standards one will not be able to reach at conclusions. These standards may be rule of thumb as in case of current ratio (2:1) and acid-test ratio (1 : 1), may be industry standards, may be budgeted or projected ratios, etc. The comparison of calculated ratios with the standards will help the analyst in forming his opinion about financial situation of the concern.

5. Calibre of the Analyst

The ratios are only the tools of analysis and their interpretation will depend upon the calibre and competence of the analyst. He should be familiar with various financial statements and the significance of changes, etc. A wrong interpretation may create havoc for the concern since wrong conclusions may

lead to wrong decisions. The utility of ratios is linked to the expertise of the analyst.

6. Ratios Provide Only a Base

The ratios are only guidelines for the analyst. He should not base his decisions entirely on them. He should study any other relevant information, situation in the concern, general economic environment, etc. before reaching final conclusions. The study of ratios in isolation may not always prove useful. A businessman will not afford a single wrong decision because it may have far-reaching consequences. The interpreter should use the ratios as guide and may try to solicit any other relevant information which helps in reaching a correct decision.

Q21. Explain about Rational and Utility of Ratio Analysis.

Ans :

Ratio analysis plays a significant role in ascertaining the financial performance of a concern. The following are the various users of ratio analysis.

i) Management

Ratio analysis-helps a management to reap many managerial uses from it. They are,

- a) Ratio analysis helps a management assess the financial position of the firm and making necessary decisions from the information available in the financial statement.
- b) It facilitates in financial forecasting' and financial planning.
- c) It helps in communicating the financial strength and weakness of a firm in a more easy and understandable form.
- d) It helps in the coordination of activities which is the most important functions of business management.
- e) It facilitates in effective control of the business by revealing the loop holes in it;

- f) Ratio analysis also serves many other purposes to the management by becoming an essential part in budgetary control and standard costing.

ii) Investors/Shareholders

Ratio analysis helps an investors or a shareholder to assess the financial position of the concern in which he is going to invest. It warns him in making up his mind whether the present financial position of the concern warrants him for further investment or not. The calculation of various ratios help him to do this.

iii) Creditors/Suppliers

Ratio analysis helps the creditors or suppliers who extend short-term credit to the concern, to know whether the financial position of the concern warrants their payment at a specified time or not.

iv) Employees

Ratio analysis also helps the employees who are interested in knowing the financial position of the concern. Various profitability ratios facilitate them to know for the increase of their wages and other benefits.

v) Government

- Ratio analysis aid the government in assessing the financial health of different industries and prepare its future policies.
- With all the utilities to various users, ratio analysis Serves as a powerful tool for ascertaining the financial position of a concern.

Q22. Explain the importance of ratio analysis

Ans :

Importance of Ratio Analysis

Ratio analysis is an important tool for analyzing the company's financial performance. The following are the important advantages of the accounting ratios.

1. Analyzing Financial Statements

Ratio analysis is an important technique of financial statement analysis. Accounting ratios

are useful for understanding the financial position of the company. Different users such as investors, management, bankers and creditors use the ratio to analyze the financial situation of the company for their decision making purpose.

2. Judging Efficiency

Accounting ratios are important for judging the company's efficiency in terms of its operations and management. They help to judge how well the company has been able to utilize its assets and earn profits.

3. Locating Weakness

Accounting ratios can also be used in locating weakness of the company's operations even though its overall performance may be quite good. Management can then pay attention to the weakness and take remedial measures to overcome them.

4. Formulating Plans

Although accounting ratios are used to analyze the company's past financial performance, they can also be used to establish future trends of its financial performance. As a result, they help formulate the company's future plans.

5. Comparing Performance

It is essential for a company to know how well it is performing over the years and as compared to the other firms of the similar nature. Besides, it is also important to know how well its different divisions are performing among themselves in different years. Ratio analysis facilitates such comparison.

4.5 ANALYSIS OF RATIOS / CLASSIFICATION OF RATIOS

Q23. Explain the classification of ratios.

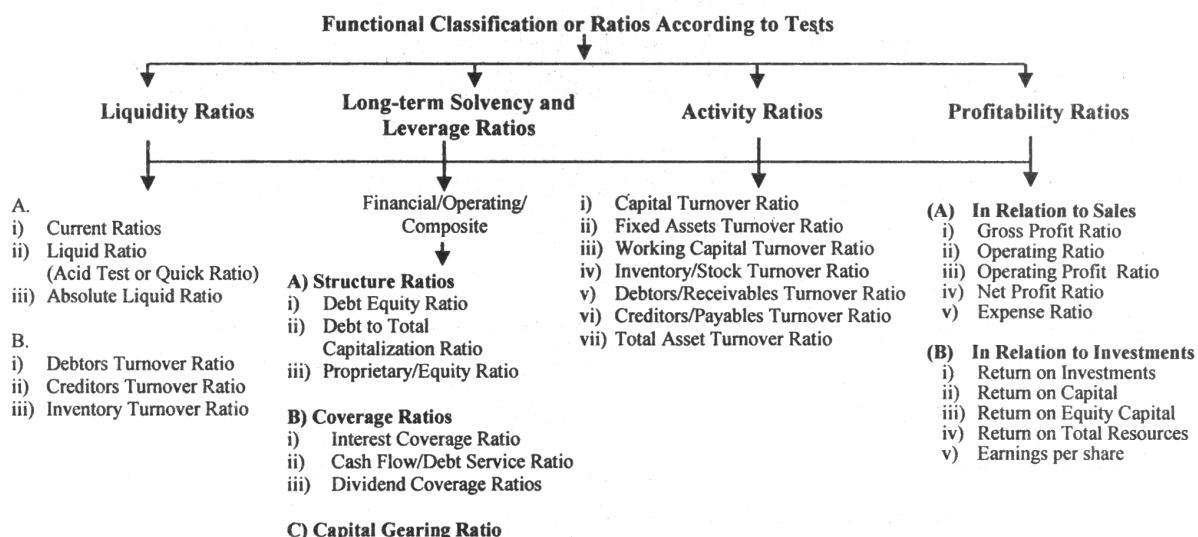
Ans :

(Jan.-21, June-18)

Functional Classification or Ratios According to Tests/Object:

i) Liquidity Ratio

These are the ratios, which measures the short-term solvency or financial position of a firm. These ratios are calculated to comment upon the short-term paying capacity of a concern or the firm's ability to meet its current obligations. The various liquidity ratios are current ratio, liquid ratio and absolute liquid ratio. Further to see the efficiency with which the liquid resources have been employed by a firm, debtor's turnover and creditor's turnover ratios are calculated.



ii) Leverage Ratio

Leverage ratios are the financial statement ratios which show the degree to which the business is leveraging itself through its use of borrowed money. By using a combination of assets, debt, equity, and interest payments, leverage ratios are used to understand a company's ability to meet its long term financial obligations.

The leverage ratios can further be classified as:

- a) Structure Ratios
- b) Coverage Ratios
- c) Capital Gearing Ratios

iii) Activity Ratios

Activity ratios are calculated to measure the efficiency with which the resources of a firm have been employed. These ratios are also called **turnover ratios** because they indicate the speed with which assets are being turned over into sales, e.g., debtor's turnover ratio. The various activity or turnover ratios have been named in the chart classifying the ratios.

iv) Profitability Ratios

These ratios measure the result of business operations or overall performance and effectiveness of the firm, e.g., gross profit ratio, operating ratio or return on capital employed. The various profitability ratios have been given in the chart exhibiting the classification of ratios according to test. Generally, two types of profitability ratios calculated are:

- a) In relation to sales, and
- b) In relation to investments.

4.5.1 Liquidity Ratios**Q24. What is liquidity ratio. Explain various types of liquidity ratios.***Ans :***(Jan.-21, June-18)**

Liquidity refers to the ability of a concern to meet its current obligations as and when these become due. Liquidity ratios are calculated to measure short-term financial soundness of the business. The short-term obligations are met by realizing amounts from current, floating or circulating assets. The current assets should either be liquid or near liquidity. These should be convertible into cash for paying obligations of short-term nature. The sufficiency or insufficiency of current assets should be assessed by comparing them with short-term (current) liabilities. If current assets can pay off current liabilities, then liquidity position will be satisfactory.

On the other hand, if current liabilities may not be easily met out of current assets then liquidity position will be bad. The bankers, suppliers of goods and other short-term creditors are interested in the liquidity of the concern. They will extend credit only if they are sure that current assets are enough to pay out the obligations. To measure the liquidity of a firm, the following ratios can be calculated:

1. Current Ratio or Working Capital Ratio
2. Quick or Acid Test or Liquid Ratio
3. Absolute Liquid Ratio or Cash Position Ratio

Note

The ideal current ratio is 2:1 The ideal quick ratio is 1:1 The ideal cash ratio is 0.5:1

1. Current Ratio**Meaning**

This ratio establishes a relationship between current assets and current liabilities.

Objective

The objective of computing this ratio is to measure the ability of the firm to meet its short-term obligations and to reflect the short-term financial strength/solvency of a firm. In other words, the objective is to measure the safety margin available for short-term creditors.

Components

There are two components of this ratio which are as under:

a) Current Assets

Current assets mean the assets which are held for their conversion into cash within a year and include the following:

Cash Balance	Bank Balance
Marketable Securities	Debtors (less Provision)
Bills Receivable (less Provisions)	Stock of all types, viz., Raw Materials.
Prepaid Expenses	Work-in-progress. Finished Goods.
Incomes accrued but not due	Short-term Loans and Advances
Advance Payment of tax	(Debit Balances)
Tax reduced at source (Debit Balance)	Incomes due but not received

Note: The 'provision of bad and doubtful debts/bills' is deducted from the total amount of trade debtors/bills receivable in order to ascertain the realizable value of trade debtors/bills receivable.

b) Current Liabilities

Current Liabilities are those obligations which are payable within a short period of generally one year and include the following:

Creditors for Goods Creditors for Expenses

Creditors for goods	Creditors for expenses
Bills Payable	Bank Overdraft
Short-term Loans and Advances	Income received-in-advance
Provision for Tax	Unclaimed dividend

Short-term Loans and Advances Income received-in-advance Provision for Tax Unclaimed dividend

Computation: This ratio is computed by dividing the current assets by the current liabilities. This ratio is usually expressed as a pure ratio **for example**, 2:1. In the form of a formula, this ratio may be expressed as under:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Interpretation of Current Ratio

A relatively high current ratio is an indication that the firm is liquid and has the ability to pay its current obligations in time as and when they become due.

On the other hand, a relatively low current ratio represents that the liquidity position of the firm is not good and the firm shall not be able to pay its current liabilities in time without facing difficulties.

A ratio equal or near to the rule of thumb of 2:1, i.e., current assets double the current liabilities is considered to be satisfactory.

The idea of having doubled the current assets as compared to current liabilities is to provide for delays and losses in the realization of current assets.

However, the rule of 2:1 should not be blindly followed while making interpretation of the ratio, because firms having less than 2:1 ratio may be having a better liquidity than even firms having more than 2:1 ratio.

This is so because the current ratio measures only the quantity of current assets and not quality of current assets.

A high current ratio may not be favorable due to the following reasons:

- i) There may be slow moving stocks. The stocks will pile up due to poor sale.
- ii) The figures of debtors may go up because debt collection is not satisfactory.
- iii) The cash or bank balances may be lying idle because of insufficient investment opportunities.

On the other hand, a low current ratio may be due to the following reasons:

- i) There may not be sufficient funds to pay off liabilities.
- ii) The business may be trading beyond its capacity. The resources may not warrant the activities.

2. Quick Ratio

Meaning

This ratio establishes a relationship between quick assets and current liabilities.

Objective

The objective of computing this ratio is to measure the ability of the firm to meet its short-term obligations as and when due without relying upon the realization of stock.

Components

There are two components of this ratio which are as under:

a) Quick Assets

Which mean those current assets which can be converted into cash immediately or at a short notice without a loss of value and include the following:

- a) Cash Balances
- b) Bank Balances
- c) Marketable Securities Debtors
- d) Bills Receivable
- e) Short-term Loans and
- f) Advances

b) Current Liabilities

(as explained earlier in Current Ratio)

Computation

This ratio is computed by dividing the quick assets by the current liabilities. This ratio is usually expressed as a pure ratio, e.g., 1:1. In the form of a formula, this ratio may be expressed as under:

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

Interpretation

It indicates rupees of quick assets available for each rupee of current liability.

Traditionally, a quick ratio of 1:1 is considered to be a satisfactory ratio.

However, this traditional rule should not be used blindly since a firm having a quick ratio of more than 1, may not be meeting its short-term obligations in time if its current assets consist of doubtful and slow paying debtors while a firm having a quick ratio of less than 1, may be meeting its short-term obligations in time because of its very efficient inventory management.

3. Absolute Liquid Ratio

Meaning

Although receivables, debtors and bills receivable are generally more liquid than inventories, yet there may be doubts regarding their realization into cash immediately or in time.

Objective

The objective of computing this ratio is to calculate it (absolute liquid ratio) together with current ratio and acid test ratio so as to exclude even receivables from the current assets and find out the absolute liquid assets.

Components

There are two components of this ratio which are as under:

a) Absolute liquid assets

Absolute liquid assets include cash in hand and at bank and marketable securities or temporary investments.

b) Current liabilities

As explained in current ratio.

Computation

This ratio is computed by dividing absolute liquid assets by current liabilities. The acceptable norm for this ratio is 50% or 0.5:1 or 1:2, i.e. Re. 1 worth absolute liquid assets are considered adequate to pay ` 2 worth current liabilities in time as all the creditors are not expected to demand cash at the same time and then cash may also be realized from debtors and inventories.

In the form of formula this ratio may be expressed as under:

$$\text{Absolute Liquid Ratio} = \frac{\text{Absolute Liquid Assets}}{\text{Current Liabilities}}$$

4.5.2 Solvency and Leverage Ratios

Q25. Explain different types of leverage ratios.

Ans : (Jan.-21, June-18)

These ratios provide an insight into the financial techniques used by a firm and focus, as a consequence, on the long term solvency position with regard to, periodic payment of interest during the period of loan, repayment of principal on maturity or in predetermined installments on due dates.

The following ratios serve the purpose of determining the solvency of the concern.

1. Structure Ratios

- i) Debt-Equity Ratio.
- ii) Funded Debt to Total Capitalization Ratio.
- iii) Proprietary Ratio or Equity Ratio.

2. Coverage Ratios

- i) Interest Coverage Ratio (or Time-interest Earned Ratio or Debt-Service Ratio).
- ii) Cash to Debt Service Ratio.
- iii) Dividend Coverage Ratio.

3. Capital Gearing Ratio

1. Structure Ratios

The capital structure ratio shows the percent of long term financing represented by long term debt.

i) Debt-Equity Ratio

Meaning

This ratio establishes a relationship between long-term debts and share-holders' funds.

Objective

The objective of computing this ratio is to measure the relative proportion of debt and equity in financing the assets of a firm.

Components

There are two components of this ratio which are as under:

1. Long-Term Debts

Long- term debts mean long-term loans whether secured or unsecured (e.g., debentures, bonds, loans from financial institutions).

2. Shareholders' Funds

Shareholder's funds mean equity share capital plus preference share capital plus reserves and surplus minus fictitious assets (e.g., preliminary expenses)

Computation

This ratio is computed by dividing the long-term debts by the shareholders' funds. This ratio is usually expressed as a pure ratio e.g., 2:1. In the form of a formula, this ratio may be expressed as under:

$$\text{Debt - Equity Ratio} = \frac{\text{Long - term Debts}}{\text{Shareholder's Funds}}$$

(or)

$$\text{Debt to Equity Ratio} = \frac{\text{External Equities}}{\text{Internal Equities}}$$

Interpretation

It indicates the margin of safety to long-term creditors. A low debt-equity ratio implies the use of more equity than debt which means a larger safety margin for creditors since owner's equity is treated as a margin of safety by creditors and vice versa.

ii) Funded Debt to Total Capitalization Ratio

Meaning

This ratio establishes a link between the long-term funds raised from outsiders and total long-term funds available in the business.

Components

The two words used in this ratio are:

1. Funded debt = Debentures + Mortgage loans + Bonds + Other long-term loans.
2. Total Capitalization = Equity Share Capital + Preference Share Capital + Reserves and

Surplus + Other Undistributed Reserves +
Debtures + Mortgage Loans + Bonds +
Other long-term loans.

Computation

Funded debt is that part of total capitalization which is financed by outsiders. This ratio can be calculated as under:

Funded Debt to Total Capitalization Ratio

$$= \frac{\text{Funded debt}}{\text{Total Capitalisation}}$$

Interpretation

Though there is no 'rule of thumb' but still the lesser the reliance on outsiders the better it will be. If this ratio is smaller, better it will be, upto 50% or 55% this ratio may be too tolerable and not beyond.

iii) Proprietary Ratio/Equity Ratio

Meaning

This ratio measures a relationship between proprietors' funds and the total assets.

Objective

The objective of computing this ratio is to find out how the proprietors have financed the assets.

Components

There are two components of this ratio which are as under:

1. Proprietors' Funds (excluding fictitious assets like preliminary exp.)
2. Total Assets

Computation

This ratio is computed by dividing the proprietors' funds by total assets. The ratio can be calculated as under:

$$\text{Proprietary Ratio} = \frac{\text{Proprietors Funds}}{\text{Total Assets}}$$

Note: Proprietors' Funds mean the Shareholders' Funds.

2. Coverage Ratios

Coverage ratios tell us the debt servicing commitments and sourcing the funds to meet them. These ratios are used to test the adequacy of cash flows generated through earnings for the purposes of meeting debt and lease obligations.

i) Interest Coverage Ratio/ Debt-Service Ratio

Meaning

This ratio establishes a relationship between net profits before interest and taxes and interest on long-term debt.

Objective

The objective of computing this ratio is to measure the debt-servicing capacity of a firm so far as fixed interest on long-term debt is concerned.

Components

There are two components of this ratio which are as under:

1. Net profits before interest and taxes;
2. Interest on long-term debts.

Computation

This ratio is computed by dividing the net profits before interest and taxes by interest on long-term debt. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as under:

Interest Coverage Ratio

$$= \frac{\text{Net Profit before Interest and Taxes}}{\text{Interest on Long - term debt}}$$

ii) Cash to Debt Service Ratio

Computation

Cash to debt service ratio, also known as Debt Cash Flow Coverage Ratio, is an improvement over the interest coverage ratio and is calculated as follows:

Cash to Debt Service Ratio

(or)

$$\text{Debt Cash Flow Coverage} = \frac{\text{Annual Cash Flow before interest and taxes}}{\text{Interest} + \frac{\text{Sinking Fund Appropriation on Debt}}{1 - \text{Tax Rate}}}$$

$$\text{or CFCD} = \frac{\text{CF}}{1 + \frac{\text{SFD}}{1 - T}}$$

Where,

CF = Annual Cash Flow before Interest and Tax

I = Interest charges

SFD = Sinking Fund Appropriation on Debt

T = Rate of Tax

Interpretation

The logic of the ratio is that the interest payments are to be made out of cash inflow of the business and not from the profits and apart from interest, expenses sinking fund appropriations on debt (which are generally made by various firms to enable itself to make repayment of the loans) should be considered to find out debt cash flow coverage as a measure of long-term solvency of a firm. Generally, higher the coverage better it is, as far as, long-term solvency of the firm is concerned.

iii) Dividend Coverage Ratio**Meaning**

This ratio measures the ability of a firm to pay dividend on preference shares which carry a stated rate of return. The ratio is expressed in 'X number of times'.

Computation

Dividend Coverage Ratio = EAT/ (Preference Dividend)

Interpretation

This ratio indicates margin of safety available to the preference share holders. Higher the ratio, more desirable on the part of preference share holders.

iv) Capital Gearing Ratio**Meaning**

The term 'capital gearing' is used to describe the relationship between equity share capital including reserves and surpluses to preference share capital and other fixed interest-bearing loans.

Computation

This ratio can be calculated as under:

$$\text{Capital Gearing Ratio} = \frac{\text{Equity Share Capital} + \text{Reserve and Surplus}}{\text{Preference Capital} + \text{Long - term debt bearing fixed interest}}$$

Interpretation

If preference share capital and other fixed interest bearing loans exceed the equity share capital including reserves, the firm is said to be highly geared. The firm is said to be in low gear if preference share capital and other fixed interest-bearing loans are less than equity capital and reserves.

Note: Long term debts bearing fixed interest are raised through debt and long term loan.

4.5.3 Turnover Ratios**Q26. Explain briefly about various activity ratios?**

Ans :

(Jan.-21, June-18)

Activity Ratios

Funds are invested in various assets in business to make sales and earn profits. The efficiency with which assets are managed directly affects the volume of sales. The better the management of assets, the larger is the amount of sales and the profits. Activity ratios measure the efficiency or effectiveness with which a firm manages its resources or assets. These ratios are also called turnover ratios because they indicate the speed with which assets are converted or turned over into sales. It includes the following ratios:

1. Capital Turnover Ratio
2. Fixed Assets Turnover Ratio
3. Working Capital Turnover Ratio
4. Stock Turnover Ratio
5. Debtors Turnover Ratio (or Receivables Turnover Ratio).
6. Creditors Turnover Ratio (or Payables Turnover Ratio).

1. Capital Turnover Ratio**Meaning**

This ratio establishes a relationship between net sales and capital employed.

Objective

The objective of computing this ratio is to determine the efficiency with which the capital employed is utilized.

Components

There are two components of this ratio which are as under:

1. Net Sales
2. Capital Employed

Computation

This ratio is computed by dividing the net sales by the capital employed. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as under:

$$\text{Capital Turnover Ratio} = \frac{\text{Net Sales}}{\text{Capital Employed}}$$

Net sales = Gross Sales – Sales return

Capital Employed = Long-term debt + Shareholder's Fund 1

2. Fixed Assets Turnover Ratio

Meaning

This ratio establishes a relationship between net sales and fixed assets.

Objective

The objective of computing this ratio is to determine the efficiency with which the fixed assets are utilized.

Components

There are two components of this ratio which are as under:

1. Net Sales
2. Net Fixed (operating) Assets

Note: An advance for purchase of a fixed asset is not an operating fixed asset.

Computation

This ratio is computed by dividing the net sales by the net fixed assets. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as under:

$$\text{Fixed Assets Turnover Ratio} = \frac{\text{Net Sales}}{\text{Net Total Fixed Assets}} = \frac{\text{Cost of goods sold}}{\text{Net Total Fixed Assets}}$$

Net Sales = Gross Sales – Sales Return

Net Fixed (operating) Assets = Gross Fixed Assets – Depreciation

Interpretation

It indicates the firm's ability to generate sales per rupee of investment in fixed assets. In general, higher the ratio, the more efficient the management and utilization of fixed assets, and vice versa. It may be noted that there is no direct relationship between sales and fixed assets since the sales are influenced by other factors as well, e.g., quality of product, delivery terms, credit terms, after sales service, advertisement and publicity, etc.

3. Working Capital Turnover Ratio

Meaning

This ratio establishes a relationship between net sales and working capital.

The working capital is taken as:

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

Objective

The objective of working capital turnover ratio is to indicate the velocity of the utilization of net working capital. This ratio indicates the number of times the working capital is turned over in the course of a year.

This ratio measures the efficiency with which the working capital is being used by a firm.

Components

The components of this ratio are as under:

- 1) Net Sales
- 2) Working Capital

Computation

This ratio is computed by dividing the net sales by the working capital. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as under:

$$\text{Working Capital Turnover Ratio} = \frac{\text{Net Sales}}{\text{Working Capital}} = \frac{\text{Cost of goods sold}}{\text{Net Working Capital}}$$

Net Sales = Gross Sales – Sales return

Working Capital = Current Assets – Current Liabilities

Interpretation

It indicates the firm's ability to generate sales per rupee of working capital. In general, higher the ratio, the more efficient the management and utilization of working capital and vice versa.

4. Stock Turnover Ratio**Meaning**

This ratio establishes a relationship between costs of goods sold and average inventory.

Objective

The objective of computing this ratio is to determine the efficiency with which the inventory is utilized.

Components

There are two components of this ratio which are as under:

- 1) Cost of Goods Sold
- 2) Average Inventory

Computation

This ratio is computed by dividing the cost of goods sold by the average inventory. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as under:

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

Cost of Goods sold = Sales – Gross Profit

or

Cost of Goods sold = Opening Stock + Purchases + Direct Expenses – Closing Stock

$$\text{Average Stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{\text{Average Stock}}$$

Note:

- i) If opening stock is not known, closing stock can be taken.
- ii) If there is any difficulty in calculating cost of goods sold, then

$$\text{Stock Turnover Ratio} = \frac{\text{Net Sales}}{\text{Average Stock}}$$

Interpretation

It indicates the speed with which the inventory is converted into sales. In general, a high ratio indicates efficient performance since an improvement in the ratio shows that either the same volume of sales has been maintained with a lower investment in stocks, or the volume of sales has increased without any increase in the amount of stocks. However, too high ratio and too low ratio, call for further investigation. A too high ratio may be the result of a very low inventory levels which may result in frequent stock-outs and thus the firm may incur high stock out costs. On the other hand, a too low ratio may be the result of excessive inventory levels, slow-moving or obsolete inventory and thus, the firm may incur high carrying costs. Thus, a firm should have neither a very high nor a very low stock turnover ratio; it should have a satisfactory level.

Inventory Conversion Period (Stock Velocity)

It may also be of interest to see average time taken for clearing the stocks. This can be possible by calculating inventory conversion period. This period is calculated by dividing the number of days by inventory turnover. The formula may be as:

$$\text{Inventory Conversion Period} = \frac{12 \text{ months} / 52 \text{ weeks} / 365 \text{ days}}{\text{Stock Turnover Ratio}}$$

5 Debtors Turn over Ratio/Receivables Turn over Ratio**Meaning**

This ratio establishes a relationship between net credit sales and average trade debtors.

Objective

The objective of computing this ratio is to determine the efficiency with which the trade debtors are managed.

Components

There are two components of this ratio which are as under:

- 1. Net Credit Sales
- 2. Average Trade Debtors

Computation

This ratio is computed by dividing the net credit sales by average trade debtors. This ratio is usually expressed as 'x' number of times. In the form of a formula, this ratio may be expressed as under:

$$\text{Debtors Turn over Ratio} = \frac{\text{Net Credit Sales}}{\text{Average Trade Debtors}}$$

$$\text{Net Credit Sales} = \text{Gross Credit Sales} - \text{Sales Returns}$$

$$\text{Trade Debtors} = \text{Sundry Debtors} + \text{Bills Receivables and Accounts Receivables}$$

$$\text{Average Trade Debtors} = \frac{\text{Opening Trade Debtors} + \text{Closing Trade Debtors}}{2}$$

Interpretation

It indicates the number of times the debtors are turned over during a year. Generally, the higher the value of debtor's turnover the more efficient is the management of debtors/sales or more liquid are the debtors. Similarly, low debtors turnover implies inefficient management of debtors/sales and less liquid debtors. But a precaution is needed while interpreting a very high debtors turnover ratio because a very high ratio may imply a firm's inability due to lack of resources to sell on credit thereby losing sales and profits. There is no 'rule of thumb' which may be used as a norm to interpret the ratio as it may be different from firm to firm, depending upon the nature of business. This ratio should be compared with ratios of other firms doing similar business and a trend may also be found to make a better interpretation of the ratio.

Debt Collection Period (or Debtors' Velocity)

The debt collection period represents the average number of days for which a firm has to wait before its receivables are converted into cash. The ratio can be calculated as follows:

$$\text{i) Debt Collection Period} = \frac{\text{Average Trade Debtors (Drs + B/R)}}{\text{Sales per day}}$$

$$\text{ii) Sales per day} = \frac{\text{Net Sales}}{\text{No. of working days}}$$

or Debt Collection Period

$$= \frac{\text{Average Trade Debtors}}{\frac{\text{Net Sales}}{\text{No. of working days}}} = \frac{\text{Average Trade Debtors} \times \text{No. of working days}}{\text{Net Sales}}$$

If the period is in months:

$$\text{Debt Collection Period} = \frac{\text{Average Trade Debtors} \times \text{No. of Months}}{\text{Net Sales}}$$

6. Creditors Turnover Ratio/Payables Turnover Ratio

Meaning

This ratio establishes a relationship between net credit purchases and average trade creditors.

Objective

The objective of computing this ratio is to determine the efficiency with which the creditors are managed.

Components

There are two components of this ratio which are as under:

1. Net credit Purchases
2. Average Trade Creditors

Computation

This ratio is computed by dividing the net credit purchases by average trade creditors. This ratio is usually expressed as 'x' number of times. In the form of formula, this ratio may be expressed as under:

$$\text{Creditors Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Trade Creditors}}$$

$$\text{Net credit Purchases} = \text{Gross Credit Purchases} - \text{Purchases Returns}$$

$$\text{Average Trade Creditor} = \frac{\text{Opening Trade Creditor} + \text{Closing Trade Creditor}}{2}$$

Interpretation

The average payment period ratio represents the average number of days taken by the firm to pay its creditors. Generally, lower the ratio, the better is the liquidity position of the firm and higher the ratio, less liquid is the position of the firm. But a higher payment period also implies greater credit period enjoyed by the firm and consequently larger the benefit reaped from credit suppliers. But one has to be careful in interpreting this ratio, as higher ratio may also imply lesser discount facilities availed or higher prices paid for the goods purchased on credit. To make correct interpretation of this ratio, a comparative analysis of different firms in the same industry and the trend may be found for various years.

Debt Payment Period (or Creditors' Velocity)

This period shows an average period for which the credit purchases remain outstanding or the average credit period actually availed of.

$$\begin{aligned} \text{Debt Payment Period} &= \frac{\text{Average Trade Creditors}}{\text{Average Net Credit Purchases Per day}} \\ &= \frac{12 \text{ months} / 52 \text{ weeks} / 365 \text{ days}}{\text{Creditors Turnover Ratio}} \end{aligned}$$

$$\text{Average Net Credit Purchases Per day} = \frac{\text{Net Credit Purchases for the year}}{\text{No. of working days in the year}}$$

7. Total Assets Turnover Ratio**Meaning**

This ratio is the relationship between sales and total asset.

Objective

The objective is to measure the overall performance and activity of the business organization.

Computation

It is computed by dividing sales by total assets. The following formula is applied to compute this ratio:

$$\text{Total Assets Turnover} = \frac{\text{Sales}}{\text{Total Assets}}$$

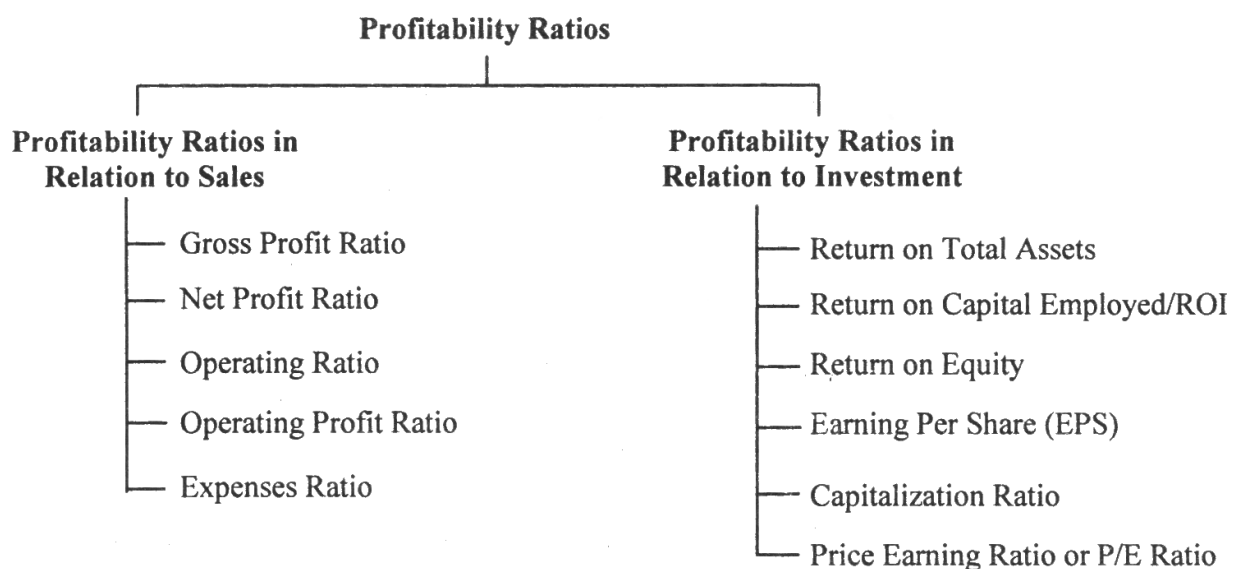
4.5.4 Profitability Ratios

Q27. Explain different types of profitability ratios.

Ans. :

(Jan.-21, June-18)

The primary objective of a business undertaking is to earn profits. Profit earning is considered essential for the survival of the business. A business needs profits not only for its existence but also for expansion and diversification. "Profits are thus, a useful measure of overall efficiency of a business. Profits to the management are the test of efficiency and a measurement of control; to owners, a measure of worth of their investment; to the creditors, the margin of safety; to employees, a source of fringe benefits; to government, a measure of tax-paying capacity and the basis of legislative action; to customers, a hint to demand for better quality and price cuts; to an enterprise, less cumbersome source of finance for growth and existence and finally to the country, profits are an index of economic progress. Profitability ratios are calculated to measure the overall efficiency of the business." Generally, profitability ratios are calculated either in relation to sales or in relation to investment. To measure the profitability of a firm, the following ratios can be calculated:



A) Profitability Ratios in Relation to Sales

i) Gross Profit Ratio

Meaning: This ratio measures the relationship between gross profit and net sales.

Objective: Gross profit ratio is calculated to know:

1. Whether the business is in a position to meet operating expenses or not, and
2. How much the share holders can get after meeting such expenses?

Components

There are two components of this ratio which are as under:

1. Gross profit
2. Net Sales

Cost of Goods Sold is calculated as under:

Particular	₹
A: Opening Stock	xxx
B: Add: Net Purchases	xxx
C: Add: Direct Expenses (for example carriage inward)	xxx
D: Less: Closing Stock	xxx
Cost of Goods Sold (A + B + C – D)	xxx

Computation

This ratio is computed by dividing the gross profit by the net sales. It is expressed as percentage. In the form of a formula, this ratio may be expressed as under:

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}} \times 100$$

Gross Profit = Net Sales - Cost of Good Sold

Net Sales = Gross Sales - Sales Return

Gross profit is higher because of the following factors:

1. When sale price is higher.
2. Cost of sales remains constant.
3. If there is an increase in the volume of sales.
4. If closing stock is valued at a higher price.

Interpretation

This ratio indicates:

- (a) An average gross margin earned on a sales of ₹ 100,
- (b) The limit beyond which the fall in sales prices will definitely result in losses, and,
- (c) What portion of sales is left to cover operating expenses, (other than the cost of goods sold) and non-operating expenses (for example, interest on borrowed funds), to pay dividend and to create reserves. Higher the ratio, the more efficient the production and/or purchase management.

ii) Net Profit Ratio**Meaning**

This ratio measures the relationship between net profit and net sales.

Objective

The main objective of computing this ratio is to determine the overall profitability due to various factors such as operational efficiency, trading on equity, etc.

Components

There are two components of this ratio which are as under:

1. Net Profit
2. Net Sales

Computation

This ratio is computed by dividing the net profit by the net sales. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as under:

$$\text{Net Profit Ratio} = \frac{\text{Net Profit}}{\text{Net Sales}} \times 100$$

Note : The figure of net profit may be taken either before tax or after tax.

Interpretation

This ratio indicates,

- (a) An average net margin earned on a sale of ₹ 100
- (b) What portion of sales is left to pay dividend and to create reserves, and
- (c) Firm's capacity to withstand adverse economic conditions when selling price is declining, cost of production is rising and the demand for the product is falling. Higher the ratio, greater is the capacity of the firm to withstand adverse economic conditions and vice versa.

iii) Operating Ratio**Meaning**

This ratio measures the relationship between operation cost and net sales.

Objective

The main objective of computing this ratio is to determine the operational efficiency with which production and/or purchases and selling operations are carried on.

Components

There are two components of this ratio which are as under:

1. Operating cost which comprises:
 - i) Cost of goods sold, and
 - ii) Other operation expenses.

For example, administrative expenses, selling and distribution expenses, interest on short-term loans, discount allowed and bad debts.

2. Net sales = Gross Sales - Sales Returns.

Computation

This ratio is computed by dividing the operating cost by the net sales. This ratio is expressed as a percentage. In the form of a formula, this ratio may be expressed as under:

$$\text{Operating Ratio} = \frac{\text{Operating Cost}}{\text{Net Sales}} \times 100$$

$$\text{Operating Cost} = \text{Cost of Good Sold} + \text{Operating Expenses}$$

$$= \frac{\text{Cost of Good Sold} + \text{Operating Expenses}}{\text{Net Sales}} \times 100$$

Interpretation

This ratio indicates an average operating cost incurred on a sale of goods worth ` 100. Lower the ratio, greater is the operating profit to cover the non-operating expenses, to pay dividend and to create reserves and vice versa.

iv) Operating Profit Ratio

Meaning: This ratio measures the relationship between operating profits and net sales.

Objective: The main objective of computing this ratio is to determine the operational efficiency of the management. Components: There are two components of this ratio which are as under:

1. Operating Profit

It is the excess of gross profit over other operating expenses. (For example, office and administrative expenses, selling and distribution expenses, discount, bad debts, interest on short-term debts).

2. Net Sales

It means gross sales (both cash and credit minus sales returns).

Computation: This ratio is computed by dividing the operating profit by the net sales. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as under:

$$\text{Operating Profit Ratio} = \frac{\text{Operating Profit}}{\text{Net Sales}} \times 100$$

$$\text{Operating Profit} = \text{Net Sales} - \text{Operating Cost}$$

(or)

$$= \text{Net Sales} - (\text{Cost of Goods Sold} + \text{Administrative and Office Expenses} + \text{Selling and Distributive Expenses})$$

$$\text{Net Sales} = \text{Gross Sales} - \text{Sales Return}$$

Alternatively,

Operating Profit can also be calculated as

$$\text{Operating Profit} = \text{Net Profit} + \text{Non-operating Expenses} - \text{Non-operating income.}$$

This ratio can also be calculated as:

$$\text{Operating Profit Ratio} = 100 - \text{Operating Ratio.}$$

Interpretation

This ratio indicates:

- i) An average operating margin earned on a sale of ` 100, and
- ii) What portion of sales is left to cover non-operating expenses, to pay dividend and to create reserves.

v) **Expenses Ratio**

Meaning: Expenses ratios indicate the relationship of various expenses to net sales.

Objective: The objective of computing this ratio is to provide information about increase or decrease in expenses. Lower expense ratio is considered better for the business.

Computation: This can be calculated by using the following formula:

$$\text{Expense Ratio} = \frac{\text{Amount of Expenses}}{\text{Net Sales}} \times 100$$

One can also calculate separate expense ratios, such as ratio of administrative expenses to net sales, ratio of selling and distribution expenses to sales, financial expenses to sales etc. The above ratios can be calculated as below:

$$\text{For Administrative Expenses to Net Sales Ratio} = \frac{\text{Administrative and Office Expenses}}{\text{Net Sales}} \times 100$$

$$\text{For Selling \& Distribution Expenses to Net Sales Ratio} = \frac{\text{Selling and Distribution Expenses}}{\text{Net Sales}} \times 100$$

$$\text{For Financial Expenses to Net Sales Ratio} = \frac{\text{Financial Expenses and Interest}}{\text{Net Sales}} \times 100$$

Interpretation: The expense ratio indicates about efficiency of the business.

B) **Profitability Ratio in Relation to Investment**i) **Return on Total Assets**

Meaning: This ratio measures a relationship between net profit before interest and tax, and total assets.

Objective: The objective of computing this ratio is to find out how efficiently the total assets have been used by the management.

Components: There are two components of this ratio which are as under:

1. Net Profit before interest and tax.
2. Total assets (excluding fictitious assets,

For example, preliminary expenses.

Computation: This ratio is computed by dividing the net profit before interest and tax by total assets. This ratio is expressed as a percentage. In the form of a formula, this ratio may be expressed as under:

$$\text{Return on Total Assets} = \frac{\text{Net Profit before Interest and Tax}}{\text{Total Assets}} \times 100$$

Interpretation: This ratio indicates the firm's ability of generating profit per rupee of total assets. Higher the ratio, the more efficient the management and utilization of total assets.

ii) Return on Capital Employed/Return on Investment

Meaning: This ratio measures a relationship between net profit before interest and tax and capital employed.

Objective: The objective of computing this ratio is to find out how efficiently the long-term funds supplied by the creditors and shareholders have been used.

Components: There are two components of this ratio which are as under:

1. Net profit before interest and tax.
2. Capital employed which refers to long-term funds supplied by the long-term creditors and shareholders. It comprises the long-term debt and shareholders' funds.

Computation

This ratio is computed by dividing the net profit before interest and tax by capital employed. It is expressed as a percentage. In the form of formula, this ratio may be expressed as under:

$$\text{Return on Capital Employed} = \frac{\text{Net Profit before Interest and Tax}}{\text{Capital Employed}} \times 100$$

Note: Generally return on capital employed is taken as return on investments.

The term 'capital employed' refers to the total of investments made in a business and can be defined in a number of ways. The three most widely used definitions of this term are:

- i) **Gross Capital Employed:** The term 'gross capital employed' usually comprises the total assets, fixed as well as current assets used in a business.

$$\text{Gross Capital Employed} = \text{Fixed Assets} + \text{Current Assets}$$

- ii) **Net Capital Employed:** The term 'net capital employed' comprises the total assets used in a business less its current liabilities.

$$\text{Net Capital Employed} = \text{Total Assets} - \text{Current Liabilities}$$

- iii) **Proprietors' Net Capital Employed:** Proprietors' net capital employed means shareholders' funds or investments in the business. This term is the same as return on shareholders' investment.

$$\text{Proprietors' Net Capital Employed} = \text{Fixed Assets} + \text{Current Assets} - \text{Outside Liabilities} \\ \text{(both long-term and short-term)}$$

Interpretation

This ratio indicates the firm's ability of generating profit per rupee of capital employed. Higher the ratio, the more efficient the management and utilization of capital employed.

iii) Return on Equity or Return on Equity Shareholders' Funds

Meaning: This ratio measures a relationship between net profit after interest, tax, and preference dividend, and equity shareholders' funds.

Objective: The objective of computing this ratio is to find out how efficiently the funds supplied by the equity shareholders have been used.

Components: There are two components of this ratio, which are as under:

1. Net profit after interest, tax and preference dividend (including participating dividend, if any, due to participating preference shareholders).

2. Equity shareholders' funds**Computation**

This ratio is computed by dividing the net profit after interest, tax and preference dividend by shareholders' funds. It is expressed as a percentage. In the form of a formula, this ratio may be expressed as under:

$$\text{Return on Equity Shareholder's Funds} = \frac{\text{Net Profit after interest, tax and preference dividend}}{\text{Equity Shareholder's Funds}} \times 100$$

$$\text{Equity Shareholder Fund} = \text{Equity Share Capital} + \text{Preference Share Capital} + \text{Reserve and Surplus} - \text{Fictitious Assets (if any)}$$

Interpretation: This ratio indicates the firm's ability of generating profit per rupee of equity shareholders' funds. Higher the ratio, the more efficient the management and utilization of equity shareholders' funds.)

iv) Earning Per Share (EPS)

Meaning: This ratio measures the earnings available to an equity shareholder on a per share basis.

Objective: The objective of computing this ratio is to measure the profitability of the firm on per equity share basis.

Components: There are two components of this ratio which are as under:

- 1) Net profit after interest, tax and preference dividend;
- 2) Number of equity shares

Computation: This ratio is computed by dividing the net profit after interest, tax and preference dividend by the number of equity shares. It is expressed as an absolute figure. In the form of a formula, this ratio may be expressed as under:

$$\text{Earning Per Share} = \frac{\text{Net Profit after interest, tax and preference dividend}}{\text{Number of Equity Shares}} \times 100$$

Interpretation: In general, higher the figure, better it is and vice versa. While interpreting this ratio, it must be seen whether there is any increase in equity shareholders' funds as a result of retained earnings without any change in numbers of outstanding shares.

For example, in the case of a company which, is following a practice of ploughing.

v) Capitalization Ratio

Meaning: This ratio measures the relationship between market price and earnings per share.

Computation: This ratio is calculated as given below:

$$\text{Capitalization Ratio} = \frac{\text{Earnings per share}}{\text{Market price per share}} \times 100$$

If market price is taken along with dividend received, this is known as **Dividend Yield Ratio**.

Only change is that in place of earnings per share, dividend per share is written. In a formula, it is:

$$\text{Dividend Yield Ratio} = \frac{\text{Dividend per share}}{\text{Market price per share}} \times 100.$$

vi) Price Earning Ratio or P/E Ratio (Earning Yield Ratio)

Meaning: This ratio measures the relationship between market price per equity share and earnings per share.

Objective: The objective of computing this ratio is to make an estimate of appreciation in the value of a share of a company and is widely used by investors to decide whether or not to buy shares in a particular company.

Computation: The ratio is calculated as:

$$\text{Price earnings ratio} = \frac{\text{Market price per equity share}}{\text{Earnings per share}}$$

$$\text{Earning Yield Ratio} = \frac{\text{Earnings per share}}{\text{Market price per share}} \times 100$$

Interpretation: Generally, higher the price-earning ratio, the better it is. If the P/E ratio falls, the management should look into the causes that have resulted into the fall of this ratio.

PROBLEMS ON RATIO ANALYSIS

11. From the following information, calculate liquidity ratios for the two companies and give your interpretation of the liquidity position of the companies as revealed by the ratios.

	(Rupees in Lakhs)	
	Company X	Company Y
Cash	360	280
Debtors	2,800	6,400
Inventory	4,000	12,000
Bills payable	600	2,000
Creditors	1,600	10,000
Accrued Expenses	200	250
Tax payable	1,200	1,000

Sol.:

- (i) **Current Ratio** = $\frac{\text{Current Assets}}{\text{Current Liabilities}}$

Current Assets	X	Y	Current Liabilities	X	Y
Cash	360	280	Bills payable	600	2,000
Debtors	2,800	6,400	Creditors	1,600	10,000
Inventory	4,000	12,000	Accrued expenses	200	250
			Tax payable	1,200	1,000
	7,160	18,680		3,600	13,250

$$\text{Current Ratio for X Co} = \frac{7,160}{3,600} = 1.98:1$$

$$\text{Current Ratio for Y Co} = \frac{18,680}{13,250} = 1.41:1$$

(ii) **Quick Ratio** = $\frac{\text{Quick Assets}}{\text{Current Liabilities}}$

Quick Assets = Current Assets – [Stock and Prepaid expenses]

Quick ratio for x co = $7,160 - 4,000 = \text{Rs. } 3,160$

Quick ratio for y co = $18,680 - 12,000 = \text{Rs. } 6,680$

$$\text{Quick ratio for x co} = \frac{3,160}{3,600} = 0.877$$

$$\text{Quick ratio for y co} = \frac{6,680}{13,250} = 0.50$$

(iii) **Absolute liquidity ratio** = $\frac{\text{Absolute Liquid Assets}}{\text{Current Liabilities}}$

Absolute liquid assets = QA – [Debtors + B/R]

Absolute liquid assets for x co. = $3,160 - 2,800 = 360$

Absolute liquid assets for y co. = $6,680 - 6,400 = 280$

Absolute Liquidity Ratio

$$\text{x co} = \frac{360}{3,600} = 0.1$$

$$\text{y co} = \frac{280}{13,250} = 0.02$$

12. You are given Trading and Profit & Loss Account of Mahesh Company limited for the year ended 31st December 1992.

Trading and Profit & Loss Account

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Opening Stock	30,000	By Net Sales	1,10,000
To Purchases	60,000	By Closing Stock	20,000
To Wages	10,000		
To Gross Profit (c/d)	30,000		
	1,30,000		1,30,000
To Administrative Expenses	10,000	By Gross Profit (b/d)	30,000
To Selling & Distribution Expenses	5,000	By Sundry Receipt	5,000
To Net Profit	20,000		
	35,000		35,000

Calculate

1. Gross Profit Ratio
2. Net Profit Ratio
3. Operating Ratio
4. Operating Profit Ratio

Sol.:

1. **Gross Profit Ratio** = $\frac{\text{Gross profit}}{\text{Net sales}} \times 100$

$$\begin{aligned}\text{GP Ratio} &= \frac{30,000}{1,10,000} \times 100 \\ &= 27.27\%\end{aligned}$$

2. **Net Profit Ratio**

$$\text{NP Ratio} = \frac{\text{Net profit}}{\text{Net sales}} \times 100$$

$$\text{NP Ratio} = \frac{20,000}{1,10,000} \times 100$$

$$\therefore \text{NP Ratio} = 18.18\%$$

3. **Operating Ratio**

$$\text{Operating Ratio} = \frac{\text{Cost of goods sold} + \text{Operating expenses}}{\text{Net sales}} \times 100$$

Cost of goods sold = Opening stock + Purchases + Direct expenses – Closing stock

$$\begin{aligned}\text{COGS} &= 30,000 + 60,000 + 10,000 - 20,000 \\ &= 1,00,000 - 20,000 \\ \text{COGS} &= 80,000\end{aligned}$$

$$\text{Operating Ratio} = \frac{\text{COGS} + \text{Operating expenses}}{\text{Net sales}} \times 100$$

$$\text{Operating Ratio} = \frac{80,000 + 15,000}{1,10,000} \times 100$$

$$= \frac{95,000}{1,10,000} \times 100$$

$$\therefore \text{Operating Ratio} = 86.36\%$$

4. **Operating Profit Ratio**

$$\begin{aligned}100 - \text{Operating Ratio} \\ &= 100 - 86.36\end{aligned}$$

$$\text{Operating Profit Ratio} = 13.64\%$$

13. From the following Trading and Profit & Loss A/c of Rim Zim Limited for the year ended 31st March 1993.

Calculate

- (i) Gross Profit Ratio
- (ii) Net Profit Ratio
- (iii) Operating Ratio
- (iv) Operating Profit Ratio. Rim Zim Company

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To Opening Stock	5,00,000	By Sales	
To Purchases	11,00,000	Cash 3,00,000	
To Wages	3,00,000	Credit 17,00,000	20,00,000
To Factory Overheads	2,00,000	By Closing Stock	6,00,000
To Gross Profit (c/d)	5,00,000		
	26,00,000		26,00,000
To Administration Expenses	75,000	By Gross Profit (b/d)	5,00,000
To Selling & Distribution Exp.	50,000	By Dividend on Investment	10,000
To Interest on Debentures	20,000	By Profit on Sale of Furniture	20,000
To Depreciation	60,000		
To Loss on Sale of Motorcar	5,000		
To Net Profit	3,20,000		
	5,30,000		5,30,000

Sol.:

1. **Gross Profit Ratio** = $\frac{\text{Gross profit}}{\text{Net sales}} \times 100$

$$\text{Gross Profit Ratio} = \frac{5,00,000}{20,00,000} \times 100$$

$$\therefore \text{GP Ratio} = 25\%$$

2. **Net Profit Ratio**

$$\text{NP Ratio} = \frac{\text{Net profit}}{\text{Net sales}} \times 100$$

$$= \frac{3,20,000}{20,00,000} \times 100$$

$$\therefore \text{NP Ratio} = 16\%$$

$$3. \quad \text{Operating Ratio} = \frac{\text{Cost of goods sold} + \text{Operating expenses}}{\text{Net sales}} \times 100$$

$$\begin{aligned} \text{(i) Cost of goods sold} &= \text{Opening stock} + \text{Purchases} + \text{Direct expenses} - \text{Closing stock} \\ &= 5,00,000 + 11,00,000 + 3,00,000 + 2,00,000 - 6,00,000 \\ &= 21,00,000 - 6,00,000 = 15,00,000 \end{aligned}$$

(OR)

$$\begin{aligned} \text{(i) COGS} &= \text{Net Sales} - \text{Gross Profit} \\ &= 20,00,000 - 5,00,000 = 15,00,000 \end{aligned}$$

$$\begin{aligned} \text{(ii) Operating Expenses} &= \text{Administrative Expenses} + \text{Selling and Distribution Expenses} \\ \text{Operating Expenses} &= 75,000 + 50,000 = 1,25,000 \end{aligned}$$

$$\text{Operating Ratio} = \frac{15,00,000 + 1,25,000}{20,00,000} \times 100$$

$$= \frac{16,25,000}{20,00,000} \times 100$$

$$\text{Operating Ratio} = 81.25\%$$

(4) Operating Profit Ratio

$$= 100\% - \text{Operating Ratio}$$

$$= 100\% - 81.25\%$$

$$\therefore \text{Operating Profit Ratio} = 18.75\%$$

14. From the information given below calculate**(1) EPS (2) EYR (3) P/E Ratio (4) DPS (5) DYR (6) Payout Ratio**

1000 Equity shares at Rs. 100/- each	Rs. 1,00,000
Reserves	50,000
Profit available to equity share holders	10,000
Market price per share	Rs. 25/-
Board of directors declared a dividend to equity holders	5%

*Sol:***1. Earnings Per Share (EPS)**

$$\text{EPS} = \frac{\text{Earnings available to equity share holders}}{\text{No. of Equity share holders}} \times 100$$

$$\text{EPS} = \frac{10,000}{10,000} \times 100$$

$$\therefore \text{EPS} = \text{Rs. 10}$$

2. Earnings Yield Ratio

$$\text{EYR} = \frac{\text{Earnings per share}}{\text{Market price per share}} \times 100$$

$$\text{EYR} = \frac{10}{25} \times 100$$

$$\therefore \text{EYR} = 40\%$$

3. Price Earning Ratio (P/E Ratio)

$$\text{P/E Ratio} = \frac{\text{Market price per share}}{\text{Earnings per share}}$$

$$\text{P/E Ratio} = \frac{25}{10}$$

$$\text{P/E Ratio} = 2.5 \text{ times}$$

4. Dividend Per Share (DPS)

$$\text{DPS} = \frac{\text{Dividend available to equity share holders}}{\text{No. of Equity share holders}}$$

Dividend available to equity share holders

$$\text{DPS} = \text{Equity share capital} \times \frac{\text{Ratio}}{100}$$

$$= 1,00,000 \times \frac{5}{100}$$

$$\text{DPS} = \frac{5,000}{1,000}$$

$$\therefore \text{DPS} = 5$$

5. Dividend Yield Ratio (DYR)

$$\text{DYR} = \frac{\text{Dividend per share}}{\text{Market price per share}} \times 100$$

$$\text{DYR} = \frac{5}{25} \times 100$$

$$\therefore \text{DYR} = 20\%$$

6. Payout Ratio

$$\text{Payout Ratio} = \frac{\text{Dividend per share}}{\text{Earnings per share}} \times 100$$

$$= \frac{5}{10} \times 100$$

$$\text{Payout Ratio} = 50\%$$

15. Net Sales Rs. 10,00,000

Gross Profit 30% on sales

Stock turnover Ratio = 7 times

Calculate closing stock value if it is 30,000 excess of opening stock.

Sol :

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

$$0.30 = \frac{\text{Gross profit}}{10,00,000}$$

$$\text{Gross profit} = 3,00,000$$

$$\text{Cost of Goods Sold} = \text{Net Sales} - \text{Gross Profit}$$

$$= 10,00,000 - 3,00,000$$

$$\therefore \text{COGS} = 7,00,000$$

$$\text{Stock turnover Ratio} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

$$7 = \frac{7,00,000}{\text{Average stock}}$$

$$\therefore \text{Average stock} = \frac{7,00,000}{7}$$

$$\text{Average stock} = \text{Rs. } 1,00,000.$$

$$\text{Average stock} = \frac{\text{Opening stock} + \text{Closing stock}}{2}$$

$$1,00,000 = \frac{x + (x + 30,000)}{2}$$

$$2,00,000 = x + (x + 30,000)$$

$$2,00,000 = 2x + 30,000$$

$$2x = 2,00,000 - 30,000$$

$$2x = 1,70,000$$

$$x = \frac{1,70,000}{2}$$

\therefore Opening Stock = 85,000
 Closing Stock = 85,000 + 30,000
 Closing Stock = 1,15,000

16. Following is the balance sheet of Vijay Industries Ltd. as on 31st March 2013. Calculate its current ratio, liquid ratio and also absolute liquid ratio and comment on the short-term solvency of this company:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital	7,80,000	Goodwill	4,60,000
Reserves and Surplus	2,12,000	Plant and Machinery	5,80,000
Debentures	3,80,000	Stock	3,00,000
Creditors	1,40,000	Debtors	1,60,000
Bills Payable	60,000	Cash Balance	48,000
Outstanding Expense	7,000	Prepaid Expenses	31,000
Total	15,79,000		15,79,000

Sol.:

a) **Current Ratio**

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\begin{aligned}
 \text{Current Assets} &= \text{Stock} + \text{Debtors} + \text{Cash Balance} + \text{Prepaid Expenses} \\
 &= 3,00,000 + 1,60,000 + 48,000 + 31,000 \\
 &= 5,39,000.
 \end{aligned}$$

$$\begin{aligned}
 \text{Current Liabilities} &= \text{Creditors} + \text{Bills Payable} + \text{Outstanding Expenses} \\
 &= 1,40,000 + 60,000 + 7,000 \\
 &= 2,07,000
 \end{aligned}$$

$$\begin{aligned}
 \therefore \text{Current Ratio} &= \frac{5,39,000}{2,07,000} \\
 &= 2.6:1
 \end{aligned}$$

Comments

The standard current ratio is 2:1 but in this case it is 2.6:1. It indicates that company have sufficient funds to meet its working capital requirements.

b) **Liquid Ratio**

$$\text{Liquid Ratio/Quick Ratio/Acid Test Ratio} = \frac{\text{Liquid / Quick Assets}}{\text{Current Liabilities}}$$

$$\text{Liquid Assets} = \text{Current Assets} - (\text{Stock} + \text{Prepaid Expenses})$$

$$= 5,39,000 - (3,00,000 + 31,000)$$

$$= 2,08,000$$

$$\therefore \text{Liquid Ratio} = \frac{2,08,000}{2,07,000} = 1:1$$

Comments

The ideal debt - equity rule for ratio is 2:1 but, in this case, it is only 0.68 which is very less this indicates that shareholders are not satisfied as the firm has not utilized the outsider's funds efficiently to enhance their earnings.

c) Absolute Liquidity Ratio

$$\text{Absolute Liquidity Ratio} = \frac{\text{Absolute Liquidity Ratio}}{\text{Current Liabilities}}$$

$$\text{Absolute Liquidity Assets} = \text{Cash Balance}$$

$$= 48,000$$

$$\therefore \text{Absolute Liquidity Ratio} = \frac{48,000}{2,07,000} = 0.23$$

Comments

The absolute liquid ratio is 0.23, which is lower than the standard 0.5. Hence it is not satisfactory and firm need to improve its short term financial position.

17. Current liabilities of a company are ₹ 5,60,000. Current Ratio is 5:2. Quick ratio is 2:1. Find the value of the stock.

Sol:

Given that,

$$\text{Current Liabilities} = 5,60,000$$

$$\text{Current Ratio} = 5:2$$

$$\text{Quick Ratio} = 2:1$$

$$\text{Stock} = ?$$

$$\text{Stock} = \text{Current Assets} - \text{Quick/Liquid Assets}$$

$$\text{Current Assets} = \text{Current Liabilities} \times \text{Current Ratio}$$

$$= 5,60,000 \times 5:2$$

$$\text{Current Assets} = 14,00,000$$

$$\text{Quick Assets} = \text{Current Liabilities} \times \text{Quick Ratio}$$

$$= 5,60,000 \times 2:1$$

$$\text{Quick Assets} = 11,20,000$$

$$\text{Stock} = 14,00,000 - 11,20,000$$

$$= 2,80,000.$$

18. From the following balance sheet, calculate:

- Current ratio
- Debt-equity ratio
- Fixed assets turnover ratio
- Return on capital employed and give your comments

Balance sheet as on 31.12.2014

Liabilities	Amount (₹)	Assets	Amount (₹)
Equity share capital	12,00,000	Fixed Assets	17,00,000
Reserves and surplus	3,00,000	Stock	3,00,000
9% Debentures	7,00,000	Debtors	2,80,000
Creditors	2,80,000	Marketable securities	200,000
Bills Payable	50,000	Cash	50,000
	25,30,000		25,30,000

Profit before interest and tax for the year are ₹ 50 lakhs and sales are ₹ 30 lakhs.

Sol:

a) Calculation of Current Ratio

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\begin{aligned} \text{Current assets} &= \text{Cash} + \text{Marketable securities} + \text{Debtors} + \text{Stock} \\ &= 50,000 + 2,00,000 + 2,80,000 + 3,00,000 \\ &= ₹ 8,30,000 \end{aligned}$$

$$\begin{aligned} \text{Current liabilities} &= \text{Bills payable} + \text{Creditors} \\ &= 50,000 + 2,80,000 \\ &= 3,30,000 \end{aligned}$$

$$= \frac{8,30,000}{3,30,000} = 2.5$$

Comments

The standard current ratio is 2:1 but in this case it is 2.5. It indicates that company have sufficient funds to meet its working capital requirements.

b) Calculation B = Debt – Equity ratio

$$\text{Debt equity ratio} = \frac{\text{Outsider's funds}}{\text{Shareholder's funds}}$$

$$\begin{aligned}
 &= \frac{\text{Debentures} + \text{Creditors} + \text{Bills payable}}{\text{Equity share} + \text{Reserves and surplus}} \\
 &= \frac{7,00,000 + 2,80,000 + 50,000}{12,00,000 + 3,00,000} \\
 &= \frac{10,30,000}{15,00,000} = 0.68
 \end{aligned}$$

Comments

The ideal debt - equity rule for ratio is 2 : 1 but, in this case, it is only 0.68 which is very less this indicates that shareholders are not satisfied as the firm has not utilized the outsider's funds efficiently to enhance their earnings.

c) Calculation of Fixed Assets Turnover Ratio

$$\begin{aligned}
 \text{Fixed assets turnover ratio} &= \frac{\text{Net sales}}{\text{Fixed assets}} \\
 &= \frac{30,00,000}{17,00,000} \\
 &= 1.76
 \end{aligned}$$

Comments

This ratio is not satisfactory as the firm did not make use of its fixed assets effectively.

$$\begin{aligned}
 \text{Return on capital employed} &= \frac{\text{Net profit before interest and tax}}{\text{Capital employed}} \times 100 \\
 &= \frac{50,00,000}{22,00,000} \times 100 \\
 &= 2.27 \times 100 \\
 &= 227.27
 \end{aligned}$$

Working Notes

$$\begin{aligned}
 \text{Capital employed} &= \text{Equity capital} + \text{Reserves} + \text{Debentures} \\
 &= 12,00,000 + 3,00,000 + 7,00,000 \\
 \text{Capital employed} &= ₹ 22,00,000
 \end{aligned}$$

Comment

This ratio indicates that the firm has the ability of generating profits efficiently.

19. Current Ratio = 2.5 ; 1

Working Capital = 50,000 calculate

Current Assets and Current Liabilities.

Sol.:

$$\text{Given Current Ratio} = \frac{\text{CA}}{\text{CL}} \quad \dots (1)$$

$$\text{Working Capital} = \text{CA} - \text{CL}$$

$$50,000 = \text{CA} - \text{CL}$$

$$50,000 + \text{CL} = \text{CA} \quad \dots (2)$$

\therefore Substituted to in No. 1

$$\text{CR} = \frac{\text{CA}}{\text{CL}}$$

$$2.5 = \frac{50,000 + \text{CL}}{\text{CL}}$$

$$2.5 \text{ CL} = 50,000 + \text{CL}$$

$$2.5 \text{ CL} - \text{CL} = 50,000$$

$$1.5 \text{ CL} = 50,000$$

$$\therefore \text{CL} = \frac{50,000}{1.5}$$

$$\therefore \text{Current Liabilities} = 33,333$$

$$\therefore \text{CA} = 50,000 + \text{CL}$$

$$= 50,000 + 33,333$$

$$\therefore \text{CA} = 83,333.$$

20. From the following Balance Sheet Calculate

(a) Current Ratio

(b) Quick Ratio

(c) Absolute Quick Ratio

(d) Debt Equity Ratio

(e) Proprietary Ratio

(f) Solvency Ratio

(g) Fixed Assets to Net worth Ratio

(h) Fixed Assets Ratio

(i) Capital Gearing Ratio

(j) Ratio of Inventory to working capital

(k) Ratio of current assets to fixed assets.

Liabilities	Amount	Assets	Amount
Equity Share Capital	10,00,000	Goodwill	5,00,000
6% Preference Share Capital	5,00,000	Plant & Machinery	6,00,000
General Reserve	1,00,000	Land & Building	7,00,000
Profit & Loss A/c	4,00,000	Furniture	1,00,000
12% Debentures	5,00,000	Stock in trade (Inventory)	6,00,000
Creditors	80,000	Bills Receivables	30,000
Bank over draft	20,000	Debtors	1,50,000
Bills Payable	1,24,000	Bank Balance	2,00,000
Provision for Taxation	1,76,000	Markatable Securities	20,000
	29,00,000		29,00,000

Sol :

a) Current Ratio

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\begin{aligned}\text{Current Assets} &= \text{Stock in trade} + \text{Bills Receivable} + \text{Debtors} + \text{Bank Balance} + \text{Markatable securities} \\ &= 6,00,000 + 30,000 + 1,50,000 + 2,00,000 + 20,000 \\ &= 10,00,000\end{aligned}$$

Current Liabilities

$$= 80,000 + 20,000 + 1,24,000 + 1,76,000 = 4,00,000$$

$$\begin{aligned}\therefore \text{Current Ratio} &= \frac{10,00,000}{4,00,000} \\ &= 2.5 : 1\end{aligned}$$

b) Quick Ratio

$$\frac{\text{Quick Ratio}}{\text{Quick Liabilities}}$$

$$\begin{aligned}\text{Quick Assets} &= \text{Current Assets} - \text{Stock (Inventory)} \\ &= 10,00,000 - 6,00,000 \\ \text{Quick Assets} &= 4,00,000 \\ \text{Quick Liabilities} &= \text{Current liabilities} - \text{Bank over draft} \\ &= 4,00,000 - 20,000 \\ &= 3,80,000\end{aligned}$$

$$\therefore \text{Quick Ratio} = \frac{6,00,000}{3,80,000}$$

$$\therefore \text{Quick Ratio} = 1.58 : 1$$

c) Absolute Quick Ratio

$$\frac{\text{Absolute Quick Assets}}{\text{Current Liabilities}}$$

$$\begin{aligned} \text{Absolute Quick Assets} &= \text{Bank Balance} + \text{Marketable Securities} \\ &= 2,00,000 + 20,000 \\ &= 2,20,000 \end{aligned}$$

$$\begin{aligned} \therefore \text{Absolute Quick Ratio} &= \frac{2,20,000}{4,00,000} \\ &= 0.55 : 1 \end{aligned}$$

d) Debt Equity Ratio

$$\frac{\text{Long term debts}}{\text{Share holders fund}}$$

$$\begin{aligned} \text{Long term debts} &= 5,00,000 \\ \text{Share holders fund} &= \text{Equity share capital} + \text{Preference share capital} + \text{Reserves} \\ &\quad + \text{P \& L A/c} - \text{Fictitious Assets} \\ &= 10,00,000 + 5,00,000 + 1,00,000 + 4,00,000 \\ &= 20,00,000 \end{aligned}$$

$$\therefore \text{Debt / Equity Ratio} = \frac{5,00,000}{20,00,000} = 0.25 : 1$$

c) Proprietary Ratio

$$\frac{\text{Share holders fund}}{\text{Total assets}} = \frac{20,00,000}{29,00,000} = 0.70 : 1$$

f) Solvency Ratio

$$\frac{\text{Debt due to outsiders}}{\text{Total assets}}$$

$$\begin{aligned} &= \text{Long term debts} + \text{Current liabilities} \\ &= 5,00,000 + 4,00,000 = 9,00,000 \end{aligned}$$

$$\therefore \text{Solvency Ratio} = \frac{9,00,000}{29,00,000}$$

$$\therefore \text{Solvency Ratio} = 0.31 : 1$$

g) Fixed Assets to Networth

$$\frac{\text{Fixed assets}}{\text{Share holders funds}}$$

$$\begin{aligned}\text{Fixed Assets} &= \text{Goodwill} + \text{Plant \& Machinery} + \text{Land \& Building} + \text{Furniture} \\ &= 5,00,000 + 6,00,000 + 7,00,000 + 1,00,000 \\ &= 19,00,000\end{aligned}$$

$$\begin{aligned}\therefore \text{Fixed Assets to Networth} &= \frac{19,00,000}{20,00,000} \\ &= 0.95 ; 1\end{aligned}$$

h) Fixed Assets Ratio

$$\frac{\text{Fixed Assets}}{\text{Capital Employed}}$$

$$\begin{aligned}\text{Capital Employed} &= \text{Equity share capital} + \text{Preference share capital} + \text{Reserves} \\ &\quad + \text{P \& L (Cr)} + \text{Debentures} - \text{Fictitious} \\ &= 10,00,000 + 5,00,000 + 1,00,000 + 4,00,000 + 5,00,000 \\ &= 25,00,000\end{aligned}$$

$$\therefore \text{Fixed Assets Ratio} = \frac{19,00,000}{25,00,000}$$

$$\therefore \text{Fixed Assets Ratio} = 0.76 ; 1$$

i) Capital Gearing Ratio

$$\frac{\text{Fixed Interest Securities}}{\text{Equity Share holders fund}}$$

$$\begin{aligned}\text{Fixed Interest Securities} &= \text{Preference share capital} + \text{Debentures} \\ &= 5,00,000 + 5,00,000 \\ &= 10,00,000\end{aligned}$$

$$\begin{aligned}\text{Equity share holders fund} &= \text{Equity share capital} + \text{Reserves} + \text{P \& L A/c (Cr) Balance} \\ &= 10,00,000 + 1,00,000 + 4,00,000 \\ &= 15,00,000\end{aligned}$$

$$\begin{aligned}\text{Capital Gearing Ratio} &= \frac{10,00,000}{15,00,000} \\ &= 0.67 ; 1\end{aligned}$$

j) Ratio of Inventory to Working Capital

$$\frac{\text{Inventory}}{\text{Working Capital}}$$

$$\begin{aligned}\text{Working Capital} &= \text{Current Assets} - \text{Current Liabilities} \\ &= 10,00,000 - 4,00,000 = 6,00,000\end{aligned}$$

$$\frac{6,00,000}{6,00,000} = 1$$

$$\therefore 1 : 1$$

k) Ratio of Current Assets to Fixed Assets

$$\frac{\text{Current Assets}}{\text{Fixed Assets}}$$

$$= \frac{10,00,000}{19,00,000} = 0.53 : 1$$

21. The following is the Balance Sheet of A Ltd. as on 31-12-1990.

Liabilities	Amount	Assets	Amount
Share capital (20,00 shares of Rs. 10/- each Rs. 5/- paid up)	1,00,000	Land & Building	1,25,000
Reserves & Surplus	65,000	Plant & Furnitures	75,000
5% Debentures	1,00,000	Stock	50,000
Creditors	18,000	Debtors	10,000
Bills Payable	7,000	Bills Receivables	5,000
		Cash at Bank	20,000
		Preliminary Expenses	5,000
	2,90,000		2,90,000

Sales for the year Rs. 6,00,000

Re arrange the above balance sheet in a form suitable for analysis and calculate the following ratios and offer your comments.

(1) Debt / Equity Ratios

(2) Proprietary Ratio

(3) Current Ratio

(4) Acid Test Ratio (Quick Ratio)

(5) Stock turnover ratio

(6) Average collection period.

Sol/:

1. Debt / Equity Ratio

$$\frac{\text{Long term debt}}{\text{Share holders fund}}$$

$$\begin{aligned}\text{Long term debt} &= \text{Debentures} + \text{Other long term liabilities} \\ &= 1,00,000 + 0 \\ &= 1,00,000\end{aligned}$$

$$\begin{aligned}\text{Share holders fund} &= \text{Equity share capital} + \text{Reserves \& Surplus} \\ &\quad + \text{P \& L A/c} + \text{Preference share capital} - \text{Fictitious assets} \\ &= 1,00,000 + 65,000 - 5,000 \\ &= 1,65,000 - 5,000 = 1,60,000\end{aligned}$$

$$\therefore \text{Debt / Equity Ratio} = \frac{1,00,000}{1,60,000} = 0.625 ; 1$$

2. Proprietary Ratio = $\frac{\text{Share holders fund}}{\text{Total assets}}$

$$= \frac{1,60,000}{2,85,000} = 0.56 ; 1$$

$$\begin{aligned}\text{Total Assets} &= \text{Total Assets} - \text{Fictitious Assets} \\ &= 2,90,000 - 5,000 = 2,85,000\end{aligned}$$

3. Current Ratio

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\begin{aligned}\text{Current Assets} &= \text{Stock} + \text{Debtors} + \text{Bills Receivable} + \text{Cash} \\ &= 50,000 + 10,000 + 5,000 + 20,000 = 85,000\end{aligned}$$

$$\begin{aligned}\text{Current Liabilities} &= \text{Creditors} + \text{Bills Payable} \\ &= 18,000 + 7,000 = 25,000\end{aligned}$$

$$\therefore \text{Current Ratio} = \frac{85,000}{25,000}$$

$$\text{Current Ratio} = 3.4 ; 1$$

4. Quick Ratio : $\frac{\text{Quick Assets}}{\text{Current Liabilities}}$

$$\begin{aligned}\text{Quick Assets} &= \text{Current Assets} - \text{Stock} \\ &= 85,000 - 50,000 = 35,000\end{aligned}$$

$$\therefore \text{Quick Ratio} = \frac{35,000}{25,000} = 1.4 : 1$$

5. Stock Turnover Ratio

$$\frac{\text{Net sales}}{\text{Closing stock}} = \frac{6,00,000}{50,000}$$

Stock turnover ratio = 12 times.

6. Average Collection Period $\frac{\text{Average closing debtors}}{\text{Net sales}}$

$$\text{In a day} = \frac{15,000}{6,00,000} \times 365 = 9.125 \text{ days.}$$

Note :

$$\text{Average Debtors} = \text{Sundry Debtors} + \text{Bills Receivable}$$

4.5.5 Limitation of Ratio Analysis

Q28. What are the Limitations of Ratio Analysis.

Ans :

Though ratio analysis is a powerful tool for analyzing the financial position of a firm, it suffers from the following limitations.

- i) As ratios are calculated based on the historical data or past performance, they may not necessarily provide the correct information that is useful in decision-making.
- ii) As there are no particular standards or rules of thumb for all the ratios, it is difficult to interpret accurate results.
- iii) In order to draw correct interpretations, a single ratio may not be helpful. For this purpose, a number of ratios are to be calculated which is likely to confuse the financial analyst than to help him in making any meaningful conclusions.
- iv) Changes in the accounting procedures by the firms may mislead the ratio analysis. For example, a change in the methods of valuating inventory from FIFO to LIFO increases the cost of sales and decreases the value of closing stock. This results in unfavourable stock turnover ratio and gross profit ratio.
- v) In inflationary conditions, the accounting data of several years cannot be compared and therefore analysis based on such data is not accurate.
- vi) As ratio analysis is purely quantitative in nature, other aspects such as managerial efficiency, employee performance cannot be interpreted.
- vii) Comparison of ratios of one firm to the other in an industry is not possible due to their differences in sizes, accounting procedures etc.
- viii) As changes in price is not considered while calculating ratios, this may adversely affect the interpretation.

In spite of these limitations, ratio analysis is considered as the powerful tool for analyzing the financial statements.

Exercises Problems

1. If a company merchandise inventory is ₹ 1,20,000; total current liabilities are ₹ 80,000; Acid Test Ratio is 2 : 1, what is current ratio ?

[Ans: Current ratio = 3.5 times]

2. If Apple Company Ltd.'s Current Ratio is 55 : 1, Quick Ratio is 4 to 1; Inventory is ₹ 30,000 what are the current liabilities ?

[Ans: Current liabilities ₹ 20,000]

3. You are given the following information about two companies

	Company A	Company B
Cash	180	140
Debtors	1,420	3,200
Inventory	1,800	5,400
Bills Payable	270	1,000
Creditors	500	4,000
Accrued Expenses	150	125
Tax Payable	750	1,000

Calculate liquidity ratios for the two companies and give your interpretation of the liquidity position of the companies, as revealed by the ratios.

[Ans : Current ratio Company A : 2.03 : 1; Company B : 1.43 : 1]

Quick ratio Company A : 0.95 : 1; Company B : 0.54 : 1]

4. From the following balance sheet and information, calculate ratios for (a) testing liquidity and (b) solvency.

Balance sheet as on 31.3.2008

(₹ in '000)

Liabilities	₹	Assets	₹
Equity	20	Good will	12
Capital Reserves	4	Fixed Assets	28
8% Loan on Mortgage	16	Stocks	6
Trade Creditors	8	Debtors	6
Taxation :		Cash	6

Current	2	
Future	2	
<u>Profit and Loss A/c</u>		
Profit for 2008 after tax and		
Interest on fixed deposits 12,000		
Less : Transfer to dividend 2,000		
Reserves 4,000	6	
	60	60

[Ans : Current ratio 1.67, Quick ratio 1.17, Long term debt Equity ratio 1 : 2, Total debt Equity ratio 7 : 8]

5. If net income of Simco Led. is ₹ 1,22,600. (after tax at 50%); its fixed interest charges on Debenture amount to ₹ 4,800. Calculate the Interest Coverage Ratio.

[Ans : Interest coverage ratio 51.08]

6. Calculate and comment on the rate of return on total assets from the following data of two companies:

	Gama Ltd	Lama Ltd
Sales	₹ x x x	₹ 2,52,75,000
Total Assets	₹ 42,50,000	₹ x x x
Net profit on sales	6%	4%
Turnover of Assets	6 times	6 times
Gross Margin	₹ 20,68,000	12%

[Ans : Rate of return on total assets, Gama Ltd 36%, Lama Ltd 24%]

7. From the following information of Nidhi Ltd. for the year 1999, Calculate i) Gross Profit Ratio, ii) Net Profit Ratio iii) Operating Ratio iv) Operating Profit Ratio, v) Return on assets, vi) Assets Turnover vii) Return on Equity.

Total Assets of the company ₹ 16,00,000

Borrowed Capital @ 8% interest per annum 50% of the total assets

Direct Cost for the year ₹ 9,60,000

Operating expenses ₹ 1,60,000

The goods are sold to customers at 150% of the direct cost

Assume tax rate 50%

[Ans : (i) 33.33% (ii) 8.89 % (iii) 77.78% (iv) 22.22% (v) 8% (vi) 0.6 times (vii) 16%]

8. Compute return on capital employed from the following details :

Net Profit after tax	₹ 43,000
Rate of Income tax	50%
14% Debentures	₹ 1,00,000
Share Capital	₹ 2,50,000
Profit and Loss Account	₹ 1,58,000
Loss on Issue of Debentures	₹ 8,000

[Ans : 8.6%]

9. The following are the summarised P & LA/C of Alind Products Ltd. for the year ending 31st March 2008, and the Balance Sheet as on that date.

Profit and Loss Account

Particulars	₹	Particulars	₹
To Opening Stock	99,500	By Sales	8,50,000
To Purchase (credit)	5,45,250	By Closing Stock	1,50,000
To Expenses	14,250		
To Gross Profit	3,41,000		
	10,00,000		10,00,000
To Operating Expenses	1,95,000	By Gross Profit	3,41,000
To Non Operating Expenses	5,000	By Non Operating Income	9,000
To Net Profit	1,50,000		
	3,50,000		3,50,000

Balance Sheet

	₹		₹
Equity Share Capital	2,00,000	Land and Building	1,50,000
Reserves	90,000	Plant and Machinery	80,000
P & L A/c	1,50,000	Stock	1,50,000
Bills Payable	60,000	Sundry Debtors	41,000
		Bills Receivable	30,000
		Cash at Bank	49,000
	5,00,000		5,00,000

From the above statements you are required to calculate the following ratios.

- (i) Gross profit ratio
- (ii) Net profit ratio
- (iii) Operating profit ratio
- (iv) Operating ratio
- (v) Return on capital employed

[Ans : (i) 40.1% (ii) 17.64% (iii) 17.18% (iv) 82.82% (v) 34.09%]

10. Following is the income statement of Strong Ltd. for the year ending 31st March, 208.

Income statement

Particulars		Particulars	
To Opening stock	45,750	By Sales	3,00,000
To Purchases	1,89,150	By Closing stock	59,100
To Carriage	1,200		
To Wages	3,000		
To Gross profit	1,20,000		
	3,59,100		3,59,100
To Administrative expenses	60,600	By Gross profit	1,20,000
To Finance Expenses		By Non- operating Income	
Interest	720	Interest.	900
Discount	1,440	Dividend	2,250
Bad debts	2,040	Profit on Sale of Securities	450
S & D Expenses	7,200		
Non - operating Expenses	1,200		
To Net profit	50,400		
	1,23,600		1,23,600

You are required to calculate :

- a) Gross profit Ratio b) Net profit Ratio c) Operating Ratio d) Operating Profit Ratio
- e) Stock Turnover Ratio

[Ans : (a) 40% (b) 16.8% (c) 84% (d) 16% (e) 3.43 times]

Short Question and Answers

1. Define Financial Statement of Analysis?

Ans :

A financial statement is an organized collection of data according to logical and consistent accounting procedures. Its purpose is to convey an understanding of some financial aspects of a business firm. It may show a position at a moment of time as in the case of a balance sheet, or may reveal a series of activities over a given period of time, as in the case of an income statement.

Analysts can obtain useful information by comparing a company's most recent financial statements with its results in previous years and with the results of other companies in the same industry. Three primary types of financial statement analysis are commonly known as horizontal analysis, vertical analysis, and ratio analysis.

Definition :

"Financial statement analysis is largely a study of relationship among the various financial factors in a business as disclosed by single set-of statements, and a study of the trend of these factors as shown in a series of statements."

- Myers

'A combination of recorded facts, accounting conventions and personal judgements and the judgements and conventions applied affect them materially.' This implies that data exhibited in the financial statements are affected by recorded facts, accounting conventions and personal judgements.

- The American Institute of Certified Public Accountants

2. Nature of Financial Statement Analysis.

Ansr :

Nature of Financial Statement Analysis

(i) Recorded Facts

The term 'recorded facts' means facts, which have been recorded in the accounting books. Facts which have not been recorded in the financial books are not depicted in the

financial statements, however material they might be. For example, fixed assets are shown at cost irrespective of their market or replacement price since such price is not recorded in the books.

(ii) Accounting Conventions

Accounting conventions imply certain fundamental accounting principles which have been sanctified by long usage. For example, on account of the convention of 'conservatism', provision is made of expected losses but expected profits are ignored. This means that the real financial position of the business may be much better than what has been shown by the financial statements.

(iii) Personal Judgements

Personal judgements also have an important bearing on the financial statements. For example, the choice of selecting a method of depreciation lies on the accountant. Similarly, the mode of amortization of fictitious assets also depends on the personal judgement of the accountant.

3. Limitations of Financial Statement Analysis.

Ans :

Limitations

(i) Manipulation

Some business enterprises resort to manipulate the information contained in the financial statements so as to cover up their bad or weak financial position. Thus, the analysis based on such financial statements may be misleading due to window dressing.

(ii) Use of Diverse Procedures

There may be more than one way of treating a particular item and when two different business enterprises adopt different accounting policies, it becomes very difficult to make a comparison between such

enterprises. For example, depreciation can be charged under straight line method or written down value method. However, results provided by comparing the financial statements of such business enterprises would be misleading.

(iii) Qualitative Aspect Ignored

The financial statements incorporate the information which can be expressed in monetary terms. Thus, they fail to assimilate the transactions which cannot be converted into monetary terms. For example, a conflict between the marketing manager and sales manager cannot be recorded in the books of accounts due to its non-monetary nature, but it will certainly affect the functioning of the activities adversely and consequently, the profits may suffer.

4. Horizontal Analysis.

Ans :

Horizontal analysis of financial statements involves comparison of a financial ratio, a benchmark, or a line item over a number of accounting periods. This method of analysis is also known as trend analysis. Horizontal analysis allows the assessment of relative changes in different items over time. It also indicates the behavior of revenues, expenses, and other line items of financial statements over the course of time.

Accounting periods can be two or more than two periods. Accounting period can be a month, a quarter or a year. It will depend on the analyst's discretion when choosing an appropriate number of accounting periods. During the investment appraisal, the number of accounting periods for analysis is based on the time horizon under consideration.

Horizontal analysis of financial statements can be performed on any of the item in the income statement, balance sheet and statement of cash flows. For example, this analysis can be performed on revenues, cost of sales, expenses, assets, cash, equity and liabilities. It can also be performed on ratios such as earnings per share (EPS), price earning ratio, dividend payout, and other similar ratio.

5. Vertical Analysis.

Ans :

Vertical analysis of financial statements is a technique in which the relationship between items in the same financial statement is identified by expressing all amounts as a percentage a total amount. This method compares different items to a single item in the same accounting period. The financial statements prepared by using this technique are known as common size financial statements.

6. What is Ratio Analysis?

Ans :

Definition

According to Myers, "Ratio analysis is a study of relationship among the various financial factors in a business".

Thus, ratio analysis measures the profitability, efficiency and financial soundness of the business.

Ratio analysis is to present the figure of financial statement in simple and intangible form. Ratio analysis is to present the figure of financial statement in simple and intangible form. Ratio analysis, in this way, is the process of establishing meaningful relationship between two figures and set of financial statement.

7. Importance of ratio analysis.

Ans :

Importance of Ratio Analysis

Ratio analysis is an important tool for analyzing the company's financial performance. The following are the important advantages of the accounting ratios.

1. Analyzing Financial Statements

Ratio analysis is an important technique of financial statement analysis. Accounting ratios are useful for understanding the financial position of the company. Different users such as investors, management, bankers and creditors use the ratio to analyze the financial situation of the company for their decision making purpose.

2. Judging Efficiency

Accounting ratios are important for judging the company's efficiency in terms of its operations and management. They help to judge how well the company has been able to utilize its assets and earn profits.

3. Locating Weakness

Accounting ratios can also be used in locating weakness of the company's operations even though its overall performance may be quite good. Management can then pay attention to the weakness and take remedial measures to overcome them.

4. Formulating Plans

Although accounting ratios are used to analyze the company's past financial performance, they can also be used to establish future trends of its financial performance. As a result, they help formulate the company's future plans.

5. Comparing Performance

It is essential for a company to know how well it is performing over the years and as compared to the other firms of the similar nature. Besides, it is also important to know how well its different divisions are performing among themselves in different years. Ratio analysis facilitates such comparison.

8. What is liquidity ratio?

Ans :

Liquidity refers to the ability of a concern to meet its current obligations as and when these become due. Liquidity ratios are calculated to measure short-term financial soundness of the business. The short-term obligations are met by realizing amounts from current, floating or circulating assets. The current assets should either

be liquid or near liquidity. These should be convertible into cash for paying obligations of short-term nature. The sufficiency or insufficiency of current assets should be assessed by comparing them with short-term (current) liabilities. If current assets can pay off current liabilities, then liquidity position will be satisfactory.

On the other hand, if current liabilities may not be easily met out of current assets then liquidity position will be bad. The bankers, suppliers of goods and other short-term creditors are interested in the liquidity of the concern. They will extend credit only if they are sure that current assets are enough to pay out the obligations. To measure the liquidity of a firm, the following ratios can be calculated:

1. Current Ratio or Working Capital Ratio
2. Quick or Acid Test or Liquid Ratio
3. Absolute Liquid Ratio or Cash Position Ratio

9. Profitability ratios.

Ans :

The primary objective of a business undertaking is to earn profits. Profit earning is considered essential for the survival of the business. A business needs profits not only for its existence but also for expansion and diversification. "Profits are thus, a useful measure of overall efficiency of a business. Profits to the management are the test of efficiency and a measurement of control; to owners, a measure of worth of their investment; to the creditors, the margin of safety; to employees, a source of fringe benefits; to government, a measure of tax-paying capacity and the basis of legislative action; to customers, a hint to demand for better quality and price cuts; to an enterprise, less cumbersome source of finance for growth and existence and finally to the country, profits are an index of economic progress. Profitability ratios are calculated to measure the overall efficiency of the business." Generally, profitability ratios are calculated either in relation to sales or in relation to investment.

10. Limitations of Ratio Analysis.

Ans :

Though ratio analysis is a powerful tool for analyzing the financial position of a firm, it suffers from the following limitations.

- i) As ratios are calculated based on the historical data or past performance, they may not necessarily provide the correct information that is useful in decision-making.
- ii) As there are no particular standards or rules of thumb for all the ratios, it is difficult to interpret accurate results.
- iii) In order to draw correct interpretations, a single ratio may not be helpful. For this purpose, a number of ratios are to be calculated which is likely to confuse the financial analyst than to help him in making any meaningful conclusions.
- iv) Changes in the accounting procedures by the firms may mislead the ratio analysis. For example, a change in the methods of valuating inventory from FIFO to LIFO increases the cost of sales and decreases the value of closing stock. This results in unfavourable stock turnover ratio and gross profit ratio.
- v) In inflationary conditions, the accounting data of several years cannot be compared and therefore analysis based on such data is not accurate.

Choose the Correct Answers

1. Profitability ratios are based on, [c]
(a) Sales (b) Investment
(c) Both (a) and (b) (d) Purchases.
2. According to modus operandi, analysis are divided into, [d]
(a) Horizontal analysis (b) Vertical analysis
(c) Internal analysis (d) Both (a) and (b)
3. Following are the methods used in analyzing financial statements are, [d]
(a) Trend ratios (b) Ratio analysis
(c) Comparative analysis (d) All the above.
4. Ratio analysis is useful to, [b]
(a) Management (b) Both (a) and (c)
(c) Government (d) Students.
5. The ratio which measures the relationship between operating cost and net sales is, [a]
(a) Operating ratio (b) Gross profit ratio
(c) Net profit ratio (d) Operating profit ratio.
6. Dividend coverage ratio = [c]
(a) $\frac{\text{PBIT}}{\text{Interest}}$ (b) $\frac{\text{PAT}}{\text{Interest}}$
(c) $\frac{\text{PAT}}{\text{Dividend}}$ (d) $\frac{\text{PBIT}}{\text{Dividend}}$
7. The ratio which establishes relationship between net sales and working capital, [a]
(a) Working capital turnover ratio (b) Debtors turnover ratio
(c) Stock turnover ratio (d) None.
8. Return on investment can be calculated by using, [d]
(a) Return on total asset (b) Return on shareholder's fund
(c) Return on capital employed (d) All the above.
9. Standard or Thumb rule of a current ratio is, [b]
(a) 1:1 (b) 2:1
(c) 2:4 (d) 1:3
10. The statement which shows the percentage of net sales that are absorbed by each individual item representing cost or expense is, [d]
(a) Common size balance sheet (b) Comparative income statement
(c) Trend ratios (d) Common size income statement.

Fill in the Blanks

1. _____ is a collection of data which is organized according to the logical and consistent accounting procedures.
2. _____ is a major tool used for analyzing the financial statements.
3. _____ ratio facilitates to identify whether the company has enough capability to meet its short term obligations/requirements.
4. Capital turnover ratio = _____
5. The ratio which measures the relationship between gross profit and net sales is _____.
6. EBIT Means _____.
7. The items of the financial statements are presented as percentage of a particular item in _____.
8. Leverage ratios are also known as _____.
9. The ratio which measures the profitability of the firm on per equity share basis is _____.
10. Ratio analysis suffers from lack of _____.
11. Rate of return on equity share capital is calculated after deducting _____ and _____ dividend from the net profit before interest.
12. Stock Turnover Ratio = $\frac{\text{.....}}{\text{Average Stock during the period}}$.
13. Debtors Turnover Ratio = $\frac{\text{....}}{\text{Average Debtors}}$.
14. Cash in hand and at Bank, Bills Receivables and Debtors _____ assets
15. Percentage of _____ plus operating expenses to operating profit is called operating ratio.
16. EBDIT represents _____
17. _____ = $\frac{\text{Net Profit after Interest and Tax}}{\text{Preference Dividend}}$
18. Capital Turnover Ratio = $\frac{\text{Sales}}{\text{Shareholders Funds} + \text{.....}}$

ANSWERS

1. Financial statements
2. Ratio analysis
3. Liquidity
4. Net sales Total capital employed

5. Gross profit ratio
6. Earning before interest and tax
7. Common size statements
8. Capital structure ratios
9. Earning per share
10. Consistency.
11. Interest , Preference
12. Cost of goods sold
13. Net Credit Sales
14. Quick
15. Cost of good sold
16. Earnings before Depreciation, Interest and Tax
17. Fixed Dividend Cover
18. Long-term Liabilities

Rahul Publications

UNIT V

Indian Accounting Standards (Ind-AS)

Concept, benefits, procedure for issuing Ind- AS in India, salient features of Ind- AS issued by ICAI; International Financial Reporting Standards (IFRS): Main features, uses and objectives of IFRS, IFRS issued by IASB.

5.1 ACCOUNTING STANDARDS

Q1. Define Accounting Standards. Explain the nature of accounting standards.

Ans :

Accounting standards are the written statements consisting of rules and guidelines, issued by the accounting institutions, for the preparation of uniform and consistent financial statements and also for other disclosures affecting the different users of accounting information.

Accounting standards lay down the terms and conditions of accounting policies and practices by way of codes, guidelines and adjustments for making the interpretation of the items appearing in the financial statements easy and even their treatment in the books of account.

Definition :

According to Kohler, Accounting standards as a "code of conduct imposed on accountants by custom law (or) professional body.

Nature of Accounting Standards

- (i) **Serve as a guide to the accountants :** Accounting standards serve the accountants as a guide in the accounting process. They provide basis on which accounts are prepared. For example, they provide the method of valuation of inventories.
- (ii) **Act as a dictator :** Accounting standards act as a dictator in the field of accounting. Like a dictator, in some areas accountants have no choice of their own but to opt for

practices other than those stated in the accounting standards. For example, Cash Flow Statement should be prepared in the format prescribed by accounting standard.

- (iii) **Serve as a service provider :** Accounting standards comprise the scope of accounting by defining certain terms, presenting the accounting issues, specifying standards, explaining numerous disclosures and implementation date. Thus, accounting standards are descriptive in nature and serve as a service provider.

- (iv) **Act as a harmonizer :** Accounting standards are not biased and bring uniformity in accounting methods. They remove the effect of diverse accounting practices and policies. On many occasions, accounting standards develop and provide solutions to specific accounting issues. It is thus clear that whenever there is any conflict on accounting issues, accounting standards act as harmonizer and facilitate solutions for accountants.

Q2. Explain the scope of Accounting Standards.

Ans :

1. Efforts will be made to issue Accounting Standards which are in conformity with the provisions of the applicable laws, customs, usages and business environment in India. However, if a particular Accounting Standard is found to be not in conformity with law, the provisions of the said law will prevail and the financial statements should be prepared in conformity with such law.

2. The Accounting Standards by their very nature cannot and do not override the local regulations which govern the preparation and presentation of financial statements in the country.

However, the ICAI will determine the extent of disclosure to be made in financial statements and the auditor's report thereon. Such disclosure may be by way of appropriate notes explaining the treatment of particular items. Such explanatory notes will be only in the nature of clarification and therefore need not be treated as adverse comments on the related financial statements.

3. The Accounting Standards are intended to apply only to items which are material. Any limitations with regard to the applicability of a specific Accounting Standard will be made clear by the ICAI from time to time. The date from which a particular Standard will come into effect, as well as the class of enterprises to which it will apply, will also be specified by the ICAI. However, no standard will have retroactive application unless otherwise stated.

Q3. Explain the importance of accounting standards ?

Ans : (Dec.-19)

The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their information needs. These needs include the following:

- (a) **Investors.** The providers of risk capital are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. They are also interested in information which enables them to assess the ability of the enterprise to pay dividends.

- (b) **Employees.** Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

- (c) **Lenders.** Lenders are interested in information which enables them to determine whether their loans, and the interest attaching to them, will be paid when due.

- (d) **Suppliers and other trade creditors.** Suppliers and other creditors are interested in information which enables them to determine whether amounts owing to them will be paid when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders unless they are dependent upon the continuance of the enterprise as a major customer.

- (e) **Customers.** Customers have an interest in information about the continuance of an enterprise, especially when they have a longterm involvement with, or are dependent on, the enterprise.

- (f) **Governments and their agencies.** Governments and their agencies are interested in the allocation of resources and, therefore, the activities of enterprises. They also require information in order to regulate the activities of enterprises and determine taxation policies, and to serve as the basis for determination of national income and similar statistics.

- (g) **Public.** Enterprises affect members of the public in a variety of ways. For example, enterprises may make a substantial contribution to the local economy in many ways including the

number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

Q4. Explain the objectives of Accounting Standards.

Ans :

- (i) **For bringing uniformity in accounting methods :** Accounting standards are required to bring uniformity in accounting methods by proposing standard treatments to the accounting issue. For example, AS-6 (Revised) states the methods for depreciation accounting.
- (ii) **For improving the reliability of the financial statements :** Accounting is a language of business. There are many users of the information provided by accountants who take various decisions relating to their field just on the basis of information contained in financial statements. In this connection, it is necessary that the financial statements should show true and fair view of the business concern. Accounting standards when used give a sense of faith and reliability to various users.

They also help the potential users of the information contained in the financial statements by disclosure norms which make it easy even for a layman to interpret the data. Accounting standards provide a concrete theory base to the process of accounting. They provide uniformity in accounting which makes the financial statements of different business units, for different years comparable and again facilitate decision making.

- (iii) **Simplify the accounting information :** Accounting standards prevent the users from reaching any misleading conclusions and make the financial data simpler for everyone. For example, AS-3 (Revised) clearly classifies

the flows of cash in terms of 'operating activities', 'investing activities' and 'financing activities'.

- (iv) **Prevents frauds and manipulations :** Accounting standards prevent manipulation of data by the management and others. By codifying the accounting methods, frauds and manipulations can be minimized.
- (v) **Helps auditors :** Accounting standards lay down the terms and conditions for accounting policies and practices by way of codes, guidelines and adjustments for making and interpreting the items appearing in the financial statements. Thus, these terms, policies and guidelines etc. become the basis for auditing the books of accounts.

Q5. Explain the advantages and limitations of accounting standards ?

Ans :

Advantages

1. Standards Improve Reliability of Financial Statements

Reliability of financial statements depends upon reliable accounting data. Various users of financial statements of business organization use financial statements for making some important decisions. These important decisions which they want to take should be based on fair and true financial statements standards help the accounting professionals to create a general sense of confidence. Standards also help to harmonise divergent accounting practices. Standards protect the users of financial statements by providing them financial information in which they can have confidence.

2. Helpful for Accounting Professionals

Accounting professionals, like accountants and auditors have to perform their work in changing environment of legal bindings. Accountants have to maintain their accounts in the fear of threats of stern actions. Whereas auditors are also to do audit work for detecting

frauds and misleading information's presented in financial statements. Accounting standards help the accountants and auditors while performing their duties.

3. Accounting Reforms

Accounting standards are also helpful in development of a logical conceptual framework and structure for measurement of information, objectives of financial reporting. Accounting standards have helped in sweeping reforms in accounting theory as well as in accounting practices.

4. Determining Managerial and Corporate Accountability

Standards also facilitate in determining corporate and managerial accountability. Standards are important factors in assessment of managerial performance. Standards ensure consistency and comparability in place of uniformity in financial reporting. Management always concentrate on choice of best alternative for performing any activity, standards act as best choice available to them.

Limitations :

The following are some of the limitations of Accounting Standards :

1. Companies are spread across the countries with different lines of operations and varied economic backdrops. Application of uniform Accounting Standards may sometimes prove to be a disadvantage to the company as they are not flexible and the transactions of the company are supposed to be reported as per the prescribed guidelines.
2. Another disadvantage of using accounting standards is regarding the costs for the company to comply with the standard. In many cases, company must design new procedures, which requires a large financial investment that includes employee costs, system upgrades and employee training.
3. Alternative solutions to certain accounting problems may each have arguments for and

against that alternative to recommend. Therefore, the choice between the different alternative accounting treatments may become difficultly.

Q6. Discuss about Carve outs/ins in Ind AS.

Ans :

I. Carve-Outs

Carve-outs are because of the existing economic conditions in India and due to the variations in the use of accounting principles and practices.

Ind AS 1, Presentation of Financial Statements

According to IFRS, IAS 1 demands that in the situation of a loan liability, if any of the conditions of the loan agreement is breached which was categorized as non-current on the reporting date, then this kind of loan liability is to be categorized as current. If the rectification of breach is after the balance sheet date, IAS want loans to be categorized as current.

Carve Out

Ind AS1 explains that, the liability is not categorized as current by the entity, if there is a violation of a material provision of a long term loan arrangement on or before the end of the reporting period as a result that the liability becomes payable on demand on the reporting date. If the lender accepts that after the reporting period and before the confirmation of the financial statements for issue will not demand payment as a result of the breach.

Reason

Usually a long-term loan agreement includes many conditions in the Indian banking system. Few of the conditions are considerable, like if interest is not paid then the loan is recalled and few conditions are procedural and not considerable, like the furnishing insurance details where the entity has taken the insurance but did not submit the details to the lender at the end of the reporting period. In a situation of any procedural breach, the customer-banker relationships are developed and usually a

loan is not recalled. Further in most of the cases, a breach is rectified after the balance sheet date and before the financial statements approval. Carve out is made as it is observed that if the breach is rectified after the balance sheet date and before the financial statements approval, it would be convenient if the users are made aware of the actual nature of liabilities being not current liabilities and non-current liabilities.

Ind AS 10, Events After the Reporting Period

According to IFRS, a non-adjusting event is the one wherein a breach is rectified after the end of the reporting period.

Carve Out

As an outcome of carve-out Ind AS 1, Ind AS 10 states in the definition of 'Events after the reporting period' that in the situation of breach of a material provision of a long-term loan agreement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, if the lender agrees to waive the breach before the confirmation of the financial statements issue then it would be regarded as an adjusting event.

Ind AS 17, Leases

According to IFRS, IAS 17 demands that all leases rentals should be charged on straight line basis to statement of profit and loss in the case of the operating leases except when another systematic basis is more representative of the pattern of time of the user's benefit even though if the payments to the lessor are not based on that.

Carve Out

A carve out is made to furnish that in case of operating leases, the lease rentals would be charged to the profit and loss statement according to the lease agreement until the payments to the lessor are designed to increase accordingly with the anticipated general inflation to compensate for the lessor's anticipated inflationary cost increases. This condition is not satisfied, if lessor's payments fluctuate due to factors apart from general inflation.

Reason

To obtain the right to use the asset of the lessor, companies get into different types of lease agreements. Lease agreements include regular rent increase, by observing the Indian inflationary conditions. Where there is regular rent increase in accordance with the anticipated inflation to compensate the lessor for anticipated inflationary cost increases, the rentals would not be straight-lined.

Ind AS 18, Revenue

According to IFRS, based on the principles of the IAS 18, IFRIC 15, agreement for construction of real estate, recommends that the construction of real estate should be regarded as sale of goods and revenue should be identified when the entity has transferred considerable risks and rewards of ownership and maintained neither continuing managerial involvement nor effective control.

Carve Out

In Ind AS 18, IFRIC 15 has not incorporated in order to scope out such agreements from Ind AS 18. Institute of Chartered Accountant of India (ICAI) issued a distinct guidance note on accounting for real estate developers i.e., for Ind AS compliant entities to resolve the matter.

Reason

It was noticed that need will result in identification of revenue in the financial statements by real estate developers on the basis of the completion method, i.e., only in the last year of the project completion. It was observed that the actual performance of the real estate developer business would not be reflected if the revenue for the whole project is identified in the last year of the project completion. In addition, it was noticed that, as Ind AS 11 needs identification of revenue of all contracts of construction with reference to completion stage, it may result in irrelevant accounting in case of some real estate development projects in case this Ind AS is used for all real estate development projects. Thus, it was regarded as convenient instead of making amendments in Ind AS 11 or Ind AS 18, a distinct

guidance note for Ind AS compliant entities should be issued in accordance with the guidance note on accounting for Real Estate Transactions issued by ICAI for entities on which AS are suitable.

II. Carve Ins

Carve ins are the additional guidance given by Ind AS in some areas. Such as,

Ind AS 102, Share-Based Payment

Accounting for employee share-based payment is managed by an organization by creating a trust. Both Ind AS 102 and IFRS 2, share based payment does not facilitate any guidance relating to accounting of employee share-based payments. It is managed by organization by creating a separate trust. The amendments which are proposed involves new guidance in Ind AS 102 relating to accounting of share based payment plan.

Trust created for the purpose have several arrangements such as,

- Shares are allotted to the trust by the organization when stock options are utilized.
- Trust is being financed through organization for subscription of shares.
- Trust is being also financed by organization to buy shares from the market.

Trust acts as a branch/agent of an organization since it manages the plan on behalf of the organization. Financial statements of organization are prepared but transactions of the trust are recorded in financial statements. Loan given to the trust will not be recorded in separate financial statements of the entity and profits earned by trust is treated as equity of the entity.

The shares which are held by the trust are shown in separate financial statements whereas face value of these shares is deducted from share capital and excess amount on face value is deducted from securities premium by giving a note.

Ind AS 103, Business Combinations

IFRS 3, business combinations is concerned with accounting done for business combinations but excludes business combinations of entities which are under common control. Whereas Ind AS 103 facilitates assistance relating to accounting of the business combination under common control and need those combinations for utilizing pooling of interest method. The amendment states that any variation in consideration paid and share capital of the transferor must be transferred to separate part of equity known as 'common control transaction capital reserve' instead of determining goodwill/capital reserve.

5.2 INDIAN ACCOUNTING STANDARDS (IND-AS)

5.2.1 Concept of Indian Accounting Standards

Q7. Explain the concept of Indian Accounting Standards.

Ans.

(June-18)

Introduction

Indian Accounting Standard (abbreviated as Ind-AS) is the Accounting standard adopted by companies in India and issued under the supervision and control of Accounting Standards Board (ASB), which was constituted as a body in the year 1977. ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. ICAI, representatives from ASSOCHAM, CII, FICCI, etc.

The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS). National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India. As on date MCA has notified 39 Ind AS. This shall be applied to the companies of financial year 2015-16 voluntarily and from 2016-17 on a mandatory basis.

Background to Ind AS

Ind AS the new set of accounting standards was notified by the Ministry of Corporate Affairs (MCA) on February 19, 2015. As of date, there are 39 Ind AS notified by the MCA. The Ind AS are named and numbered in the same way as the corresponding IFRS. The application of Ind AS is based on the listing status and net worth of a company.

5.2.2 Benefits of Indian Accounting Standards

Q8. Explain the benefits of Indian Accounting Standards.

Ans : (June-18)

Ind AS have many benefits, some of which are discussed below:

➤ **Wider acceptability:**

Since Ind AS are converged form of IFRS which are widely acceptable and will give confidence to the user of financial statements.

➤ **Comparability of Financials:**

Financial statements prepared using Ind AS are easily comparable with the financial statements prepared by companies of other countries.

➤ **Changes in standards as per economic situations:**

Principles of Ind AS are revised/modified in case there is any major change in economy. Ind AS 29 is 'Financial Reporting in hyperinflationary Economies' which deals with situations related to inflation.

➤ **Attracts Foreign Investment:**

Adopting Ind AS may attract foreign investors to invest in Indian Companies as that will ensure better comparability with similar companies across the globe.

➤ **Saves financial statement preparation cost:**

For multinational companies, it will be beneficial as it will be able to use the same accounting standards in all the markets in

which they operate. This will save preparation costs of aligning financial statements of Indian company with other operations.

5.2.3 Procedure for Issuing Ind-AS in India

Q9. Explain the procedure of issuing AS in India.

Ans : (June-18)

Procedure for Issuing Accounting Standards in India

Broadly, the following procedure is adopted for formulating Accounting Standards in India :

1. Determination of Broad Areas

The ASB determines the broad areas in which accounting standards need to be formulated and fixes the priority in regard to the selection thereof.

2. Preparation of Accounting Standards

In the preparation of accounting standards, the ASB will be assisted by study groups constituted to consider specific subjects. In the formation of study groups, wide participation from the members of Institute of Chartered Accountants in India and others shall be made.

3. Draft of Proposed Standard

The draft of the proposed standard will normally include the following :

- i) Objective of the standard,
- ii) Scope of the standard,
- iii) Definitions of the terms used in the standard,
- iv) Recognition and measurement principles, wherever applicable,
- v) Presentation and disclosure requirements.

4. Consideration of Preliminary Draft

The ASB will consider the preliminary draft prepared by the study group and if any revision of the draft is required on the basis of deliberations, the ASB will make the same or refer the same to the study group.

5. Circulation of the Draft

The ASB will circulate the draft of the accounting standard to the council members of the ICAI and the following specified bodies for their comments :

- i) Department of Company Affairs (DCA)
- ii) Comptroller and Auditor General of India (C&AG)
- iii) Central Board of Direct Taxes (CBDT)
- iv) The Institute of Cost and Works Accountants of India (ICWAI)
- v) The Institute of Company Secretaries of India (ICSI)
- vi) Associated Chambers of Commerce and Industry (ASSOCHAM), Confederation of Indian Industry (CII) and Federation of Indian Chambers of Commerce and Industry (FICCI)
- vii) Reserve Bank of India (RBI)
- viii) Securities and Exchange Board of India (SEBI)
- ix) Standing Conference of Public Enterprises (SCOPE)
- x) Indian Banks Association (IBA)
- xi) Any other body considered relevant by the ASB keeping in view the nature of the accounting standard.

6. Finalization of Exposure Draft

The ASB will hold a meeting with the representatives of specified bodies to ascertain their views on the draft of the proposed accounting standard. On the basis of comments received and discussion with the representatives of specified bodies, the ASB will finalize the exposure draft of the proposed accounting standard.

7. Sending Exposure Draft for Comments

The exposure draft of the proposed draft will be issued for comments by the members of ICAI and the public. The exposure draft will

specifically be sent to certain bodies, stock exchanges, and other interest groups, as appropriate.

8. Finalization and Submission to Council

After taking comments into consideration, the draft of the proposed standard will be finalized by the ASB and shall be submitted to the council of the ICAI.

9. Issuance of Standard by ICAI

The council of the ICAI will consider the final draft of the proposed standard and if found necessary, modify the same in consultation with the ASB. The Accounting Standard on the relevant subject will then be issued by the ICAI.

10. Revision

For a substantive revision of an accounting standard, the procedure followed for formulation of a new accounting standard will be followed as above. Some aspects may require revision which are not substantive in nature. For this purpose, the ICAI may make limited revision to an accounting standard. The procedure followed for the limited revision will substantially be the same as that to be followed for formulation of an accounting standard, ensuring that sufficient opportunity is given to various interest groups and general public to react to the proposal for limited revision.

5.2.4 Salient Features of Ind-AS Issued by ICAI**Q10. Explain the salient features of Ind AS issued by ICAI.**

Ans :

(July-17)

An entity moving from Indian GAAP to Ind AS needs to apply the requirements of Ind AS 101. It applies to an entity's first Ind AS financial statements and the interim reports presented under Ind AS 34, 'Interim financial reporting', which are part of that period.

The basic requirement is for full retrospective application of all Ind AS, effective at the reporting date. However, there are a number of optional exemptions and mandatory exceptions to the requirement of retrospective application.

The exemptions cover standards for which it is considered that retrospective application could prove too difficult or could result in a cost likely to exceed related benefits to users. The exemptions are optional. Any, all or none of the exemptions may be applied.

The optional exemptions relate to the following:

- Share-based payment transactions
- Insurance contracts
- Deemed cost
- Leases
- Cumulative translation differences
- Investment in subsidiaries, joint ventures and associates
- Assets and liabilities of subsidiaries, joint ventures and associates
- Compound financial instruments
- Designation of previously recognised financial instruments
- Fair value measurement of financial assets or financial liabilities at initial recognition
- Decommissioning liabilities included in the cost of property, plant and equipment
- Financial assets or intangible assets accounted for in accordance with service concession arrangements
- Borrowing costs
- Extinguishing financial liabilities with equity instruments
- Severe hyperinflation
- Joint arrangements

- Stripping costs in the production phase of a surface mine
- Designation of contracts to buy or sell a non-financial item
- Revenue from contracts with customers
- Non-current assets held for sale and discontinued operations

Further, there are mandatory exceptions in applying the Ind AS requirements as summarised below:

- Derecognition of financial assets and liabilities
- Hedge accounting
- Non-controlling interests
- Classification and measurement of financial assets
- Impairment of financial assets
- Embedded derivatives
- Government loans
- Estimates

Comparative information is prepared and presented on the basis of Ind AS. Almost all adjustments arising from the first-time application of Ind AS are adjusted against opening retained earnings (or, if appropriate, another category of equity) of the first period that is presented on an Ind AS basis. Disclosures of certain reconciliations from Indian GAAP to Ind AS are required.

This standard does not provide exemptions from the presentation and disclosure requirements in other Ind ASs. The standard requires that an entity's first Ind AS financial statements shall include at least three Balance Sheets, two Statements of Profit and Loss, two Statements of Cash Flows and two Statements of Changes in Equity and related notes, including comparative information for all statements presented. This statement also requires that an entity shall explain how the transition from previous GAPP to Ind ASs affected the reported Balance Sheet, financial performance and cash flows.

Q11. List out the various Indian Accounting Standards (Ind-AS).*Ans :*

S.No.	Ind ASs	Particulars
1	Ind AS 1	Presentation of Financial Statements
2.	Ind AS 2	Inventories
3.	Ind AS 7	Statement of Cash Flows
4.	Ind AS 8	Accounting Policies, Changes in Accounting Estimates and Errors
5.	Ind AS 10	Events after the Reporting Period
6.	Ind AS 12	Income Taxes
7.	Ind AS 16	Property, Plant and Equipment
8.	Ind AS 17	Leases
9.	Ind AS 19	Employee Benefits
10.	Ind AS 20	Accounting for Government Grants and Disclosure of Government Assistance
11.	Ind AS 21	The Effects of Changes in Foreign Exchange Rates
12.	Ind AS 23	Borrowing Costs
13.	Ind AS 24	Related Party Disclosures
14.	Ind AS 27	Separate Financial Statements
15.	Ind AS 28	Investments in Associates and Joint Venture
16.	Ind AS 29	Financial Reporting in Hyperinflationary Economies
17.	Ind AS 32	Financial Instruments: Presentation
18.	Ind AS 33	Earnings per Share
19	Ind AS 34	Interim Financial Reporting
20.	Ind AS 36	Impairment of Assets
21.	Ind AS 37	Provisions, Contingent Liabilities and Contingent Assets
22.	Ind AS 38	Intangible Assets
23.	Ind AS 40	Investment Property
24.	Ind AS 41	Agriculture
25.	Ind AS 101	First-time Adoption of Indian Accounting Standards
26.	Ind AS 102	Share-based payment
27.	Ind AS 103	Business Combinations
28.	Ind AS 104	Insurance Contracts
29.	Ind AS 105	Non-current Assets Held for Sale and Discontinued Operations

30.	Ind AS 106	Exploration for and Evaluation of Mineral Resources
31.	Ind AS 107	Financial Instruments: Disclosures
32.	Ind AS 108	Operating Segments
33.	Ind AS 109	Financial Instruments
34.	Ind AS 110	Consolidated Financial Statements
35.	Ind AS 111	Joint Arrangements
36.	Ind AS 112	Disclosure of Interests in Other Entities
37.	Ind AS 113	Fair Value Measurement
38.	Ind AS 114	Regulatory Deferral Accounts
39.	Ind AS 115	Revenue from Contracts with Customers

Q12. Compare and contrast Accounting Standards & Indian Accounting Standards.

Ans :

The differences between the two can be summarized as under :

1. Governance

Accounting Standards (ASs) are governed by Companies (Accounting Standards) Rules 2006. While Indian Accounting Standards (Ind ASs) are governed by the Companies (Indian Accounting Standards) Rules 2015. Both the rules have been framed by the Central Government and are revised by it as and when required.

2. Objective

Both ASs and Ind ASs are expected to act as pillars of sound financial reporting system of the country. However, Ind ASs are basically IFRS Converged Indian Accounting Standards. The notification of Ind ASs can be taken as a significant step towards bringing Indian Financial Reporting System at par with Global Financial Reporting System.

3. Applicability

The Institute of Chartered Accountant of India has so far issued 32 accounting standards out of which two (ASs 6 & 8) have been withdrawn and three (ASs 30, 31 and 32) are still recommendatory. The rest 27 are mandatory for different business enterprise (Level I, Level II and Level III) since a long time starting with 1.04.1991.

The Ministry Corporate Affairs has so far notified 40 Ind ASs. They are being made mandatory in a phased manner w.e.f. financial year 2015-16. It may be noted here that in the years to come Ind ASs will be applicable to all corporate enterprises through appropriate notification(s) by the Ministry of Corporate Affairs or the concerned regulatory authority, e.g. RBI in case of banks, IRDA in case of insurance companies etc. While ASs will be applicable to all other business enterprises: sole proprietorships, partnership firms and even corporate enterprises to which Ind ASs are not applicable. The role of the Institute of Chartered Accountants of India (ICAI) is to harmonies accounting standard issued by ICAI for non-corporate entities. As a result in the event of amendment to the accounting standards being notified by Central Government, the ICAI will also in corporate appropriate changes in the accounting standards issued by it.

5.3 INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Q13. Explain briefly about International Financial Reporting Standards (IFRS).

Ans : (Jan.-21)

International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries. They are progressively replacing the many different national accounting standards.

IFRS began as an attempt to harmonize accounting across the European Union but the value of harmonization quickly made the concept attractive around the world. They are sometimes still called by the original name of International Accounting Standards (IAS). IAS was issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC).

On 1 April 2001, the new International Accounting Standards Board (IASB) took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs). The IASB has continued to develop standards calling the new standards International Financial Reporting Standards.

Meaning of IFRS

International Financial Reporting Standards (IFRS) are a set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements. IFRS are issued by the International Accounting Standards Board. The goal with IFRS is to make international comparisons as easy as possible. This is difficult because, to a large extent, each country

has its own set of rules. For example, U.S. GAAP is different from Canadian GAAP. Synchronizing accounting standards across the globe is an ongoing process in the international accounting community.

According to Kieso, 2011, there are four underlying assumptions in IFRS:

1. **Economic Entity:** Economic activity can be identified with particular unit of accountability. That means, company must separate its activity from the owners and other business.
2. **Going Concern:** The company will have long life and will be operate for foreseeable future.
3. **Monetary Unit Assumption:** Money is used as common denominator of economic activity and provides appropriate basic accounting measurement and analysis. It ignores price-level changes such as inflation and deflation because it assumes that the unit of measure currency remains stable, except if the dramatically change such as hyperinflation.
4. **Accrual Basis:** The transactions in accounting are recorded when the events are recognized as they occur, not when cash is paid or received.

5.3.1 Main Features of IFRS

Q14. What are the main features of IFRS ?

Ans : (June-18, July-17)

1. **For accounting standards to garner worldwide acceptance they must be universally applied.** Comparability is essential if "in accordance with IFRS" means that the same or similar transactions are accounted for the same way everywhere, producing financial statements in accordance with IFRS will add value. Investors would no longer need to waste time and effort to reconcile financial information as they compare similar companies from different countries. Capital would flow more efficiently, at less cost to more companies in more places.

2. **A single system of financial reporting would benefit a host of constituents.** With quality standards, consistently applied, investor understanding and confidence rises. That translates to strong, stable, liquid markets. With quality reporting, investors wouldn't need to compensate for a lack of understanding by demanding a risk premium. With consistent application and the resulting comparability investors and analysts have an easier time knowing how to best allocate capital. Having one financial language reduces preparation and audit costs. No longer is there a need to learn different standards or keep current in them, at the expense of more fruitful pursuits. Regulation can be easier if properly coordinated. Education and training become easier and more focused.

3. **Convergence of accounting standards has played a major role in the growing acceptance of IFRS.** As the differences narrow between IFRS and other widely-accepted accounting systems, resistance to IFRS is beginning to fall away.

5.3.2 Objectives of IFRS

Q15. What are the Objectives of IFRS ?

Ans : (Dec.-19, July-17)

The objectives of IFRS are as follows :

1. To develop in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles.
2. To ensure high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions.

3. To promote the use and rigorous application of those standards.
4. To promote and facilitate adoption of International Financial Reporting Standards (IFRSs), being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.
5. To make a common platform for better understanding of accounting, internationally.
6. Synchronization of accounting standards across the globe.
7. To create comparable, reliable, and transparent financial statements.
8. To facilitate greater cross-border capital raising and trade.
9. To having company-wide one accounting language which has subsidiaries in different countries.

5.3.3 Uses/Advantages of IFRS

Q16. What are the Uses/Advantages of IFRS ?

Ans : (June-18, July-17)

1. IFRS provides better financial information for the shareholders and regulatory system in India.
2. IFRS enhance global ability and improve transparency of results.
3. IFRS users can increase ability to secure cross boarder listing their companies.
4. With the help of IFRS one can improve management of global operations and better access the capital market.
5. IFRS eliminates of multiple reporting, likewise Tata, Birla, Ambani & Vijay Mallya firstly register in India and then outside India before implementing IFRS system.
6. IFRS facilitate global investment opportunities inbound and outbound and also reduced cost of capital.

7. It Reduces barriers to enter global market and lowered the risk associated with dual filings of accounts.
8. IFRS provides new and enhanced services especially in the field of business process outsourcing and professional services firms.
9. With the help of IFRS one can conduct once-only review of financial reporting and information system for control.
10. Uniform accounting standard enabled investors to understand investment opportunity as against two different set of national standard.
11. With the help of IFRS corporate and investors would know it's true worth because fair valuation is mandated for many balance sheet items.

5.3.4 List of IFRS Issued by IASB

Q17. Explain the List of IFRS Issued by IASB.

Ans :

Listing of International Financial Reporting Standards International Financial Reporting Standards is developed by the International Accounting Standards Board.

Following is a list of the standards as issued at January 1, 2011: IASB.

- IFRS 1:** First- time Adoption of International Financial Reporting Standards
- IFRS 2:** Share-based Payment
- IFRS 3:** Business Combinations **IFRS 4:** Insurance Contracts
- IFRS 5:** Non- current Assets Held for Sale and Discontinued Operations
- IFRS 6:** Exploration for and Evaluation of Mineral Assets
- IFRS 7:** Financial Instruments: Disclosures
- IFRS 8:** Operating Segments
- IFRS 9:** Financial Instruments IAS

List of International Financial Reporting Standards (IFRS)

The IFRS overview is as follows :

- IFRS 1:** First Time Adoption of IFRS
- IFRS 2:** Share Based Payment
- IFRS 3:** Business Combination
- IFRS 4:** Insurance Contracts
- IFRS 5:** Non-Current Assets held for Sale & Discontinued Operations
- IFRS 6:** Exploration for and Evaluation of Mineral Resources
- IFRS 7:** Financial Instruments
- IFRS 8:** Operating Segments
- IFRS 9:** Financial Instruments
- IFRS 10:** Consolidated Financial Statements
- IFRS 11:** Joint Arrangements
- IFRS 12:** Disclosure of Interests in Other Entities
- IFRS 13:** Fair Value Measurement
- IFRS 14:** Regulatory Deferral Accounts
- IFRS 15:** Revenue from Contracts with Customer

► IFRS 1: First Time Adoption of IFRS

Effective date

IFRS 1(2008) issued November 2008

Objective

- (i) To prescribe the procedures when an entity adopts IFRSs for the first time as the basis for preparing its general purpose financial statements.

A first time adopter is an entity that for the first time makes an explicit and unreserved statement that their financial statements comply with IFRS. An entity may be a first time adopter if in the preceding year it prepared IFRS financial statements for internal management use as long as those IFRS financial statements were not made available to owners or external parties such as investors

or creditors. If a set of IFRS financial statements are made available to owners or external parties in the preceding year, than the entity will already be considered to be on IFRS.

The entity should reclassify GAAP opening Balance Sheet items into the appropriate IFRS classification. In preparing IFRS estimates at the date of transition of IFRS retrospectively, the entity must use the inputs and the assumptions that had been used to determine previous GAAP estimates as of that date. The entity is not permitted to use information that become available only after the previous GAAP estimates were made except to correct an error.

The objective of these standards is to ensure financial statements and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

- (a) It is transparent for users and comparable over all periods presented.
- (b) It provides a suitable starting point for accounting in accordance with Ind-ASs.
- (c) It can be generated at a cost that does not exceed the benefits.

► **IFRS 2: Share Based Payment**

Effective date

Annual periods beginning on or after 1 January 2005.

Objective

To prescribe the accounting for transactions in which an entity receives or acquires goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's shares or other equity instruments of the entity

A Share Based Payment transaction is transaction in which the entity receives goods or services as consideration for equity instruments of the entity. It includes transactions where the terms

of the arrangements provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash or through the issuance of equity instruments.

The objective of this Standard is to specify the financial reporting by an entity when it undertakes a share-based payment transaction. In particular, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees.

► **IFRS 3: Business Combination**

Effective date:

IFRS 3 (2008) issued January 2008, replacing IFRS 3 (2004). Effective for business combinations in periods beginning on or after 1 July 2009.

Objective

The objective of this standard is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. To accomplish that, this standard establishes principles and requirements for how the acquirer:

- (a) Recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest is acquire.
- (b) Recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase 1.
- (c) Determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

► **IFRS 4: Insurance Contracts**

Effective date

Annual periods beginning on or after 1 January 2005.

Objective:

To prescribe the financial reporting for insurance contracts until the IASB completes the second phase of its project on insurance contracts. This standard applies to insurance contracts that an entity issues.

The objective of this standard is to specify the financial reporting for insurance contracts by any entity that issues such contracts (described in this Indian Accounting Standard as an insurer). In particular, this standard requires limited improvements to accounting by insurers for insurance contracts. Disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

► **IFRS 5: Non-Current Assets held for Sale and Discontinued Operations**

Effective date

Annual periods beginning on or after 1 January 2005.

Objective:

To prescribe the accounting for non-current assets held for sale and the presentation and disclosure of discontinued operations.

Here we look at the assets held for sale to be measured at the lower of carrying amount and the fair value less cost to sell and depreciation on such assets to cease. An entity shall classify a non current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. A discontinued operation is a component of an entity that either has been disposed off or is classified as held for sale and represents a separate major line of business or geographical area of operations to be sold off or a subsidiary to be sold.

The objective of this standard is to specify the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. It requires :

- (a) Assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell and depreciation on such assets to cease.
- (b) Assets that meet the criteria to be classified as held for sale to be presented separately in the balance sheet and the results of discontinued operations to be presented separately in the statement of profit and loss.

► **IFRS 6: Exploration for and Evaluation of Mineral Resources**

Effective date

Annual periods beginning on or after 1 January 2006.

Objective

To prescribe the financial reporting for the exploration for and evaluation of mineral resources until the IASB completes a comprehensive project in this area. IFRS requires disclose of information that identifies and explains the amounts recognized in its financial statements arising from the exploration for and evaluation of mineral resources including its accounting policies for exploration and evaluation of assets.

The objective of this standard is to specify the financial reporting for the exploration for and evaluation of mineral resources. It requires:

- a) Limited improvements to existing accounting practices for exploration and evaluation expenditures.
- b) Entities that recognize exploration and evaluation assets to assess such assets for impairment in accordance with this Indian accounting standard and measure any impairment in accordance with Ind as 36 impairment of assets.
- c) Disclosures that identify and explain the amounts in the entity's financial statements arising from the exploration for and evaluation of mineral resources and help users of those financial statements understand the amount, timing and certainty of future cash flows from any exploration and evaluation assets recognized.

► IFRS 7: Financial Instruments

Effective date and transition

Annual periods beginning on or after 1 January 2007.

Objective:

To prescribe disclosures that enable financial statement users to evaluate the significance of financial instruments to an entity, the nature and extent of their risks, and how the entity manages those risks.

It requires disclosures of various financial assets at fair value and not directly book value, also held to maturity investments, loans and receivables, available for sale assets and financial liabilities measured at amortized cost. It should look at the liabilities at credit risk, market risk and liquidity risk. Information also should be provided at carrying cost of amounts and the fair value of the liabilities.

The objective of this standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- a) The significance of financial instruments for the entity's financial position and performance.
- b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

► IFRS 8: Operating Segments

Effective date

Periods beginning on or after 1 January 2009.

Objective

An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

Here we look at the organization as Parent, or a group, whose debt or equity instruments are traded in a public market. When both separate and consolidated financial statements for the parent are

presented in single financial report segment information need be presented only on the basis of the consolidated financial statement.

IFR interpretations committee provides guidance about decommissioning, restoration and similar liabilities that have previously been recognized both as part of the cost of an item of property, plant and equipment and sometimes as a provision. An example would be the liability of a plant after it is decommissioned or shut down. Sometimes we may also have to take account of restoration of a plant and commission it and ascertain its market value for accounting purpose. Interpretations may have to be made as the revised estimated of outflows of resources against the economic benefits of commissioning/decommissioning of Plant and equipment for both timing and amount. Mostly the cost model is taken but when changes happen to the property then how about its depreciation whether revised or it has to be capitalized and if a discount rate is to be charged how to effectively take the market based discount rate.

The IFRs Interpretations committee also reflects on the issue of Members rights in Co-operative entity. Member's shares in co-operative may have some features of equity. It may also give the member the rights to redemption of his shares in cash within certain Limitations. The IFRs guidance notes speaks about how the equity values maybe evaluated and how the financial liabilities are to be classified.

The IFRs Interpretations committee also reflects on the issue of an arrangement in case of a lease contract. Nowadays many arrangements in terms of a lease can have various arrangements as an outsourcing arrangement.

IFRs interpretations committee also reflects on the issue of obligations towards acts of restoring or rehabilitating environment and the aspect of waste disposal. The industry now has a major role into providing us good articles but also ensuring that Hazardous Industrial waste is properly disposed off so that it does not become a problem. We have seen enough of this in society where people have

to suffer because of Medical waste disposal, the problem of river becoming practical waste carriers, and the hazardous waste affecting the common man. The entities contribute to a fund established to reimburse the decommissioning restoration or rehabilitating cost when they are incurred. The funds may be set up to meet the decommissioning cost of a single contributor or for many contributors.

► **IFRS 9: (2014) Financial Instruments**

Effective date and transition

IFRS 9 Financial Instruments issued in July 2014 is the IASB's replacement of IAS 39 Financial Instruments Recognition and Measurement.

Objective

IFRS 9 sets out requirements for recognition and measurement, impairment, derecognition and general hedge accounting.

► **IFRS 10 : Consolidated Financial Statements**

Effective date and transition

Annual periods beginning on or after 1 January 2013.

Objective

To prescribe a single consolidation model for all entities based on control, irrespective of the nature of the investee i.e., whether an entity is controlled through voting rights of investors or through other contractual arrangements as is common in special purpose entities.

► **IFRS 11: Joint Arrangements**

Effective date and transition

Annual periods beginning on or after 1 January 2013.

Objective

To establish principles for financial reporting by entities that have an interests in joint arrangements.

► **IFRS 12: Disclosure of Interests in Other Entities**

Effective date and transition

Annual periods beginning on or after 1 January 2013.

Objective

To require information to be disclosed in an entity's financial statements that will enable users of those statements to evaluate the nature of, and risks associated with, the entity's interests in other entities as well as the effects of those interests on the entity's financial position, financial performance and cash flows.

► **IFRS 13: Fair Value Measurement**

Effective date and transition

Annual periods beginning on or after 1 January 2013.

Objective

To establish a definition of fair value, provide guidance on how to determine fair value and prescribe the required disclosures about fair value measurements. However, IFRS 13 does not stipulate which items should be measured or disclosed at fair value.

► **IFRS 14: Regulatory Deferral Accounts**

Effective date

First annual IFRS financial statements beginning on or after 1 January 2016 with earlier application permitted.

Objective

To specify the financial reporting requirements for 'regulatory deferral account balances' that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation.

► **IFRS 15: Revenue from Contracts with Customers**

Effective date

Annual periods beginning on or after 1 January 2017 with earlier application permitted.

Objective

To prescribe the accounting treatment for revenue arising from sales of goods and rendering of services to a customer.

Q18. Elucidate the challenges and problems of IFRS.*Ans. :***(Imp.)****1. Difference in GAAP and IFRS**

Adoption of IFRS means that the entire set of financial statements will be required to undergo a drastic change. The differences are wide and very deep route. It would be a challenge to bring about awareness of IFRS and its impact among the users of financial statements.

2. Training and Education

Lack of training facilities and academic courses on IFRS will also pose challenge in India. There is a need to be educated on IFRS and its application. Charles Noski, former chief financial officer and Vice Chairman of the Board of AT & T Corporation and a former Deloitte & Touche partner noted that Educating 100,000 employees on how they must do their business is not a trivial activity,"

3. Legal and Regulatory Considerations

Currently, the reporting requirements are governed by various regulators in India and their provisions override other laws. IFRS does not recognise such overriding laws. The regulatory and legal requirements in India will pose a challenge unless the same is been addressed by respective regulatory.

4. Taxation

IFRS convergence would affect most of the items in the financial statements and consequently the tax liabilities would also undergo a change. Thus the taxation laws should address the treatment of tax liabilities arising on convergence from Indian GAAP to IFRS.

5. Fair Value Measurement

IFRS uses fair value as a measurement base for valuing most of the items of financial statements. The use of fair value accounting can bring a lot of volatility and subjectivity to

the financial statements. It also involves a lot of hard work in arriving at the fair value and valuation experts have to be used.

6. Re-negotiation of Contract

The contracts would have to be re-negotiated which is also a big challenge. This is because the financial results under IFRS are likely to be very different from those under the Indian GAAP

7. Reporting Systems

Companies would have to ensure that the existing business reporting model is amended to suit the reporting requirements of IFRS. The information systems should be designed to capture new requirements related to fixed assets, segment disclosures, related party transactions, etc.

Conversion is much more than a technical accounting issue. IFRS or Ind AS may significantly affect any number of a company's day-to-day operations and may even impact the reported profitability of the business itself. Since the timeline in the roadmap is no longer valid, the new implementation date for Ind AS is awaited from the MCA. It is unclear if the MCA will release a fresh roadmap or just amend the implementation date. Understanding IFRS or Ind AS and its implications is a business imperative for Indian companies.

Short Question and Answers

1. Define Accounting Standards.

Ans :

Accounting standards are the written statements consisting of rules and guidelines, issued by the accounting institutions, for the preparation of uniform and consistent financial statements and also for other disclosures affecting the different users of accounting information.

Accounting standards lay down the terms and conditions of accounting policies and practices by way of codes, guidelines and adjustments for making the interpretation of the items appearing in the financial statements easy and even their treatment in the books of account.

Definition :

According to Kohler, Accounting standards as a "code of conduct imposed on accountants by custom law (or) professional body.

2. Scope of Accounting Standards

Ans :

- (i) Efforts will be made to issue Accounting Standards which are in conformity with the provisions of the applicable laws, customs, usages and business environment in India. However, if a particular Accounting Standard is found to be not in conformity with law, the provisions of the said law will prevail and the financial statements should be prepared in conformity with such law.
- (ii) The Accounting Standards by their very nature cannot and do not override the local regulations which govern the preparation and presentation of financial statements in the country.

However, the ICAI will determine the extent of disclosure to be made in financial statements and the auditor's report thereon.

Such disclosure may be by way of appropriate notes explaining the treatment of particular items. Such explanatory notes will be only in the nature of clarification and therefore need not be treated as adverse comments on the related financial statements.

- (iii) The Accounting Standards are intended to apply only to items which are material. Any limitations with regard to the applicability of a specific Accounting Standard will be made clear by the ICAI from time to time. The date from which a particular Standard will come into effect, as well as the class of enterprises to which it will apply, will also be specified by the ICAI. However, no standard will have retroactive application unless otherwise stated.

3. Objectives of Accounting Standards

Ans :

- (i) **For bringing uniformity in accounting methods :** Accounting standards are required to bring uniformity in accounting methods by proposing standard treatments to the accounting issue. For example, AS-6(Revised) states the methods for depreciation accounting.
- (ii) **For improving the reliability of the financial statements :** Accounting is a language of business. There are many users of the information provided by accountants who take various decisions relating to their field just on the basis of information contained in financial statements. In this connection, it is necessary that the financial statements should show true and fair view of the business concern. Accounting standards when used give a sense of faith and reliability to various users.

They also help the potential users of the information contained in the financial

statements by disclosure norms which make it easy even for a layman to interpret the data. Accounting standards provide a concrete theory base to the process of accounting. They provide uniformity in accounting which makes the financial statements of different business units, for different years comparable and again facilitate decision making.

(iii) Simplify the accounting information :

Accounting standards prevent the users from reaching any misleading conclusions and make the financial data simpler for everyone. For example, AS-3 (Revised) clearly classifies the flows of cash in terms of 'operating activities', 'investing activities' and 'financing activities'.

(iv) Prevents frauds and manipulations :

Accounting standards prevent manipulation of data by the management and others. By codifying the accounting methods, frauds and manipulations can be minimized.

4. Indian Accounting Standards

Ans :

Indian Accounting Standard (abbreviated as Ind-AS) is the Accounting standard adopted by companies in India and issued under the supervision and control of Accounting Standards Board (ASB), which was constituted as a body in the year 1977. ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. ICAI, representatives from ASSOCHAM, CII, FICCI, etc.

The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS). National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India. As on date MCA has notified 39 Ind AS. This shall be applied to the companies of financial year 2015-16 voluntarily and from 2016-17 on a mandatory basis.

5. Compare and contrast Accounting Standards & Indian Accounting Standards.

Ans :

The differences between the two can be summarized as under :

(i) Governance

Accounting Standards (ASs) are governed by Companies (Accounting Standards) Rules 2006. While Indian Accounting Standards (Ind ASs) are governed by the Companies (Indian Accounting Standards) Rules 2015. Both the rules have been framed by the Central Government and are revised by it as and when required.

(ii) Objective

Both ASs and Ind ASs are expected to act as pillars of sound financial reporting system of the country. However, Ind ASs are basically IFRS Converged Indian Accounting Standards. The notification of Ind ASs can be taken as a significant step towards bringing Indian Financial Reporting System at par with Global Financial Reporting System.

(iii) Applicability

The Institute of Chartered Accountant of India has so far issued 32 accounting standards out of which two (ASs 6 & 8) have been withdrawn and three (ASs 30, 31 and 32) are still recommendatory. The rest 27 are mandatory for different business enterprise (Level I, Level II and Level III) since a long time starting with 1.04.1991.

6. International Financial Reporting Standards

Ans :

International Financial Reporting Standards (IFRS) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are

particularly important for companies that have dealings in several countries. They are progressively replacing the many different national accounting standards.

IFRS began as an attempt to harmonize accounting across the European Union but the value of harmonization quickly made the concept attractive around the world. They are sometimes still called by the original name of International Accounting Standards (IAS). IAS was issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC).

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Meaning of IFRS

International Financial Reporting Standards (IFRS) are a set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements. IFRS are issued by the International Accounting Standards Board. The goal with IFRS is to make international comparisons as easy as possible. This is difficult because, to a large extent, each country has its own set of rules. *For example*, U.S. GAAP is different from Canadian GAAP. Synchronizing accounting standards across the globe is an ongoing process in the international accounting community.

7. Main features of IFRS.

Ans :

- (i) **For accounting standards to garner worldwide acceptance they must be universally applied.** Comparability is essential if "in accordance with IFRS" means that the same or similar transactions are accounted for the same way everywhere,

producing financial statements in accordance with IFRS will add value. Investors would no longer need to waste time and effort to reconcile financial information as they compare similar companies from different countries. Capital would flow more efficiently, at less cost to more companies in more places.

- (ii) **A single system of financial reporting would benefit a host of constituents.** With quality standards, consistently applied, investor understanding and confidence rises. That translates to strong, stable, liquid markets. With quality reporting, investors wouldn't need to compensate for a lack of understanding by demanding a risk premium. With consistent application and the resulting comparability investors and analysts have an easier time knowing how to best allocate capital. Having one financial language reduces preparation and audit costs. No longer is there a need to learn different standards or keep current in them, at the expense of more fruitful pursuits. Regulation can be easier if properly coordinated. Education and training become easier and more focused.
- (iii) **Convergence of accounting standards has played a major role in the growing acceptance of IFRS.** As the differences narrow between IFRS and other widely-accepted accounting systems, resistance to IFRS is beginning to fall away.

Choose the Correct Answer

1. Accounting standards are like a _____ [d]
(a) guide (b) dictator
(c) service provider (d) all of the above
2. _____ written statements consisting of rules and guidelines, issued by the accounting institution [c]
(a) accounting principles (b) accounting policies
(c) accounting standards (d) all of the above
3. The ASB was established by ICFAI on _____ [c]
(a) 1-4-1979 (b) 1-6-1985
(c) 21-4-1977 (d) 22-4-1977
4. Accounting standards are intended to apply items which are _____ [b]
(a) material (b) non-material
(c) both (d) none of the above
5. With convergence to IFRS, accounting profession can provide [d]
(a) skills (b) knowledge
(c) recommendations (d) all of the above
6. The ICAI has categorised the entities into _____ groups [a]
(a) 3 (b) 2
(c) 4 (d) 1
7. IASC stands for _____ [d]
(a) International Accounting Strong Committee
(b) International about Standards Committee
(c) International Accounting Standards community
(d) International Accounting Standards Committee
8. The standards formulated by the ASB include paragraphs in [c]
(a) plain (b) italic
(c) both (d) none
9. IFRS are regarded as _____ set of standards [a]
(a) principle based (b) account based
(c) rule based (d) all of the above
10. International Accounting Standards Committee was started in _____ 1973 [a]
(a) June (b) September
(c) November (d) July

Fill in the blanks

1. IFRS stands for _____.
2. ICAI stands for _____.
3. GAAP stands for _____.
4. AS 1 deals with _____ of accounting policies.
5. _____ acts as a dictator in the field of accounting.
6. ASB stands for _____.
7. AS 28 deals with _____.
8. IFRS are considered as _____ set of standards.
9. Non-corporate entities comes under level _____.
10. The entities which are not covered under I, II entities are treated as _____ entities.

ANSWERS

1. International Financial Reporting Standards
2. Institute of Chartered Accountants of India.
3. Generally Accepted Accounting Principles
4. Disclosure
5. Accounting standards
6. Accounting Standard Board
7. Impairment of Assets
8. Principle based
9. I
10. Level - III

FACULTY OF MANAGEMENT
B.B.A. II - Semester (CBCS) Examination
January - 2021
FINANCIAL ACCOUNTING

Time : 2 Hours]

[Max. Marks : 80

PART - A (4 × 5 = 20 Marks)

Note : Answer any four questions.

ANSWERS

- | | |
|--|----------------------|
| 1. Explain the golden rules of accounting with examples. | (Unit-II, Q.No. 9) |
| 2. Conventions of Accounting. | (Unit-I, Q.No. 15) |
| 3. Book of original entry. | (Unit-II, SQA-4) |
| 4. Write about adjustment entries. | (Unit-III, Q.No. 16) |
| 5. Trial Balance | (Unit-II, SQA-7) |
| 6. Accounting equation. | (Unit-II, SQA-3) |
| 7. IASB. | (Unit-V, SQA-4) |
| 8. Importance of ratio analysis. | (Unit-IV, SQA-7) |

PART - B (4 × 15 = 60 Marks)

Note : Answer any four questions.

- | | |
|---|----------------------------|
| 9. Is accounting an information system? What is its importance in modern corporate environment? | (Unit-I, Q.No. 7) |
| 10. Explain the principles of accounting. | (Unit-I, Q.No. 13, 14, 15) |
| 11. Journalise the following transactions in the books of M/s. Agarwal & Co. | |

2019		Rs.
April		
1	Started company with	
	- Cash	75,000
	- Machinery	5,00,000
5	Bought goods from Mr. Kanth worth	1,75,000
8	Sold good to Mr. Kranti	3,95,000
9	Bought furniture for cash	40,000
14	Paid rent	9,000

25 Paid Insurance Rs. 12,000 and out of which Rs. 4,000 is paid in Advance.

Sol :

Journal entries in the books of Agarwal & Co.

Date	Particulars	LF	Debt	Credit
1-4-19	Cash A/c Dr. To Capital A/c (Being started company with cash)		75,000	75,000
1-4-19	Machinery A/c Dr. To Cash A/c (Being machinery purchased for cash)		5,00,000	5,00,000
5-4-19	Purchases A/c Dr. To Mr. Kanth A/c (Being purchased goods from Kanth)		1,75,000	1,75,000
8-4-19	Mr. Kranti A/c Dr. To Sales A/c (Being goods sold to Mr. Kranti)		3,95,000	3,95,000
9-4-19	Furniture A/c Dr. To Cash A/c (Being furnitures purchased for cash)		40,000	40,000
14-4-19	Rent A/c Dr. To Cash A/c (Being rent paid)		9,000	9,000
25-4-19	Insurance A/c Dr. To Cash A/c To Advance A/c (Being insurance paid)		12,000	8,000 4,000

12. Describe the accounting cycle.

Ans :

The process which starts with the transactions taking place and ends up with preparation of final accounts is known as accounting process. This process involves a sequence of activities which are repeated in every accounting period, so it is also known as accounting cycle.

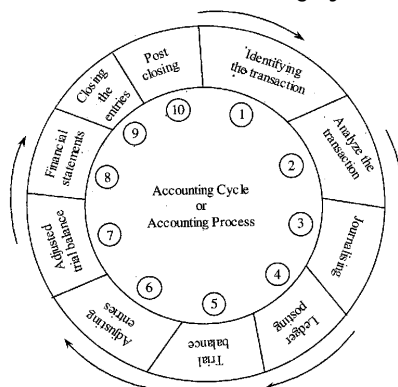


Fig : Accounting Cycle/Process

Various Steps of Accounting Cycle

Following are the steps involved in accounting cycle,

i) Identifying Transaction

The first step in accounting cycle is to identify the transaction and ascertain its source document like purchase order or sales invoice i.e., from where the transaction has been recorded.

ii) Analyzing Transaction

In this step transactions which are expressed in terms of money i.e., monetary transactions and the accounts which are affected by these transactions are identified and analyzed.

iii) Journalizing

After analyzing the transaction they are recorded in journal in the form of entries. These entries are based on principle of double entry in which every transaction has a two fold effect i.e., dual effect.

iv) Ledger Posting

When all the transactions are journalized they must be posted into ledger account. Ledger is a book wherein similar transactions are being recorded in one particular account.

v) Trial Balance

After posting the entries into ledger the entries must be posted in the trial balance in order to evaluate whether the balance of credit and debit side are equal to each other. All the ledger accounts which has debit balance are recorded in the left column and ledger accounts with credit balance are posted on the right column of the trial balance.

vi) Adjusting Entries

The accrued, deferred and estimated amounts are recorded with the help of adjustment entries. These adjustment entries are journalized and recorded into respective ledger account.

vii) Adjusted Trial Balance

The next step in accounting cycle after adjusting the accrued and deferred accounts is to prepare new trial balance which is similar to unadjusted trial balance with the only difference that the adjusting entries are included in the new trial balance.

viii) Financial Statements

In order to analyze the financial position of the company financial statements are prepared which include,

- a) Income Statement :** The income statement is prepared with the help of revenues and incomes earned by the company and losses and expenses incurred by the company.
- b) Balance Sheet :** Balance sheet is prepared with the help of assets, liabilities and equity accounts.
- c) Statement of Retained Earning :** It is prepared by using net income and dividend information.
- d) Cash Flow Statement :** Either direct or indirect method is used to extract cash flow statement from other financial statements of the company.

ix) Closing the Entries

After the preparation of financial statements the balances of temporary accounts are transferred to owner's equity.

x) After-closing Trial Balance

After closing the entries a new trial balance is prepared in order to verify whether the Debit balance is equal to the credit balance or not.

13. Prepare trading, Profit & Loss and balance sheet from the below given trial balance of M/s. Suraj Metals for the year 2018-19.

Particulars	Debit	Credit
Opening stock	1,20,000	
Purchases	3,25,000	
Sales		7,50,000
Returns	6,000	9,000
Wages	30,000	
Carriage	10,000	
Salaries	45,000	
Audit fee	10,000	
Insurance	8,000	
Discount	1,000	2,000
Commission	3,000	4,000
Selling expenses	12,000	
Equity share capital		3,75,000
Loans		3,50,000
Debtors	1,70,000	
Creditors		1,00,000
Plant & Machinery	5,00,000	
Land	2,50,000	
Bills Receivable	45,000	
Cash	55,000	
Total	15,90,000	15,90,000

Additional Information :

- (i) Closing stock Rs. 85,000.
- (ii) Prepaid Insurance Rs. 2,500.
- (iii) Depreciation on P & M 10%
- (iv) Provide bad debts Rs. 10,000 and Provision for bad debts @ 10%.

*Sol.:***Trading and profit loss A/c of Suraj Materials for the year 31/3/2019**

Dr.

Cr.

Particulars	Amount	Particulars	Amount
To Opening stock	1,20,000	By Sales	7,50,000
To Purchases	3,25,000	(-) Returns	6,000
(-) Returns	9,000	By Closing stock	85,000
To Wages	30,000		
To Carriage	10,000		
To Gross profit	3,53,000		
	<u>8,29,000</u>		<u>8,29,000</u>
To Salaries	45,000	By Gross profit	3,53,000
To Audit fee	10,000	By Discount received	2,000
To Discount	1000	By Commission	4,000
To Commission	3,000		
To Selling expenses	12,000		
To Insurance	8,000		
(-) Prepaid	2,500		
To Dep. on Plant & Machinery	5,000		
To Provision	16,000		
To Net profit	2,61,500		
	<u>3,59,000</u>		<u>3,59,000</u>

Balance sheet as on Suraj Materials as on 31-3-2019

Liabilities	Amount	Assets	Amount
Equity	3,75,000	Prepaid Insurance	2,500
Share capital	2,61,500	Closing stock	85,000
Loans	3,50,000	Debtors	1,70,000
Creditors	1,00,000	(-) Bad debts	10,000
			<u>1,60,000</u>
		(-) Provision	16,000
		Plant & Machinery	5,00,000
		(-) Depreciation	5,000
			<u>4,95,000</u>
		Provision	10,000
		Land	2,50,000
		Bills receivable	45,000
		Cash	55,000
	<u>10,86,500</u>		<u>10,86,500</u>

14. What are final statements? Explain how they are useful for stakeholders. (Pending)
15. Balance sheet of Mr. Suraj Steels for the year 2018 is presented below.

Liabilities	2018	Assets	2018
Equity Share Capital	1,00,000	Land	1,90,000
10% Preference Capital	2,50,000	Plant & Machinery	2,50,000
11% Debentures	1,50,000	Investments	1,15,000
P & L Account	1,50,000	Creditors	1,00,000
Creditors	1,10,000	Bills Receivables	40,000
Profit & Loss Account	35,000	Debtors	1,40,000
Creditors	1,10,000	Bills Receivable	40,000
Bills Payable	70,000	Stock	1,00,000
Outstanding salaries	25,000	Cash	40,000
		Marketable Securities	20,000
	<u>8,40,000</u>		<u>8,40,000</u>

Additional Information :

Sales – Rs. 18,00,000

Calculate :

- Quick Ratio
- Cash Ratio
- Debt Equity Ratio
- Return on Investment
- Inventory turnover ratio
- Assets turnover ratio

Sol :

- (a) Quick Ratio

$$= \frac{\text{Quick Assets}}{\text{Quick Liabilities}}$$

$$\begin{aligned} \text{Quick Assets} &= \text{Current} + \text{Assets} - \text{Stock} \\ &= 1,00,000 + 40,000 + 1,40,000 - 1,000 + 40,000 + 1,00,000 \\ &= 4,80,000 - 1,00,000 = 3,80,000 \end{aligned}$$

$$\begin{aligned} \text{Quick liabilities} &= \text{Current liabilities} - \text{Bank Overdraft} \\ &= 1,10,000 + 35,000 + 1,10,000 + 70,000 + 25,000 \\ &= 3,50,000 - \text{Nil} = 3,50,000 \\ &= \frac{3,80,000}{3,50,000} = 1.08 \end{aligned}$$

$$(b) \text{ Cash Ratio} = \frac{40,000}{18,00,000} \times 100 = 2.22$$

(c) Debt Equity Ratio

$$= \frac{\text{Long term debts}}{\text{Shareholder's funds}}$$

$$\text{Long term debts} = 1,50,000$$

$$\begin{aligned} \text{Shareholder funds} &= 1,00,000 + 2,50,000 + 1,50,000 + 35,000 \\ &= 5,85,000 \end{aligned}$$

$$= \frac{1,50,000}{5,85,000} = 0.25\%$$

(d) Inventory Turnover Ratio

$$= \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

$$\text{Cost of goods sold} = \text{Sales} - \text{Gross profit}$$

$$= 18,00,000 - \text{Nil}$$

$$= 18,00,000$$

Average inventory information is not provided in the problem. So incomplete problem.

$$\begin{aligned} (e) \text{ Assets turnover ratio} &= \frac{\text{Net Sales}}{\text{Total Assets}} \\ &= \frac{18,00,000}{8,40,000} = 2.14 \end{aligned}$$

16. Discuss classification of ratios. Explain the importance of ratio analysis. (Unit-IV, Q.No. 23, 24, 25, 26, 27)
17. What is Ind-AS and how do the accounting standards guide in preparation of accounts? (Unit-V, Q.No. 7)
18. What is IFRS? How IFRS is different from Ind-AS. (Unit-V, Q.No. 13)

Ind AS	IFRS
1. Ind AS1 Presentation of Financial Statement.	1. IAS1 Presentation of Financial Statements.
2. Ind AS2 Inventories.	2. IAS2 Inventories.
3. Ind AS7 Statement of Cash Flows.	3. IAS7 Statement of Cash Flows.
4. Ind AS8 Accounting Policies, Changes in Accounting Estimates and Errors.	4. IAS8 Accounting Policies, Changes in Accounting Estimates and Errors.
5. Ind AS to Events after the Reporting period Ind AS to Appendix A.	5. IFRIC17 Distribution of Non-cash Assets to owners.

FACULTY OF MANAGEMENT
B.B.A. III - Semester (CBCS) Examination
November / December - 2019
FINANCIAL ACCOUNTING

Time : 3 Hours]

[Max. Marks : 80

PART - A (5 × 4 = 20 Marks)**[Short Answer Type]**

I, Answer any five of the following in not exceeding 20 lines.

ANSWERS

- | | |
|--------------------------------|--------------------------------|
| (a) Full Disclosure Concept | (Unit-I, Q.No. 15 (2nd Point)) |
| (b) GAAP | (Unit-I, Q.No. 16) |
| (c) Rules of Personal Accounts | (Unit-II, Q.No. 11 (A point)) |
| (d) Ledger Balancing | (Unit-II, SQA-6) |
| (e) Provision of Taxation | |

Ans :

Reserve kept aside for paying tax is known as provision for taxation. It is made out of current year profits and loss appropriation A/c. It appears on the liabilities side of balance sheet.

P & L A/c Dr.

To Provisions for Taxation A/c.

- | | |
|----------------------------------|---------------------|
| (f) Financial Statement Analysis | (Unit-IV, SQA-1) |
| (g) Solvency Ratios | (Unit-IV, Q.No. 25) |
| (h) Ind-As | (Unit-V, SQA-4) |

PART - B (5 × 12 = 60 Marks)**[Essay Answer Type]**

- | | |
|---|--------------------|
| 2. (a) State the various users of accounting information. | (Unit-I, Q.No. 12) |
|---|--------------------|

OR

- | | |
|--|--------------------|
| (b) Explain in detail-about the Accounting-Concepts. | (Unit-I, Q.No. 14) |
|--|--------------------|

- | | |
|--|---------------------|
| 3. (a) What is Ledger ? State different types of vouchers. | (Unit-II, Q.No. 18) |
|--|---------------------|

OR

- | | |
|--|--|
| (b) From the following transactions, prepare journal for the month of January, 2018. | |
|--|--|

- (i) Commenced business with a capital of ₹ 5,00,000.
- (ii) Purchased machinery ₹ 1,00,000.
- (iii) Purchased goods worth ₹ 1,20,000 for cash.
- (iv) Sold goods of cash ₹ 75,000.
- (v) Purchased goods from Mr. Surya ₹ 20,000.

- (vi) Sold goods to Mr. Ramana ` 35,000.
 (vii) Paid for advertisements ` 10,000.
 (viii) Paid for machinery ` 5,000.
 (ix) Received cash from Ramana ` 32,000 on full settlement of his account.
 (x) Paid for salaries ` 50,000
 (xi) Received interest on Fixed Deposits ` 7,500.

Ans :

Journal Entries for the Month of January, 2019

S.No.	Particulars	LF	Debt	Credit
(i)	Cash A/c Dr. To Capital A/c (Being business commenced with cash)		5,00,000	5,00,000
(ii)	Machinery A/c Dr. To Cash A/c (Being machinery purchased for cash)		1,00,000	1,00,000
(iii)	Purchases A/c Dr. To Cash A/c (Being goods purchased for cash).		1,20,000	1,20,000
(iv)	Cash A/c Dr. To Sales A/c (Being goods sold for cash)		75,000	75,000
(v)	Purchases A/c Dr. To Mr. Surya A/c (Being goods purchased from Mr. Surya)		20,000	20,000
(vi)	Mr. Ramesh A/c Dr. To Sales A/c (Being goods sold to Mr. Ramana on Credit)		35,000	35,000
(vii)	Advertisement A/c Dr. To Cash A/c (Being advertisement expenses paid)		10,000	10,000
(viii)	Stationery A/c Dr. To Cash A/c (Being stationery expenses paid)		5,000	5,000

(ix)	Cash A/c	Dr.	32,500	
	Discount allowed A/c	Dr.	2,500	
	To Ramana A/c (Being cash received from Ramana on full settlement)			35,000
(x)	Salaries A/c	Dr.	50,000	
	To Cash A/c (Being salaries paid)			50,000
(xi)	Bank A/c	Dr.	7,500	
	To Interest on fixed deposit A/c (Being interest on fixed deposits received)			7,500

4. (a) State the distinguished features of Profits and Loss Account. (Unit-III, Q.No. 7)

OR

- (b) From the following trial balance, you are required to prepare trading, profit and loss Account for the year ended 31st December 2018 and Balance Sheet as on that date.

Particulars	Debit (₹)	Particulars	Credit (₹)
Investment in Shares of Relianced Co. Ltd.	1,18,000	Capital	1,00,000
Buildings	1,15,000	Loan from SBI @ 12% interest p.a.	1,50,000
Furniture & Fittings	1,07,500	Sales	2,00,000
Motor Van	75,000	Commission received	7,500
Interest on Debentures	9,000	Sundry Creditors	10,000
Purchases	75,000	Capital Reserve	50,000
Opening Stock	25,000	Provision of Bad Debts	1,100
Staff Salaries	15,000	Bills Payable	20,000
Wages	2,000		
Insurance	1,000		
Sundry Debtors	78,100		
Cash at Bank	70,000		
Goodwill	50,000		
	<u>7,40,600</u>		<u>7,40,600</u>

Additional Information :

- The value of closing stock as on 31st December, 2018 amounted to ₹ 3,19,000.
- Write off ₹ 1,000 as bad debts, and provide for doubtful debts @ 5%.
- Outstanding wages ₹ 500.
- Depreciation Building @ 2%. Furniture and Fittings @ 10% and Motor Van @ 10%.

*Ans :***Trading and Profit and Loss A/c for the year ending 31-12-2018**

Dr.

Cr.

Particulars	Amount	Particulars	Amount
To Opening Stock	25,000	By Sales	2,00,000
To Purchases	75,000	By Closing Stock	3,19,000
To Wages 2,000			
(+) O/S 500	2,500		
To Gross Profit c/d	4,16,500		
	<u>5,19,000</u>		<u>5,19,000</u>
To Staff salaries	15,000	By Gross profit b/d	4,16,500
To Insurance	1,000	By Commission received	7,500
To Bad debts	1,000		
To Provisions for doubtful debts (3855 – 3100)	755		
To Interest on debentures	9,000		
To Depreciation on buildings	2,300		
To Depreciation of furnitures	10,750		
To Depreciation on motor van	7,500		
To Interest on loan from SBI	18,000		
To Net profit	3,58,695		
	<u>4,24,000</u>		<u>4,24,000</u>

Balance Sheet as on 31-12-2018

Liabilities	Amount	Assets	Amount
Capital 3,00,000		Investment	1,18,000
(+) Net profit 3,58,675		Buildings 1,15,000	
	6,58,695	(-) Depreciation 2,300	1,12,700
Capital Reserve	50,000	Furnitures and	
O/s wages	500	fixtures 1,07,500	
Loan 1,50,000		(-) Depreciation 10,750	96,750
(+) Outstanding 18,000	1,68,000	Motor Van 75,000	
Creditors	10,000	(-) Deprecation 7,500	67,500

Bills payable	20,000	Debtors	78,100	
		(-) Bad debts	1,000	
			<u>77,000</u>	
		(-) Provisions	3,855	73,245
		Cash at bank		70,000
		Goodwill		50,000
		Closing stock		3,19,000
	<u>9,07,195</u>			<u>9,07,195</u>

5. (a) Explain the significance and various tools of Financial Statement Analysis.

(Unit-IV, Q.No. 6, 9)

OR

- (b) The following figures are available for X Ltd. for the year ended 31st March, 2019.

Net Profit before interest and tax ` 2,75,000

Net Profit after tax ` 2,20,000

Net Profit after interest and tax ` 1,10,000

Preference Dividend ` 35,000

Capital employed ` 11,00,000

Total Assets ` 12,65,000

Equity Shareholders, Fund ` 7,50,000

You are required to calculate :

- Return on Capital Employed
- Return on Total Assets and
- Return on Shareholders' Funds.

Ans :

- (i) **Calculation of return on capital employed**

$$= \frac{\text{Net profit before interest and tax}}{\text{Capital employed}} \times 100$$

$$= \frac{2,75,000}{11,00,000} \times 100 = 25\%$$

- (ii) **Calculation of return on total assets**

$$= \frac{\text{Net profit before interest and tax}}{\text{Total assets}} \times 100$$

$$= \frac{2,75,000}{12,65,000} \times 100 = 21.74\%$$

(iii) **Calculation of return on share holder's funds**

$$= \frac{\text{Net profit before interest and tax} - \text{Preference dividend}}{\text{Equity shareholders funds}} \times 100$$

$$= \frac{1,10,000 - 35,000}{7,50,000} \times 100$$

$$= \frac{75,000}{7,50,000} \times 100 = 10\%$$

6. (a) Describe the importance of Accounting Standards.

(Unit-V, Q.No. 3)

OR

(b) Write the objectives of IFRS.

(Unit-V, Q.No. 15)

Rahul Publications

FACULTY OF MANAGEMENT
B.B.A. III - Semester (CBCS) Examination
June / July - 2019
FINANCIAL ACCOUNTING

Time : 3 Hours]

[Max. Marks : 80

PART - A (5 × 4 = 20 Marks)**Answer any five of the following questions.****ANSWERS**

- | | |
|----------------------------------|---------------------------------|
| 1. Accounting Standards. | (Unit-V, SQA-1) |
| 2. Rules of Accounting | (Unit-I, Q.No. 9) |
| 3. Three Column Cash Book | (Unit-II, Q.No. 2, (iii) Point) |
| 4. Capital Loss Vs. Revenue Loss | |

*Ans :***Capital losses**

Capital losses are losses realized on sale of fixed assets or when a company issues shares at a discount to the general public. These losses are not recurring and are not realized through the normal business activities of a company

Revenue losses

Revenue losses are losses which are realized by carrying on the normal business activities of a company. They occur as a result of sale of stock-in-trade or provision of services to customers at a price that is less than the cost.

- | | |
|-----------------------------|-------------------|
| 5. Debentures | (Out of Syllabus) |
| 6. Right Shares | (Out of Syllabus) |
| 7. Depreciation Method | (Out of Syllabus) |
| 8. Weighted Average Method. | (Out of Syllabus) |

PART - B (5 × 12 = 60 Marks)

- | | |
|---|-----------------------|
| 9. (a) Define Financial Accounting. Explain its functions and advantages. | (Unit-I, Q.No. 9, 10) |
|---|-----------------------|

OR

- | | |
|--|--------------------|
| (b) Explain accounting concepts. | (Unit-I, Q.No. 14) |
| 10. (a) Explain any four Subsidiary Books. | (Unit-II, Q.No. 1) |

OR

- (b) Journalize the following :

Date	Particulars	Amount (₹)
2006 Jan-1	Started business with cash	1,00,000
2	Goods purchased for cash	50,000
4	Purchased furniture and paid by cheque	1,000

6	Sold goods for cash	20,000
8	Sold goods to Ramesh	10,200
10	Purchased goods from April	15,000
12	Returned goods to Ajay	2,000
14	Withdrew from bank for personal use	3,000
16	Withdrew from bank for office use	2,000

Ans.:

Journal Entries

Date	Particulars	LF	Debit	Credit
1-1-16	Cash A/c Dr. To Capital A/c (Being started business with cash)		1,00,000	1,00,000
2-1-16	Purchases A/c Dr. To Cash A/c (Being goods purchased for cash)		30,000	30,000
4-1-16	Furniture A/c Dr. To Bank A/c (Being furniture purchased)		1,000	1,000
6-1-16	Cash A/c Dr. To Sales A/c (Being goods sold for cash)		20,000	20,000
8-1-16	Ramesh A/c Dr. To Sales A/c (Being goods sold to ramesh on credit)		1,000	1,000
10-1-16	Purchases A/c Dr. To Ajay A/c (Being goods purchased from Ajay on credit)		15,000	15,000
12-1-16	Ajay A/c Dr. To Purchase returns A/c (Being goods returned to ajay)		2,000	2,000
14-1-16	Drawings A/c Dr. To Bank A/c (Being cash withdrawn from bank for personal use)		3,000	3,000
16-1-16	Cash A/c Dr. To Bank A/c (Being cash withdrawn from bank for office use)		2,000	2,000

11. (a) Distinguish between Journal and Ledger.

(Unit-II, Q.No. 21)

OR

(b) What do you mean by capital and revenue reserve? Write the differences between them with examples.

Ans :

BASIS FOR COMPARISON	REVENUE RESERVE	CAPITAL RESERVE
Meaning	Revenue Reserve refers to the sum of money retained in business, so as to meet out future contingencies.	Capital Reserve alludes to a fund, that is created to finance long term project or write off capital expenses.
Source	Revenue profit of the firm are the source of revenue reserves.	Capital profit of the firm are the source of capital reserve.
Aim	To meet unforeseen contingencies and improve entity's financial position.	To adhere to the statutory requirements or accounting principles.
Utilization	Based on the type of reserve it can be utilized for any or particular purpose only.	Capital reserve can be utilized for the purpose for which it is created.
Dividend	It is freely available for distribution as dividend.	It is not available for distribution as dividend.

12. (a) Explain the steps in formation of a Joint Stock Company.

Ans :

(i) Promotion:

Promotion means the generation to start the company. This is the process of planning and organizing all the resources which are needed to form a company. The person who performs all these activities related to the promotion of the company is called a promoter.

(ii) Incorporation:

This is the second stage of the formation of a Joint Stock Company. It means the registration of the company which is incorporated under companies act 1956.

(iii) Capital Subscription:

This stage includes the task of obtaining the required capital for the commencement of the company. In the case of a private company, after getting the certificate of incorporation it can start the business

(iv) Commencement:

The registrar issue the certificate of Commencement of business after receiving the minimum subscription, along with the application. this is the final stage and in this stage legal documents are prepared the after certification company can run its operation smoothly.

OR

(b) From the following prepare final account as on 31-12-2017.

	₹		₹
Capital	30,000	Drawings	6,000
Creditors	41,000	Bills Payable	4,000
Debtors	51,000	Bills receivable	37,000
Furniture	8,500	Opening Stock	47,000
Cash in hand	900	Cash at SBI	12,500
Overdraft with Central Bank	6,000	Purchases	48,900
Duty and cleaning charges	3,500	Sales	1,27,000
Salaries	9,500	Travelling Expenses	4,700
General Expenses	2,500	Rent Paid	2,000
Commission received	4,000		

Adjustments :

1. Closing Stock ₹ 50,000.
2. Trading and profit & Loss A/c for the year ending 31-12-20217

Ans :

Particulars	Amount	Particulars	Amount
To Opening stock	47,000	By Sales	1,27,000
To Purchases	48,900	By Closing stock	50,000
To Gross profit c/d	81,100		
	<u>1,77,000</u>		<u>1,77,000</u>
To Salaries	9,500	By Gross profit b/d	81,100
To Duty and cleaning charges	3,500	By Commission received	4,000
To General expenses	2,500		
To Travelling expenses	4,700		
To Rent paid	2,000		
To Net profit c/d	62,900		
	<u>85,100</u>		<u>85,100</u>

Balance Sheet as on 31-12-2017

Liabilities		Amount	Assets		Amount
Capital	30,000		Furniture		8,500
(-) Drawings	6,000		Debtors		51,000
	<u>24,000</u>		Cash at bank		900
(+) Net profit	62,900	86,900	Bills receivables		17,000
Overdraft with central bank		6,000	Cash at SBI		12,500
Bills payable		4,000	Closing stock		50,000
Creditors		43,000			
		<u>1,39,900</u>			<u>1,39,900</u>

13. (a) A firm purchased Plant and Machinery on 1st April 2016 for ₹ 1,00,000. Depreciation is written off at rate of 10 percent per annum under diminishing method. The firm closes books on 31st December every year. Show Machinery Account for 3 years. **(Out of Syllabus)**

OR

- (b) The following transaction are taken in respect of a material used in a factory.

Date	Quantity Received	Rate Per Unit	Quantity Issued
31-1-18	400	2.10	—
15-1-18	500	2.20	—
19-1-18	—	—	500
23-1-18	600	2.50	—
27-1-18	—	—	900

Prepare a stock ledger pricing the issues at weighted average method. **(Out of Syllabus)**

FACULTY OF MANAGEMENT
B.B.A. III - Semester (CBCS) Examination
November / December - 2018
FINANCIAL ACCOUNTING

Time : 3 Hours]

[Max. Marks : 80

PART - A (5 × 4 = 20 Marks)**Answer any five of the following questions.****ANSWERS**

- | | |
|----------------------------------|--------------------------------|
| 1. Accounting Equation | (Unit-II, Q.No. 7) |
| 2. Double Entry System | (Unit-II, Q.No. 6) |
| 3. Bank Reconciliation Statement | (Out of Syllabus) |
| 4. Petty Cash Book | (Unit-II, Q.No. 2, (IV) Point) |
| 5. Capital Vs. Revenue Profit | |

Ans :

Following are the main differences between capital profit and revenue profit.

- (i) **Mode of Earning:** Capital profit is earned by selling assets, shares and debentures at a price more than their book value and face value. Revenue profit is earned in the ordinary course of the business.
- (ii) **Distribution:** Capital profit is not available for the distribution to shareholders as dividend. Revenue profit is available for the distribution to shareholders as dividend.
- (iii) **Use:** Capital profit is transferred to capital reserve and used for meeting capital losses. Revenue profit is used to distribute dividend and create reserve and fund for various purposes.
- (iv) **Treatment:** Whenever, capital profit is made it should either be transferred to the capital account of the proprietor or credited to capital reserve account which would appear as a liability on the balance sheet. But capital profits should in no case be transferred to profit and loss account because it is non-trading profit. Revenue profits on the other hand should be transferred to profit and loss account because they arise out of regular trading operation.

-
6. Secret Reserve

Ans :

A secret reserve is the amount by which the assets of an organization are understated or its liabilities are overstated. An entity might establish a secret reserve for competitive reasons, to hide from other businesses that it is in a better financial position than appears in its financial statements.

-
- | | |
|---------------------------------|-------------------|
| 7. Bonus Shares | (Out of Syllabus) |
| 8. Preference of Shares | |
| (i) Depreciation | (Out of Syllabus) |
| (ii) Inventory Valuation Method | (Out of Syllabus) |

PART - B (5 × 12 = 60 Marks)

9. (a) Define Financial Accounting. What are its functions and limitations? (Unit-I, Q.No. 7, 10, 11)

OR

- (b) Explain accounting concept and conventions. (Unit-I, Q.No. 14, 15)

10. (a) What are the different types of cash budget? Explain briefly two column cash book.

(Unit-II, Q.No. 2)

OR

- (b) Journalize the following transactions.

2018		
Jan. 1	Started business with	50,000
Jan. 2	Paid into bank	30,000
Jan. 3	Bought goods from Singh & Co. on credit	22,000
Jan. 4	Purchased furniture	4,200
Jan. 5	Paid Postage	200
Jan. 7	Sold goods for cash	5,000
Jan. 9	Sold goods on credit to Standards	4,600
Jan. 12	Paid to Singh & Co.	21,000
Jan. 15	Received cheque from Sharada in full settlement	4,500

*Sol.:***Journal Entries**

Date	Particulars	LF	Debit	Credit
1-1-18	Cash A/c Dr. To Capital A/c (Being capital brought into business)		50,000	50,000
2-1-18	Bank A/c Dr. To Cash A/c (Being cash deposited into bank)		30,000	30,000
3-1-18	Purchases A/c Dr. To Singh & Co. A/c (Being goods purchased on credit from Singh & Co.)		22,000	22,000
4-1-18	Furniture A/c Dr. To Cash A/c (Being furniture purchased on cash)		4,200	4,200
5-1-18	Postage A/c Dr. To Cash A/c (Being cash paid to postage)		200	200

7-1-18	Cash A/c To Sales A/c (Being sold goods on cash)	Dr.	5,000	5,000
9-1-18	Sharadha A/c To Sales A/c (Being goods sold to sharadha on credit)	Dr.	4,600	4,600
12-1-18	Singh & Co A/c To Cash A/c (Being paid to Singh Co.)	Dr.	21,000	21,000
15-1-18	Bank A/c Discount allowed A/c To Sharadha A/c (Being cheque received from sharadha in full settlement)	Dr. Dr.	4,560 40	4,600

11. (a) Enumerate different kinds of errors. Give two examples of each.

Ans :

1. Error of Principle

Transactions are recorded as per generally accepted accounting principles. If any of these principles are violated or ignored, errors resulting from such violation are known as errors of principle.

For example, Purchase of machinery recorded in the purchases book. It is an error of principle, because the purchases book is meant for recording credit purchases of goods meant for resale and not fixed assets. Trial balance will not disclose errors of principle. These errors may arise, when the distinction is not made between the Capital and Revenue nature items.

Example

- i) Purchase of Machinery, debited to purchases a/c

Machinery a/c is - Capital nature

Purchase a/c is - Revenue nature

Instead of debiting capital nature A/c (Machinery A/c), debiting a Revenue nature a/c (Purchases A/c) is an error of principle.

- ii) Rent paid to land lord, debited to his personal A/c

Rent A/c is - Nominal Account

Land lord A/c is - Personal Account

If Land lord A/c is debited instead of Rent A/c, it becomes an error of principle

2. Error of Omission

When a transaction is completely or partly omitted from the books of accounts such error is known as Error of Omission.

- (i) **Error of Complete Omission:** This error arises when a transaction is totally omitted in the books of accounts.

For example, Furniture purchased from Saketh & Co. completely not recorded. This error does not affect the trial balance.

- (ii) **Error of Partial Omission:** This error arises when only one aspect of the transaction either debit or 'credit is recorded.

For example, a credit sale of goods to Sunder is recorded in sales book but not posted in Sunder's account. This error affects the trial balance.

3. Error of Commission

This error arises due to wrong recording, wrong posting, wrong casting, wrong balancing, wrong carrying forward etc. Errors of commission may be classified as follows:

- (i) **Error of Recording:** This error arises when a transaction is wrongly recorded in the books of original entry.

For example. Goods of ₹ 8,500, purchased on credit from Praveen, is recorded in the book as ₹ 5,800. This error does not affect the trial balance.

- (ii) **Error of Posting:** This error arises when information recorded in the books of original entry are wrongly entered in the ledger. Error of posting may be

- Right amount in the right side of wrong account
- Right amount in the wrong side of correct account
- Wrong amount in the right side of correct account
- Wrong amount in the wrong side of correct account
- Wrong amount in the wrong side of wrong account
- Wrong amount in the right side of wrong account etc.

These errors may or may not affect the trial balance.

4. Compensating Errors

The errors arising from excess debits or under debits of accounts being neutralized by the excess credits or under credits to the same extent of some other account is compensating error. Since the errors in one direction are compensated by errors in another direction, arithmetical accuracy of the trial balance is not at all affected. In other words, If two or more errors are committed and one error nullifies another error, the net effect is unchanged.

Committing an error to compensate the previous or another error is known as compensating error.

Example: Amount paid to Ram ₹ 5000 recorded as ₹ 4500, and amount received from Syam ₹ 10,000 recorded as ₹ 9,500.

5. Error of Posting to Wrong Head of A/c

Instead of recording in one account, recording in another account is known as error of posting to wrong head of a/c

Example: Paid to Mahesh ₹ 1000 is debited to Suresh A/c.

OR

(b) Prepare a Trial Balance

Capital	60,000
General Expenses	5,400
Manufacturing Expenses	1,500
Provision for dividend debts	1,000
Office rent	2,000
Machinery	28,000
Furnitures	10,000
Bills payable	4,200
Carriage Onward	1,500
Furnitures	68,000
Sales	94,500
Carriage Outward	1,700
Debtors	23,500
Creditors	14,300
Opening stock	20,500
Drawings	7,200
Cash at bank	4,700

Sol :

Trial Balance

Particulars	Debit	Credit
Capital		60,000
General expenses	54,00	
Manufacturing expenses	1,500	
Provision for doubtful debts		1,000
Office rent	2,000	
Machinery	28,000	
Furniture	10,000	
Bills payable		4,200
Carriage onward	1,500	
Purchases	68,000	
Sales		94,500

Carriage outward	1,700	
Debtors	23,500	
Creditors		14,300
Opening stock	20,500	
Drawings	7,200	
Cash at bank	4,700	—
	<u>1,74,000</u>	<u>1,74,000</u>

12. (a) Define company and explain its characteristics.

Ans :

Meaning

A company is a voluntary association of persons, recognized by law, having a distinctive name, a common seal, formed to carry on business for profit, with capital divisible into transferable shares, limited liability, a corporate body and perpetual succession.

Characteristics

- (i) **Registration:** A company comes into existence on registration under the Companies Act. It is an incorporated association. A joint stock company may be incorporated as a private or public company or one person company.
- (ii) **Legal Entity:** A company formed and registered under the Companies Act is a legal entity separate and distinct from its members. It may contract, sue and be sued in its own name. It has no physical body and exists only in the eyes of law.
- (iii) **Perpetual Succession:** As the life of the company is not affected by changes in individual shareholders, it is said to have perpetual succession (i.e., continuity of life). Even the death or insolvency of a member (or even all members) does not affect the corporate existence of the company. Members may come, members may go, but the company continues its operations unless it is wound up.
- (iv) **Transferability of Shares:** Shareholders have the right to transfer their shares. The shares of a company are freely transferable and can be sold or purchased in the stock exchange. However, in the case of a private company, certain restrictions are placed on the rights of a member to transfer his shares.
- (v) **Limited Liability of Members:** It means that the liability of the shareholders is limited upto the value of the shares held by them. Once the shareholders have paid the full nominal value of the shares they have agreed to take, they cannot be held responsible for any of the debts of the company which cannot be met from company's assets.

OR

- (b) Prepare Trading, Profit & Loss and Balance Sheet as on March 31st, 2018 from following Trial Balance.

Debit Balance	✓	Credit Balance	✓
Purchases	1,40,000	Capital	1,30,000
Sales Return	5,000	Sales	1,59,000
Opening Stock	20,000	Purchase Return	7,000
Drawings	5,000	Creditors	40,000
Wages	10,000	Discount	1,000
Manufacturing Expenses	5,000	Interest	5,000
Salaries	10,000	Commission	800
Discount	2,000	Premium	2,200
Repairs	600		
Debtors	80,000		
Machinery	58,000		
Rent	2,500		
Office	1,900		
	<u>3,40,000</u>		<u>3,40,000</u>

Adjustments :

- (i) Closing Stock ` 50,000
(ii) Provide 10% interest on capital
(iii) Charge 12% interest on drawing.

Sol :

Trading and Profit and Loss A/c for the year ended 31-03-2018

Dr.

Cr.

Particulars	Amount	Particulars	Amount
To Opening stock	20,000	By Sales	1,59,000
To Purchases	1,40,000	(-) Returns	<u>5,000</u>
(-) Returns	<u>2,000</u>	By Closing stock	50,000
To Manufacturer expenses	5,000		
To Wages	10,000		
To Gross profit c/d	31,000		
	<u>2,04,000</u>		<u>2,04,000</u>

To Salaries	10,000	By Gross profit b/d	31,000
To Discount	2,000	By Commission	800
To Repairs	600	By Discount	1,000
To Rent	2,500	By Premium	2,200
To Office expenses	1,900	By Interest on drawings	600
To Interest on capital	13,000	By Interest	5,000
To Net profit c/d	10,600		
	<u>40,600</u>		<u>40,600</u>

Balance sheet as on 31-03-2018

Liabilities		Amount	Assets		Amount
Capital	1,30,000		Machinery		58,000
(+) Net profit	10,600		Debtors		80,000
	<u>1,40,600</u>		Closing stock		50,000
(+) Interest capital	13,000				
	<u>1,53,600</u>				
(-) Drawings	5,600	1,48,000			
Creditors		40,000			
		<u>1,88,000</u>			<u>1,88,000</u>

13. (a) Explain various depreciation methods.

(Out of Syllabus)

OR

(b) The following is an extract of receipts and issues.

Jan. 1	Opening Balance	500 units @ ` 4
5	Received from vendor	200 units @ ` 4.25
12	Received from vendor	150 units @ ` 4.10
20	Received from supplier	300 units @ ` 4.50

Issues of materials were as follows :

Jan. 4	200 units
15	100 units
26	200 units
27	400 units

Issues are to be priced on principle of FIFO. Draw up Stores Ledger.

(Out of Syllabus)

FACULTY OF MANAGEMENT
B.B.A. III - Semester (CBCS) Examination
May / June - 2018
FINANCIAL ACCOUNTING

Time : 3 Hours]

[Max. Marks : 80

PART - A (5 × 4 = 20 Marks)**I. Answer any five of the following in not exceeding 20 lines.****ANSWERS**

- | | |
|---------------------------------|--|
| (a) Matching Concept | (Unit-I, Q.No. 14 (7 th Point)) |
| (b) Principle of Materiality | (Unit-I, Q.No. 15 (4 th Point)) |
| (c) Ledger | (Unit-II, SQA-6) |
| (d) Opening and Closing Entries | (Unit-II, Q.No. 15) |
| (e) Adjustments | (Unit-III, Q.No. 16) |
| (f) Paid up Capital | (Out of syllabus) |
| (g) Vertical Analysis | (Unit-IV, SQA-5) |
| (h) Solvency Ratios | (Unit-IV, Q.No. 25) |

PART - B (5 × 12 = 60 Marks)

2. (a) Explain the uses and limitation of accounting. (Unit-I, Q.No. 12, 4)
- OR
- (b) Describe the concepts and convention of accounting. (Unit-I, Q.No. 14, 15)
3. (a) Explain the classification of accounts. Explain the rules of debit and credit with examples. (Unit-II, Q.No. 9)

OR

- (b) Enter the following transactions in the Journal of Bhagwat and Sons.

2006	Amount (₹)
Jan. 1 Tarun started business with cash	1,00,000
Jan. 2 Goods purchased for cash	20,000
Jan. 4 Machinery purchased from Vibhu	30,000
Jan. 6 Rent paid in cash	10,000
Jan. 8 Goods purchased on credit from April	25,000
Jan. 10 Goods sold for cash	40,000
Jan. 15 Goods sold on credit to Gurmeet	30,000
Jan. 18 Salaries paid	12,000
Jan. 20 Cash withdrawn for personal use	5,000

*Sol.:***Journal entries in the books of Bhagwat & Sons**

Date	Particulars	LF	Debt	Credit
1-1-16	Cash A/c Dr. To Capital A/c (Being tarun started business with cash)		1,00,000	1,00,000
2-1-16	Purchase A/c Dr. To Cash A/c (Being goods purchased for cash)		20,000	20,000
4-1-16	Machinery A/c Dr. To Vibhu A/c (Being machinery purchased from Vibhu)		30,000	30,000
6-1-16	Rent A/c Dr. To Cash A/c (Being rent paid in cash)		10,000	10,000
8-1-16	Purchases A/c Dr. To Anil A/c (Being goods purchased from Anil on credit)		25,000	25,000
10-1-16	Cash A/c Dr. To Sales A/c (Being goods sold for cash)		40,000	40,000
15-1-16	Gurmeet A/c Dr. To Sales A/c (Being goods sold to gurmeet on credit)		30,000	30,000
18-1-16	Salaries A/c Dr. To Cash A/c (Being salaries paid)		12,000	12,000
20-1-16	Drawings A/c Dr. To Cash A/c (Being cash withdrawn for personal use)		5,000	5,000

4. (a) On 31st March 2003, the following Trial Balance was extracted from the books of ABC Ltd.

Particulars	Dr. (₹)	Cr. (₹)
Capital	–	50,000
Plant & Machinery	80,000	–
Sales	–	1,77,000
Purchases	60,000	–
Returns	1,000	750
Opening Stock	30,000	–
Discount	350	–
Bank Charges	75	–
Sundry Debtors	45,000	–
Sundry Creditors	–	75,000
Salaries	6,000	–
Manufacturing Wages	10,000	–
Carriage Inward	750	–
Carriage Outward	1,200	–
Bad Debts Provisions	–	525
Rent, Rates and Taxes	10,000	–
Advertisement	2,000	–
Cash in hand	900	–
Cash at bank	6,000	–
	<u>2,53,275</u>	<u>2,53,275</u>

You are required to prepare Trading, Profit and Loss Account for the year ended 31st March 2003 and the Balance Sheet as on that date.

The following adjustments are required :

- (i) Closing Stores ₹ 35,000
- (ii) Depreciation Plant and Machinery at 0%
- (iii) Bad debts provision to be adjusted to ₹ 500
- (iv) Interest on Capital to be allowed at 5% per annum.

Sol.:

Trading and profit loss A/c of ABC Ltd. for the year ending 31/3/2003

Dr.

Cr.

Particulars	Amount	Particulars	Amount
To Opening stock	30,000	By Sales	1,77,000
To Purchases	60,000	(-) Returns	1,000
(-) Returns	750	By Closing stock	35,000
To Manufacturing wages	10,000		
To Carriage inward	750		
To Gross profit c/d	1,11,000		
	<u>2,11,000</u>		<u>2,11,000</u>
To Salaries	6,000	By Gross profit b/d	1,11,000
To Discount	350	By Provisions for bad debts	25
To Bank charges	75		
To Rent, Rates and Taxes	10,000		
To Advertisement	2,000		
To Dep. on plant machinery	4,800		
To Interest on capital	2,500		
To Carriage outward	1,200		
To Net profit	84,100		
	<u>1,11,025</u>		<u>1,11,025</u>

Balance sheet of ABC Ltd. as on 31-3-2003

Liabilities	Amount	Assets	Amount
Capital	50,000	Plant and Machinery	80,000
(+) Net profit	84,100	(-) Depreciation	4,800
	<u>1,34,100</u>	Debtors	45,000
(+) Interest	2,500	(-) Provision for bad debts	500
Creditors	25,000	Closing stock	35,000
		Cash in hand	900
		Cash at bank	6,000
	<u>1,61,600</u>		<u>1,61,600</u>

OR

- (b) Describe the contents of financial statements of joint stock company as per companies Act.

(Unit-III, Q.No. 18)

5. (a) Describe the classification of ratios.

(Unit-IV, Q.No. 23, 24, 25, 26, 27)

OR

- (b) The following Trading and Profit and Loss Account of Fantasy Ltd for the year 31-3-2000 is given below.

Particulars		Particulars	
To Opening Stock	76,250	By Sales	5,00,000
To Purchases	3,15,250	By Closing Stock	98,500
To Carriage	2,000		
To Wages	5,000		
To Gross Profit c/d	2,00,000		
	2,98,500		2,98,500
To Administration Expenses	1,01,000	By Gross Profit b/d	2,00,000
To Selling and Debt. Expenses	12,000	By Non-operating incomes;	
To Non-operating Expenses	2,000	By Interest on Securities	1,500
To Financial Expenses	7,000	By Dividend on Shares	1,750
Non-Profit c/d	84,000	By Profit on sale of shares	750
	2,06,000		2,06,000

Calculate :

- (i) Gross profit ratio
- (ii) Expenses ratio
- (iii) Operating ratio
- (iv) Net profit ratio
- (v) Operating (Net) profit ratio
- (vi) Stock turnover ratio

Sol :

$$\begin{aligned}
 \text{(i) Gross profit Ratio} &= \frac{\text{Gross profit}}{\text{Net sales}} \times 100 \\
 &= \frac{2,00,000}{5,00,000} \times 100 = 40\%
 \end{aligned}$$

(ii) Expenses Ratio

(a) Selling and distribution expenses ratio

$$= \frac{\text{Selling and distribution expenses}}{\text{Net sales}} \times 100$$

$$= \frac{12,000}{5,00,000} \times 100 = 2.4\%$$

(b) Administration expenses ratio

$$= \frac{\text{Administration expenses}}{\text{Net sales}} \times 100$$

$$= \frac{1,01,000}{5,00,000} \times 100 = 20.2\%$$

(c) Non-operating expenses ratio

$$= \frac{\text{Non – operating expenses}}{\text{Net sales}} \times 100$$

$$= \frac{2,000}{5,00,000} \times 100 = 0.4\%$$

(iii) Operating Ratio = $\frac{\text{Operating Cost}}{\text{Net sales}} \times 100$

Operating cost = Costs of goods sold + Operating expenses

Cost of goods sold = Sales – Gross profit

$$= 5,00,000 - 2,00,000$$

$$= 3,00,000$$

Operating expenses = 1,01,000 + 12,000 + 7,000

$$= 1,20,000$$

Operating cost = 3,00,000 + 1,20,000

$$= 4,20,000$$

$$= \frac{4,20,000}{5,00,000} \times 100 = 84\%$$

(iv) Net profit ratio = $\frac{\text{Net profit}}{\text{Net sales}} \times 100$

$$= \frac{84,000}{5,00,000} \times 100 = 16.8\%$$

(v) Operating profit ratio

$$= \frac{\text{Operating profit}}{\text{Net sales}} \times 100$$

$$\begin{aligned}\text{Operating profit} &= \text{Sales} - \text{Operating cost} \\ &= 5,00,000 - 4,20,000 \\ &= 80,000\end{aligned}$$

$$= \frac{80,000}{5,00,000} \times 100 = 16\%$$

(vi) Stock turnover ratio

$$= \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

$$= \frac{\text{Operating stock} + \text{Closing stock}}{2}$$

$$= \frac{76,250 + 98,500}{2} = 87,375$$

$$= \frac{3,00,000}{87,375} = 3.43 \text{ times}$$

-
6. (a) Explain the concept, benefits and procedure for issuing Ind-AS in India.

(Unit-V, Q.No. 7, 8, 9)

OR

- (b) Explain the main features, uses of IFRS.

(Unit-V, Q.No. 14, 16)

FACULTY OF MANAGEMENT
B.B.A. II Year III - Semester Examination
December - 2017
FINANCIAL ACCOUNTING

Time : 3 Hours]

[Max. Marks : 80

SECTION - A (5 × 4 = 20 Marks)**Answer any 5 questions.**

I, Answer any five of the following in not exceeding 20 lines.

ANSWERS

- | | |
|---------------------------|---|
| (a) Going Concern Concept | (Unit-I, Q.No. 14, (2 nd point)) |
| (b) Accounting Equation | (Unit-II, SQA-3) |
| (c) Journal | (Unit-II, SQA-4) |
| (d) Balancing of Ledger | (Unit-II, Q.No. 20) |
| (e) Trial Balance | (Unit-II, SQA-7) |
| (f) P & L A/c | (Unit-III, SQA-3) |
| (g) Horizontal Analysis | (Unit-IV, SQA-4) |
| (h) Liquidity Ratios | (Unit-IV, SQA-8) |

SECTION - B (5 × 12 = 60 Marks)**Answer all the questions.**

2. (a) Explain the importance and scope of Accounting. (Unit-I, Q.No. 3, 4)
- OR
- (b) Describe the accounting concepts and conventions. (Unit-I, Q.No. 14, 15)
3. (a) Describe the preparation of Journal. Explain the types of Journal. (Unit-II, Q.No. 13, 14, 15)
- OR
- (b) Enter the following transactions in Journal.

Date	Particulars	Amount (₹)
2006		
Jan.-1	Sushil & Co. Started business with cash	1,00,000
Jan.-2	Paid into Bank	60,000
Jan.-4	Purchased Machinery and paid by cheque	30,000
Jan.-6	Bought goods from Naresh	20,000
Jan.-14	Paid salaries	5,000
Jan.-15	Sold goods to Rajesh Kumar	15,000
Jan.-17	Paid for Sundry Expenses	8,500
Jan.-18	Cash deposited into Bank	20,000
Jan.-19	Received Rent	6,000

*Ans. :***Journal entries**

Date	Particulars	LF	Debt	Credit
1-1-06	Cash A/c Dr. To Capital A/c (Being started business with cash)		1,00,000	1,00,000
2-1-06	Bank A/c Dr. To Cash A/c (Being cash deposited in bank)		60,000	60,000
4-1-06	Machinery A/c Dr. To Bank A/c (Being machinery purchased and paid by cheque)		30,000	30,000
6-1-06	Purchase A/c Dr. To Naresh A/c (Being goods purchased from Naresh)		20,000	20,000
14-1-06	Salaries A/c Dr. To Cash A/c (Being salaries paid)		5,000	5,000
15-1-06	Rajesh Kumar A/c Dr. To Sales A/c (Being goods sold to Rajesh Kumar)		15,000	15,000
17-1-06	Sundry expenses A/c Dr. To Cash A/c (Being sundry expenses paid)		8,500	8,500
18-1-06	Bank A/c Dr. To Cash A/c (Being cash deposited in bank)		20,000	20,000
19-1-06	Cash A/c Dr. To Rent A/c (Being rent received)		6,000	6,000

4. (a) Explain the concerns of Final Account as per Companies Act 2003. **(Unit-III, Q.No. 18)**

OR

- (b) The following are the balances extracted from the ledger of Meenakshi & Co. as on 31st March 2014.

Particulars	₹	Particulars	₹
Capital A/c	2,00,000	Reserves for discount on Debtors	2,000
Drawings	35,000	Loan at 10%	50,000
Buildings	1,00,000	Salaries	44,000
Machinery	25,000	Wages	75,000
Furniture & Fixtures	6,000	Rent	27,500
Loose Tools	4,000	Travelling Expenses	12,500
Opening Stock	1,25,000	Postage and Telegrams	1,350
Purchases	7,50,000	Rates and Taxes	900
Sales	12,50,000	Carriage Inwards	25,000
Sales Returns	50,000	Carriage Outwards	7,500
Purchases returns	1,50,000	General Charges	9,000
Sundry Debtors	1,00,000	Interest paid	3,750
Sundry Creditors	75,000	Bad debts	3,000
Reserve for Bad and Dividend debts	4,000	Cash on hand	2,500
		Cash at Bank	24,000

Adjustments Information

1. Stock as on 31-3-2004, ₹ 1,40,000
2. Rent Outstanding, ₹ 2,500
3. Wages Outstanding, ₹ 6,000
4. Salary Outstanding, ₹ 4,000
5. Maintain the reserve for doubtful debts are 5% and reserve for discounts on debtors at 2.5%

Ans :

Trading and P & L A/c of meenakshi & Co. for the year ending 31-3-2014

Dr.

Cr.

Particulars	Amount	Particulars	Amount
To Opening Stock	1,25,000	By Sales 12,50,000	
To Purchases 7,50,000		(-) Returns 50,000	12,00,000
(-) Returns 1,50,000	6,00,000	By Closing stock	1,40,000
To Wages 75,000			
(+) Outstanding 6,000	81,000		
To Carriage Inwards	25,000		
To Gross profit c/d	5,09,000		
	<u>13,40,000</u>		<u>13,40,000</u>

To Salaries	44,000		By Gross profit b/d	5,09,000
(+) Outstanding	<u>4,000</u>	48,000		
To Rent	27,500			
(+) Outstanding	<u>2,500</u>	30,000		
To Travelling expenses		12,500		
To Postage & Telegrams		1,350		
To Rates and Taxes		900		
To Carriage outward		7,500		
To General charges		9,000		
To Interest paid		3,750		
To Reserve for doubtful debts	5,000			
(+) Bad debts	<u>3,000</u>			
	8,000			
(-) Reserve for bad & doubtful debts	<u>4,000</u>	4,000		
Reserve for discount on debtors	2,375			
(-) Discount	<u>2,000</u>	375		
To Net profit c/d		3,91,625		
		<u>5,09,000</u>		<u>5,09,000</u>

Balance sheet of Meenakshi as on 31-3-2014

Liabilities	Amount	Assets	Amount
Capital	2,00,000	Buildings	1,00,000
(-) Drawings	<u>35,000</u>	Machinery	25,000
	1,65,000	Furniture	6,000
(+) Net profit	<u>3,91,625</u>	Loose Tools	4,000
Loans	50,000	Cash at bank	24,000
Creditors	75,000	Cash on hand	2,500
Outstanding salaries	4,000	Closing stock	1,40,000
Outstanding wages	6,000	Debtors	1,00,000
Outstanding rent	2,500	(-) Reserve	<u>5,000</u>
			95,000
		(-) Discount	<u>2,375</u>
		Suspense A/c	92,625
	<u>6,94,125</u>		<u>3,00,000</u>
			<u>6,94,125</u>

5. (a) Explain the techniques of financial statement analysis.

(Unit-IV, Q.No. 12)

OR

- (b) The Balance Sheet of Punjab Auto Limited as on 31-12-2002 was as follows:

Particulars	₹	Particulars	₹
Equity share capital	40,000	Plant and Machinery	24,000
Capital Reserve	8,000	Land and Buildings	40,000
8% Loan on Mortgage	32,000	Furniture & Fixtures	16,000
Creditors	16,000	Stock	12,000
Bank Overdraft	4,000	Debtors	12,000
Taxation		Investment (Short Term)	4,000
Current	4,000	Cash in hand	12,000
Future	4,000		
Profit & Loss A/c	12,000		
	<u>1,20,000</u>		<u>1,20,000</u>

From the above compute (a) The Current Ratio, (b) Quick Ratio, (c) Debt-Equity Ratio and (d) Proprietary Ratio.

Ans :

$$(a) \text{ Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\begin{aligned} \text{Current Assets} &= 12,000 + 12,000 + 4,000 + 12,000 \\ &= 40,000 \end{aligned}$$

$$\begin{aligned} \text{Current Liabilities} &= 16,000 + 4,000 + 4,000 + 4,000 \\ &= 28,000 \end{aligned}$$

$$\text{Current Ratio} = \frac{40,000}{28,000} = 1.43 : 1$$

$$(b) \text{ Quick Ratio} = \frac{\text{Quick Assets}}{\text{Quick Liabilities}}$$

$$\begin{aligned} \text{Quick Assets} &= \text{Current Assets} - \text{Stock} \\ &= 40,000 - 12,000 \\ &= 28,000 \end{aligned}$$

$$\begin{aligned} \text{Quick Liabilities} &= \text{Current Liabilities} - \text{Bank O.D and Provision for Tax} \\ &= 28,000 - (4,000 + 4,000) \\ &= 28,000 - 8,000 = 20,000 \end{aligned}$$

$$\text{Quick Ratio} = \frac{28,000}{20,000} = 1.40 : 1$$

$$(c) \text{ Debt Equity Ratio} = \frac{\text{Longterm debts}}{\text{Shareholders funds}}$$

$$\text{Longterm debts} = 8\% \text{ loan on Mortgage} = 32,000$$

$$\begin{aligned} \text{Shareholder's fund} &= 40,000 + 8,000 + 12,000 \\ &= 60,000 \end{aligned}$$

$$\begin{aligned} \text{Debt Equity Ratio} &= \frac{32,000}{60,000} \\ &= 0.53 : 1 \end{aligned}$$

$$(d) \text{ Proprietary Ratio} = \frac{\text{Shareholder's Fund}}{\text{Total Assets}}$$

$$= \frac{60,000}{1,20,000} = 0.5 : 1$$

6. (a) Explain the salient features of Ind-AS issued by ICAI. (Unit-V, Q.No. 10)

OR

- (b) Explain the main features, uses and objectives of IFRS. (Unit-V, Q.No. 14, 15, 16)

FACULTY OF MANAGEMENT
B.B.A I Year II Semester (CBCS) Examination
MODEL PAPER - I
FINANCIAL ACCOUNTING

Time : 3 Hours]

[Max. Marks : 80

SECTION - A (5 × 4 = 20 M)

Answer any 5 Questions

ANSWERS

1. (a) Define book keeping (Unit - I, SQA. 4)
(b) Define trial balance. (Unit - II, SQA. 7)
(c) Journalize the following transactions in the books of Gopal
1999
- | | | |
|---------|--|--------|
| Sept. 1 | Gopal commenced business with | 75,000 |
| " 2 | Deposited into bank | 30,000 |
| " 5 | Purchased furniture and paid by cheque | 1,500 |
| " 7 | Goods purchased from Srividya | 20,000 |
| " 9 | Goods returned to Srividya | 400 |
| " 13 | Paid to Srividya in full settlement | 19,500 |
| " 17 | Goods sold to Prakash | 500 |
| " 20 | Goods distributed by way of free samples | 1,000 |
| " 24 | Commission received | 250 |
| " 30 | Paid salaries | 5,000 |
- (Unit - II, Prob.11)
- (d) What is divisible profits ? (Unit - III, SQA. 8)
(e) Define the term financial statement. (Unit - III, SQA. 7)
(f) Nature of Financial Statement Analysis. (Unit - IV, SQA. 2)
(g) What is liquidity ratio? (Unit - IV, SQA. 8)
(h) Main features of IFRS. (Unit - V, SQA. 7)

SECTION - B (5 × 12 = 60 M)

Answer all the Questions

2. (a) Explain briefly about Accounting as a Information System. (Unit - I, Q.No. 7)
(OR)
(b) What are the various Accounting Concepts? (Unit - I, Q.No. 14)

3. (a) Pass necessary Journal entries for the following transactions and post them in the appropriate ledger accounts of Lal.

1999		
Jan. 1	Lal started business with cash	40,000
" 4	Goods purchased from Gopal	23,000
" 6	Goods sold to Prakash	16,000
" 8	Goods returned to Gopal	5,000
" 10	Goods returned by Prakash	800
" 13	Deposited into bank	3,000
" 15	Interest received	50
" 31	Salaries paid	5,000

(Unit - II, Prob.13)

(OR)

- (b) Prepare a trial balance as on 31st July 2009 from the following balances of Mr. Rajvansh.

Particulars	Amount	Particulars	Amount
Capital	10,000	Bank overdraft	8,700
Sales returns	1,000	Opening stock	15,000
Drawings	5,000	Cash	2,500
Bills payable	5,000	Purchases	9,000
Sales	15,000	Rent	1,000
Furniture	2,000	Bad debts	700
Creditors	12,000	Bills Receivable	3,500
Interest received	1,500	Debtors	14,500
Purchase returns	2,500		
Wages	500		

(Unit - II, Prob.15)

4. (a) From the following trial balance of Arun Goyal, prepare trading and profit & loss account for the year ended on 31st March, 2006 and a balance sheet as on that date :

Name of Accounts	Dr.	Cr.
Capital	—	3,00,000
Drawings	22,000	—
Fixed Assets	2,90,000	—
Purchases and Sales	3,40,000	6,50,000
Returns Inwards	8,000	—
Returns Outwards	—	6,000
Carriage	15,600	—
Wages	36,000	—
Salaries	20,000	—
Rent	—	13,000

Insurance	1,200	—
Audit Fees	500	—
Debtors and Creditors	1,68,000	47,500
Bills Receivable and Bills Payable	4,800	3,600
Printing and Stationery	1,500	—
Commission	—	400
Opening Stock	45,000	—
Cash in hand	14,300	—
Cash at bank	62,250	—
Bank Loan	—	10,000
Interest on Loan	1,350	—
	10,30,500	10,30,500

Adjustments

1. Stock at the end Rs. 51,700.
2. Depreciate fixed assets by 10%.
3. Allow 7% p.a. interest on capital and charge Rs. 2,600 as interest on drawings.
4. Rent received in advance Rs. 1,000.
5. Commission earned but not received amounted to Rs. 150.
6. Interest on bank loan @ 18% p.a. is unpaid for the last 3 months.

(Unit - III, Prob.18)

(OR)

- (b) Who is responsible for maintenance of books of accounts ?

(Unit - III, Q.No.18)

5. (a) From the following information, calculate liquidity ratios for the two companies and give your interpretation of the liquidity position of the companies as revealed by the ratios.

	(Rupees in Lakhs)	
	Company X	Company Y
Cash	360	280
Debtors	2,800	6,400
Inventory	4,000	12,000
Bills payable	600	2,000
Creditors	1,600	10,000
Accrued Expenses	200	250
Tax payable	1,200	1,000

(Unit - IV, Prob.11)

(OR)

- (b) From the following Balance Sheets, prepare Comparative Balance Sheet for Vijaya Laxmi Ltd., and give a brief report of the inferences you draw :

Particulars	31-3-2016	31-3-2015
I. Equity and Liabilities		
Shareholders Fund		
Share Capital	3,00,000	2,00,000
Reserves and Surplus	2,00,000	2,00,000
Non-Current Liabilities		
Long Term Borrowings	1,60,000	40,000
Current Liabilities		
Trade Payables (Creditors)	1,00,000	60,000
Total	7,60,000	5,00,000
II. Assets		
Non-Current Assets		
Fixed Assets	5,60,000	3,60,000
Non-Current Investments	40,000	40,000
Current Assets :		
Trade Receivables (Book Debts)	1,20,000	80,000
Cash and cash equivalent	40,000	20,000
Total	7,60,000	5,00,000

(Unit - IV, Prob.2)

6. (a) Explain the advantages and limitations of accounting standards ?

(Unit - V, Q.No. 5)

(OR)

- (b) Explain the procedure of issuing AS in India.

(Unit - V, Q.No. 9)

FACULTY OF MANAGEMENT
B.B.A I Year II Semester (CBCS) Examination
MODEL PAPER - II
FINANCIAL ACCOUNTING

Time : 3 Hours]

[Max. Marks : 80

SECTION - A (5 × 4 = 20 M)

Answer any 5 Questions

ANSWERS

1. (a) Dual Aspect Concept (Unit - I, SQA. 8)
 (b) Accounting equation (Unit - II, SQA. 3)
 (c) Define ledger. (Unit - II, SQA. 6)
 (d) Define final accounts. (Unit - III, SQA. 1)
 (e) Ascertain gross profit from the following :

Particulars	Rs.
Opening Stock	5,570
Purchases	13,816
Sales	15,284
Purchases Returns	390
Returns Inwards	524
Warehouse Wages Paid	1,400
Import Charges	252
Closing Stock	8,880

- (Unit - III, Prob.1)
 (f) Importance of ratio analysis. (Unit - IV, SQA. 7)
 (g) Horizontal Analysis. (Unit - IV, SQA. 4)
 (h) Compare and contrast Accounting Standards & Indian Accounting Standards. (Unit - V, SQA. 5)

SECTION - B (5 × 12 = 60 M)

Answer all the Questions

2. (a) What are the various Accounting Conventions ? (Unit - I, Q.No. 15)
 (OR)
 (b) Elucidate the nature of accounting. (Unit - I, Q.No. 17)
3. (a) Ramya is not an expert in accountig she prepared the following trial abalance your are requested to correct it and prepare a correct trial balance of Ramya.

Particulars	Dr	Cr
Ramya Capital		25,500
Ramya drawings	500	
Promises	7,000	
Sales		50,000
Debtors		5,500
Purchases	20,000	
Purchase returns	2,000	
Loan from the bank		2,500
Creditors	6,000	
Trade and Office expenses	700	
Cash at Bank	1,500	
Bills Payable	1,000	
Salaries	1,300	
Opening stock		3,000
Rent	2,500	
Sales returns	6,000	
Machinery	39,000	
Discount allowed		1,000
Discount received	1,000	
Bills receivable		1,000
Sold old news paper	500	-
Old Furniture Sold	-	500

(Unit - II, Prob.17)

(OR)

- (b) Following are the accounting transactions relating to Mr. P's business.
Use the accounting equation to show their effect on his assets, liabilities and capital.

1. Commenced business with a Capital of 50,000
2. Bought Machinery for cash 10,000
3. Purchased goods for cash 15,000
4. Purchased goods from A on credit 5,000
5. Sold goods for cash 10,000
6. Paid to A 2,000
7. Sold goods to B on credit 3,000
8. Paid into Bank 6,000
9. Paid to A by cheque 1,000
10. Received from B a cheque for 2,000

(Unit - II, Prob.2)

4. (a) Define final accounts. What are the objectives of final accounts ? (Unit - III, Q.No. 1)

(OR)

- (b) Prepare Balance Sheet as at 31st March, 2017 from the particulars furnished by Vision Ltd., as per Schedule III of the Companies Act, 2013.

Particulars		₹
Equity Share Capital (T 10 each, fully paid)		8,00,000
Call in arrear		800
Land		1,70,640
Building		2,80,000
Plant & Machinery		4,20,000
Furniture		40,000
General Reserve		1,68,000
Loan from IDBI		1,20,000
Loans (Unsecured)		96,800
Provision for Taxation		54,400
Sundry Debtors		1,60,000
Advances (Dr.)		34,160
Proposed Dividend		48,000
Surplus A/c		80,000
Cash Balance		24,000
Cash at Bank		1,97,600
Sundry Creditors (For Goods & Expenses)		
Stock:		
Finished Goods	1,60,000	
Raw Material	40,000	
		2,00,000

Adjustments :

- 1,500 equity shares were issued for consideration other than cash. 1,60,000 2,00,000
- Loan of ₹ 1,20,000 from IDBI is inclusive of ₹ 6,000 for interest accrued but not due. The loan is hypothecated by plant and machinery.
- Debtors of ₹ 50,000 are due for more than six months.
- The cost of assets :

Building	3,20,000
Plant & Machinery	5,60,000
Furniture	50,000
- Bank balance includes ₹ 2,000 with Trust Bank Ltd. which is not a scheduled Bank.
- Bills receivable for ₹ 2,20,000 maturing on 30th June, 2017 have been discounted.
- The company had contract for the erection of machinery at ₹ 1,50,000 which is still incomplete.

(Unit - III, Prob. 24)

5. (a) From the following Balance Sheet Calculate
- (a) Current Ratio (b) Quick Ratio
- (c) Absolute Quick Ratio (d) Debt Equity Ratio
- (e) Proprietary Ratio (f) Solvency Ratio
- (g) Fixed Assets to Net worth Ratio (h) Fixed Assets Ratio
- (i) Capital Gearing Ratio (j) Ratio of Inventory to working capital
- (k) Ratio of current assets to fixed assets.

Liabilities	Amount	Assets	Amount
Equity Share Capital	10,00,000	Goodwill	5,00,000
6% Preference Share Capital	5,00,000	Plant & Machinery	6,00,000
General Reserve	1,00,000	Land & Building	7,00,000
Profit & Loss A/c	4,00,000	Furniture	1,00,000
12% Debentures	5,00,000	Stock in trade (Inventory)	6,00,000
Creditors	80,000	Bills Receivables	30,000
Bank over draft	20,000	Debtors	1,50,000
Bills Payable	1,24,000	Bank Balance	2,00,000
Provision for Taxation	1,76,000	Marketable Securities	20,000
	29,00,000		29,00,000

(Unit - IV, Prob.20)

(OR)

- (b) What is Ratio Analysis? What are the objectives of ratio analysis? (Unit - IV, Q.No. 17)
6. (a) List out the various Indian Accounting Standards (Ind-AS). (Unit - V, Q.No. 11)

(OR)

- (b) What are the Objectives of IFRS ? (Unit - V, Q.No. 15)

FACULTY OF MANAGEMENT
B.B.A I Year II Semester (CBCS) Examination
MODEL PAPER - III
FINANCIAL ACCOUNTING

Time : 3 Hours]

[Max. Marks : 80

SECTION - A (5 × 4 = 20 M)

Answer any 5 Questions

ANSWERS

1. (a) Accounting Period Concept . (Unit - I, SQA. 9)
 (b) Define journal. (Unit - II, SQA. 4)
 (c) What are the features of Trial Balance? (Unit - II, SQA. 8)
 (d) Explain Limitations of the Balance Sheet. (Unit - III, SQA. 6)
 (e) From the following information prepare trading account of Shylaja Traders for the year ending 31.12.2018:
- | | |
|---------------------|----------|
| Opening Stock | 40,000 |
| Purchases | 85,000 |
| Sales | 1,80,000 |
| Purchase Returns | 3,000 |
| Sales Returns | 5,000 |
| Wages | 8,000 |
| Carriage | 2,000 |
| Coal & Gas and Fuel | 7,000 |
| Factory Rent | 4,000 |
| Closing Stock | 9,000 |
- (Unit - III, Prob. 4)
- (f) Limitations of Ratio Analysis. (Unit - IV, SQA. 10)
 (g) Limitations of Financial Statement Analysis. (Unit - IV, SQA. 3)
 (h) Define Accounting Standards. (Unit - V, SQA.1)

SECTION - B (5 × 12 = 60 M)

Answer all the Questions

2. (a) Define Accounting. What are the objectives of Accounting ? (Unit - I, Q.No. 1, 2)
 (OR)
 (b) What is meant by the term Generally Accepted Accounting Principles (GAAP) ? (Unit - I, Q.No. 16)
3. (a) What are the difference between Double Entry System and Single Entry System ? (Unit - II, Q.No. 8)

(OR)

(b) Journalize the following transactions in the books of Gopal 1999

Sept. 1	Gopal commenced business with	75,000
" 2	Deposited into bank	30,000
" 5	Purchased furniture and paid by cheque	1,500
" 7	Goods purchased from Srividya	20,000
" 9	Goods returned to Srividya	400
" 13	Paid to Srividya in full settlement	19,500
" 17	Goods sold to Prakash	500
" 20	Goods distributed by way of free samples	1,000
" 24	Commission received	250
" 30	Paid salaries	5,000

(Unit - II, Prob.11)

4. (a) Prepare a specimen form of balance sheet according to the companies act 2013.

(Unit - III, Q.No. 21)

(OR)

(b) The following trial balance is extracted from the books of Vinit on 31st March, 2003. Stock is valued at Rs 11,360. Prepare Trading and Profit and Loss Account for the year ending 31st March, 2003 and a balance sheet as on that date :

Particulars	Dr. Amount	Cr. Amount
Sundry Debtors and Creditors	9,000	8,800
Cash at Bank	3,040	—
Furniture	10,000	—
Stock	9,180	—
Purchases and Sales	44,500	67,200
Returns	860	1,500
Salaries	9,000	—
Rent	1,000	—
Advertisement	400	—
Drawings	5,000	—
Printing and Stationary	100	—
Freight on Sales	180	—
Trade Expenses	1,600	—
Capital	—	16,000
Discount Received	—	360
	93,860	93,860

(Unit - III, Prob. 14)

5. (a) From the following Trading and Profit & Loss A/c of Rim Zim Limited for the year ended 31st March 1993.
Calculate
- Gross Profit Ratio
 - Net Profit Ratio
 - Operating Ratio
 - Operating Profit Ratio. Rim Zim Company

Dr.		Cr.	
Particulars	Amount	Particulars	Amount
To Opening Stock	5,00,000	By Sales	
To Purchases	11,00,000	Cash 3,00,000	
To Wages	3,00,000	Credit 17,00,000	20,00,000
To Factory Overheads	2,00,000	By Closing Stock	6,00,000
To Gross Profit (c/d)	5,00,000		
	26,00,000		26,00,000
To Administration Expenses	75,000	By Gross Profit (b/d)	5,00,000
To Selling & Distribution Exp.	50,000	By Dividend on Investment	10,000
To Interest on Debentures	20,000	By Profit on Sale of Furniture	20,000
To Depreciation	60,000		
To Loss on Sale of Motorcar	5,000		
To Net Profit	3,20,000		
	5,30,000		5,30,000

(Unit - IV, Prbo.13)

(OR)

- (b) Explain the various tools of Financial Statement Analysis. (Unit - IV, Q.No. 12)
6. (a) Explain the List of IFRS Issued by IASB. (Unit - V, Q.No. 17)

(OR)

- (b) Define Accounting Standards. Explain the nature of accounting standards. (Unit - V, Q.No. 1)