BHU

& OTHER UNIVERSITIES

B.Com

ENTRANCE EXAM 2020

ACCOUNTANCY

LILHA EDUCATION CENTRE


xdx
(x+a)·(x+b) =
1
a-b

B.H.U B.Com Entrance Pattern

1. **Names and type of questions**- The Exam Paper will certain total of **150** multiple choice questions of **450** Marks.

2. **Time Duration** – **150** Minutes or **2:30 Hours**

S.No.	Subjects	Marks	No. of questions
1.	Accountancy	45	15
2.	Financial Markets	45	15
3.	Financial Statement Analysis	45	15
4.	Money and Banking	45	15
5.	Economics	45	15
6.	Business Organisations	45	15
7.	Basic Mathematics	45	15
8.	Business Environment	45	15
9.	Business Management	45	15
10.	Basic Computer	18	6
11.	Current Economic Affair	27	9
	Total	**450**	**150**

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CHAPTER – 1

ACCOUNTING: AN INTRODUCTION

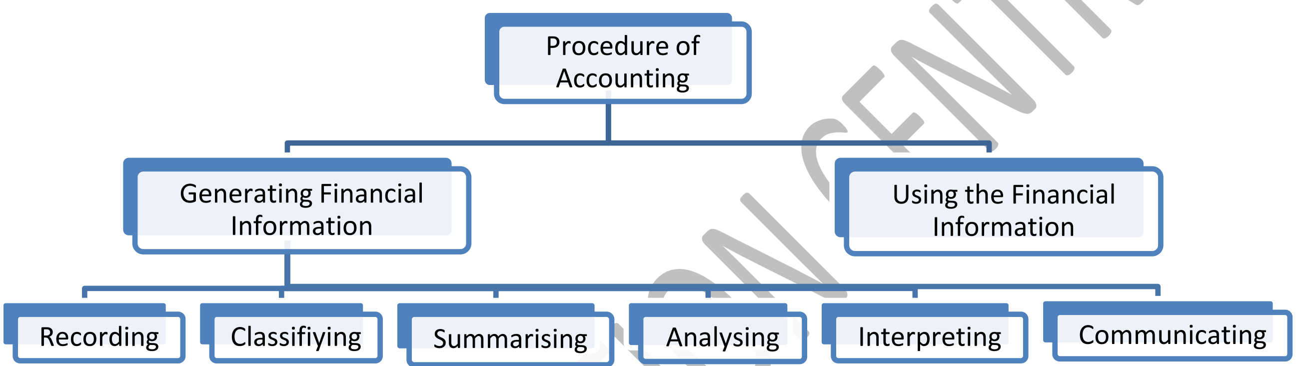
Unit 1

Meaning and Scope of Accounting

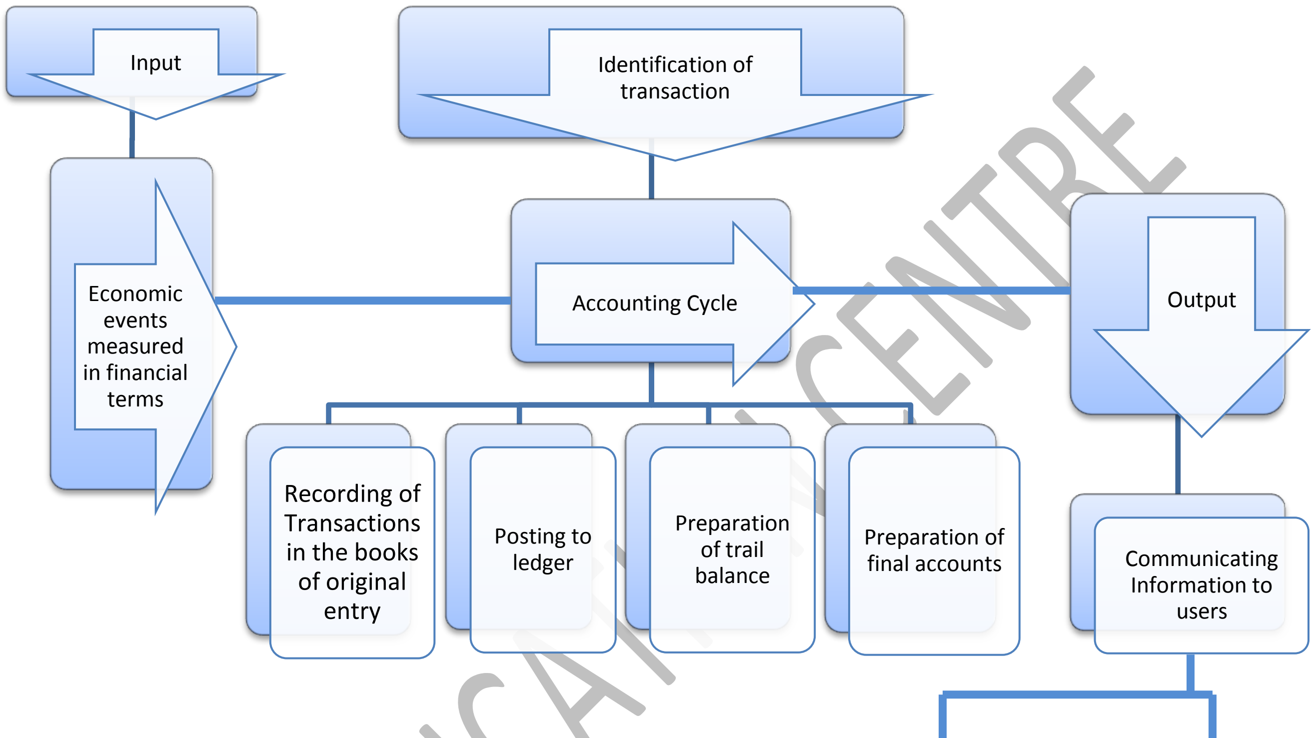
1- MEANING OF ACCOUNTING

"Accounting is the art of recording, classifying, and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof."

1.1- PROCEDURAL ASPECTS OF ACCOUNTING



PROCESS OF ACCOUNTING



Internal Users

1 - Board of Directors

2 - Partners

3 – Managers

4 – Officers

External users

1 - Investors

2 - Lenders

3 - Suppliers

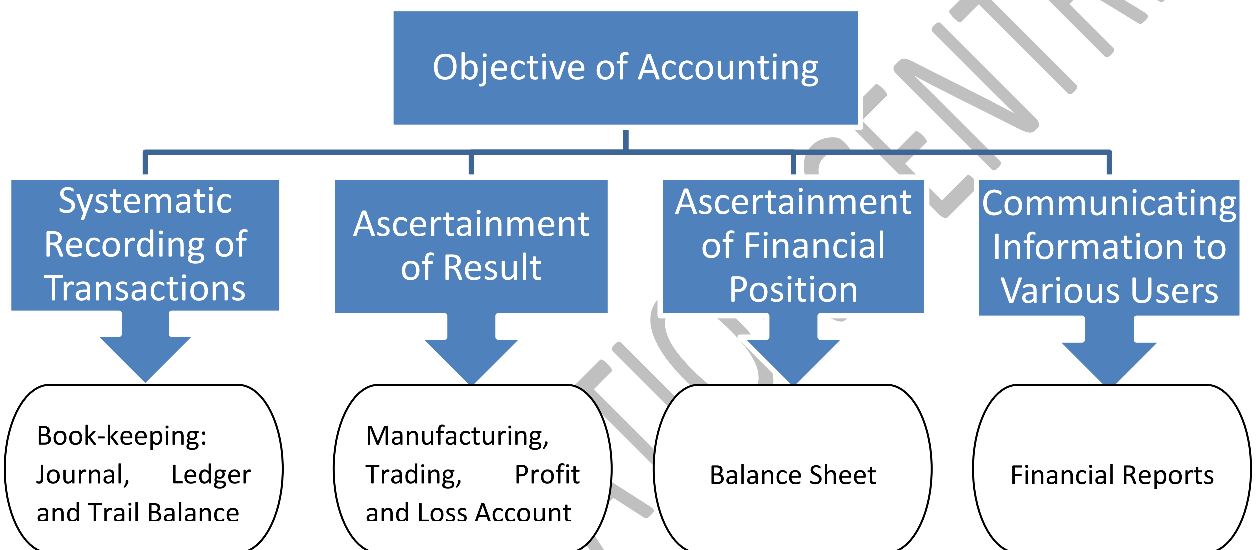
4 - Govt. agencies

5 – Customers

1- OBJECTIVES OF ACCOUNTING

The objectives of accounting can be given as follows:

1- Systematic recording of transactions.
2- Ascertainment of results of above recorded transactions.
3- Ascertainment of the financial position of the business.
4- Providing information to the users for rational decision-making.
5- To know the solvency position.



2- BOOK-KEEPING

Book-keeping is an activity concerned with the recording of financial data relating to business operations in a significant and orderly manner. It covers procedural aspects of accounting work and embraces record keeping function. Obviously book-keeping procedures are governed by the end product, the financial statements.

3.1- OBJECTIVES OF BOOK-KEEPING

1- **Complete Recording of Transactions -** It is concerned with complete and permanent record of all transactions in a systematic and logical manner to show its financial effect on the business.
2- **Ascertainment of Financial Effect on the Business -** It is concerned with the combined effect of all the transactions made during the accounting period upon the financial position of the business as a whole.

4- DISTINCTION BETWEEN BOOK-KEEPING AND ACCOUNTING

S. No.	Book-keeping	Accounting

1.	It is a process concerned with recording of transactions.	It is a process concerned with summarising of the recorded transactions.
2.	It constitutes as a base for accounting.	It is considered as a language of the business.
3.	Financial statements do not form part of this process.	Financial statements are prepared in this process on the basis of book-keeping records.
4.	Managerial decisions cannot be taken with the help of these records.	Management takes decisions on the basis of these records.
5.	There is no sub-field of book- keeping.	It has several subfields like financial accounting, management accounting etc.
6.	Financial position of the business cannot be ascertained through book-keeping records.	Financial position of the business is ascertained on the basis of the accounting reports.

5- SUB-FIELDS OF ACCOUNTING

The various sub-fields of accounting are:

1- Financial Accounting
2- Management Accounting
3- Cost Accounting
4- Social Responsibility Accounting
5- Human Resource Accounting

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1. Which of the following is not a subfield of accounting?
(a) Management accounting,
(b) Cost accounting.
(c) Financial accounting.
(d) Book-keeping.

2. Purposes of an accounting system include all the following except
(a) Interpret and record the effects of business transaction.
(b) Classify the effects of transactions to facilitate the preparation of reports.
(c) Summarize and communicate information to decision makers.
(d) Dictate the specific types of business enterprise transactions that the enterprises may engage in.

3. Bookkeeping is mainly concerned with
   (a) Recording of financial data.
   (b) Designing the systems in recording, classifying and summarising the recorded data.
   (c) Interpreting the data for internal and external users.
   (d) None of the above.

4. All of the following are functions of Accounting except
   (a) Decision making.
   (b) Measurement.
   (c) Forecasting.
   (d) Ledger posting.

5. Financial statements are part of
   (a) Accounting.
   (b) Book-keeping.
   (c) Management Accounting.
   (d) None of the above

6. Financial position of the business is ascertained on the basis of
   (a) Records prepared under book-keeping process.
   (b) Trial balance.
   (c) Accounting reports.
   (d) None of the above.

7. Users of accounting information include
   (a) Creditors/Suppliers
   (b) Lenders.
   (c) Customers.
   (d) All of the above

8. Financial statements do not consider
   (a) Assets expressed in monetary terms.
   (b) Liabilities expressed in monetary terms.
   (c) Only assets expressed in non-monetary terms.
   (d) Assets and liabilities expressed in non-monetary terms.

9. On January 1, Sohan paid rent of Rs. 5,000. This can be classified as
   (a) An event.
   (b) A transaction.
   (c) A transaction as well as an event.
   (d) Neither a transaction nor an event.

10. On March 31, 2015 after sale of goods worth Rs. 2,000, he is left with the closing inventory of Rs. 10,000. This is

(A) An event.
(B) A transaction.
(C) A transaction as well as an event.
(D) Neither a transaction nor an event.

[Ans. 1.(d), 2.(d), 3.(a), 4.(d), 5.(a), 6.(c), 7.(d), 8.(d), 9.(b), 10.(a)]

CHAPTER – 1

ACCOUNTING: AN INTRODUCTION

Unit 2

Accounting Concepts, Principles and Convention

1- ACCOUNTING CONCEPTS

Accounting concepts define the assumptions on the basis of which financial statements of a business entity are prepared. Certain concepts are perceived, assumed and accepted in accounting to provide a unifying structure and internal logic to accounting process. The word concept means idea or notion, which has universal application. These accounting concepts lay the foundation on the basis of which the accounting principles are formulated.

2- ACCOUNTING PRINCIPLES

"Accounting principles 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 exits."

Accounting principles must satisfy the following conditions:

1. They should be based on real assumptions;
2. They must be simple, understandable and explanatory;
3. They must be followed consistently;
4. They should be able to reflect future predictions;
5. They should be informational for the users.

3- ACCOUNTING CONVENTIONS

Accounting conventions emerge out of accounting practices, commonly known as accounting principles, adopted by various organizations over a period of time. These conventions are derived by usage and practice. The accountancy bodies of the world may change any of the convention to improve the quality of accounting information. Accounting conventions need not have universal application.

4- CONCEPTS, PRINCIPLES AND CONVENTIONS - AN OVERVIEW

(A) Entity concept : Entity concept states that business enterprise is a separate identity apart from its owner. Accountants should treat a business as distinct from its owner. Business transactions are recorded in the business books of accounts and owner's transactions in his personal books of accounts.

(B) Money measurement concept : As per this concept, only those transactions, which can be measured in terms of money are recorded. Since money is the medium of exchange and the standard of economic value, this concept requires that those transactions alone that are capable of being measured in terms of money be only to be recorded in the books of accounts.

(C) Periodicity concept : This is also called the concept of definite accounting period. As per 'going concern' concept an indefinite life of the entity is assumed. For a business entity it causes inconvenience to measure performance achieved by the entity in the ordinary course of business.

(D) Accrual concept : Under accrual concept, the effects of transactions and other events are recognised on mercantile basis i.e., when they occur (and not as cash or a cash equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past events involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future.

(E) Matching concept : In this concept, all expenses matched with the revenue of that period Should only be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.

This concept is based on accrual concept as it considers the occurrence of expenses and income and do not concentrate on actual inflow or outflow of cash.

(F) Going Concern concept : The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future.

(G) Cost concept : By this concept, the value of an asset is to be determined on the basis of historical cost, in other words, acquisition cost. Although there are various measurement bases, accountants traditionally prefer this concept in the interests of objectivity.

(H) Realisation concept : it closely follows the cost concept. Any change in value of an asset is to be recorded only when the business realises it. When an asset is recorded at its historical cost of Rs. 5,00,000 and even if its current cost is Rs. 15,00,000 such change is not counted unless there is certainty that such change will materialise.

(I) Dual aspect concept : This concept is the core of double entry book-keeping. Every transaction or event has two aspects:

(1) It increases one Asset and decreases another Asset;
(2) It increases an Asset and simultaneously increases Liability;
(3) it decreases one Asset, increases another Asset;
(4) It decreases one Asset, decreases a Liability; & vice versa.

(J) Conservatism : Conservatism states that the accountant should not anticipate income and should provide for all possible losses. When there are many alternative values of an asset, an accountant should choose the method which leads to the lesser value. Later on we shall see that the golden rule of current assets valuation – 'cost or market price' whichever is lower originated from this concept.

Three qualitative characteristics of financial statements, namely,

(1) *Prudence*, i.e., judgement about the possible future losses which are to be guarded, as well as gains which are uncertain.
(2) *Neutrality*, i.e., unbiased outlook is required to identify and record such possible losses, as well as to exclude uncertain gains,
(3) Faithful representation of alternative values.

(K) Consistency : In order to achieve comparability of the financial statements of an enterprise through time, the accounting policies are followed consistently from one period to another; a change in an accounting policy is made only in certain exceptional circumstances. The concept of consistency is applied particularly when alternative methods of accounting are equally acceptable.

(L) Materiality : Materiality principle permits other concepts to be ignored, if the effect is not considered material. This principle is an exception of full disclosure principle. According to materiality principle, all the items having significant economic effect on the business of the enterprise should be disclosed in the financial statements and any insignificant item which will only increase the work of the accountant but will not be relevant to the users need should not be disclosed in the financial statements.

5- FUNDAMENTAL ACCOUNTING ASSUMPTIONS

There are three fundamental accounting assumptions:

(1) Going Concern
(2) Consistency
(3) Accrual

6- QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS

(1) Understandability;
(2) Relevance;
(3) Reliability;
(4) Comparability;
(5) Materiality;
(6) Faithful Representation;
(7) Substance Over Form;
(8) Neutrality;
(9) Prudence;
(10) Full, fair and adequate disclosure;
(11)Completeness

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices :

(1) All the following items are classified as fundamental accounting assumptions except
- **(a)** Consistency
- **(b)** Business entity
- **(c)** Going concern
- **(d)** Accrual.

(2) Two primary qualitative characteristics of financial statements are
- **(a)** Understandability and materiality.
- **(b)** Relevance and reliability.
- **(c)** Neutrality and understandability.
- **(d)** Materiality and reliability.

(3) Kanika Enterprises follows the written down value method of depreciating machinery year after year due to
- **(a)** Comparability.
- **(b)** Convenience.
- **(c)** Consistency.
- **(d)** All of the above

(4) Mohan purchased goods for Rs. 15,00,000 and sold 4/5th of the goods amounting Rs. 18,00,000 and met expenses amounting Rs. 2,50,000 during the year, 2015. He counted net profit as Rs. 33,50,000 Which of the accounting concept was followed by him?
- **(a)** Entity.
- **(b)** Periodicity.
- **(c)** Matching.
- **(d)** Conservatism.

(5) A businessman purchased goods for Rs. 25,00,000 and sold 80% of such goods during the accounting year ended 31st March, 2015. The market value of the remaining goods was Rs. 4,00,000. He valued the closing Inventory at cost. He violated the concept of
- **(a)** Money measurement.
- **(b)** Conservatism.
- **(c)** Cost.
- **(d)** Periodicity.

(6) Assets are held in the business for the purpose of
- **(a)** Resale.
- **(b)** Conversion into cash.
- **(c)** Earning revenue.
- **(d)** None of the above.

(7) Revenue from sale of products, is generally, realized in the period in which
- **(a)** Cash is collected.
- **(b)** Sale is made.
- **(c)** Products are manufactured.
- **(d)** None of the above.

(8) The concept of conservatism when applied to the balance sheet results in
- **(a)** Understatement of assets.
- **(b)** Overstatement of assets.
- **(c)** Overstatement of capital.
- **(d)** None of the above

(9) The determination of expenses for an accounting period is based on the principle of
- **(a)** Objectivity.
- **(b)** Materiality.
- **(c)** Matching.
- **(d)** Periodicity.

(10) Economic life of an enterprise is split into the periodic interval to measure its performance is as per
- **(a)** Entity.
- **(b)** Matching.
- **(c)** Periodicity.
- **(d)** Accrual.

(11) Consider the following data pertaining to Alpha Ltd.:

Particulars	Rs.
Cost of machinery purchased on 14th April, 2014	10,00,000
Installation charges	1,00,000
Market value as on 31st March, 2015	12,00,000

While finalizing the annual accounts, if the company values the machinery at Rs. 12,00,000. Which of the following concepts is violated by the Alpha Ltd.?
- **(a)** Cost.
- **(b)** Matching.
- **(c)** Accrual.
- **(d)** Periodicity.

[Ans. – 1.(b), 2.(b), 3.(c), 4.(c), 5.(b), 6.(c), 7.(b), 8.(a), 9.(c), 10.(c), 11.(a)

CHAPTER – 1

ACCOUNTING: AN INTRODUCTION

Unit 3

Accounting Standards-Concepts, Objectives, Benefits

1- INTRODUCTION

Accounting as a 'language of business communicates the financial results of an enterprise to various stakeholders by means of financial statements.

2- CONCEPTS

Accounting standards are written policy documents issued by expert accounting body or by government or other regulatory body covering the aspects of recognition, treatment, measurement presentation and disclosure of accounting transactions and events in the financial statements.

The accounting standards deal with the issues of-

(1) recognition of events and transactions in the financial statements;
(2) measurement of these transactions and events;
(3) presentation of these transactions and events in the financial statements in a manner that meaningful and understandable to the reader; and
(4) the disclosure requirements which should be there to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements are trying to reflect and thereby facilitating them to take prudent and informed business decisions.

3- OBJECTIVES

(1) Eliminate the non-comparability of financial statements and thereby improving the reliability of financial statements; and
(2) Provide a set of standard accounting policies, valuation norms and disclosure requirements.

List of Accounting Standards

Sl. No.	Number of the No. Accounting Standard (AS)	TITLE OF THE ACCOUNTING STANDARD
1	AS1	Disclosure of Accounting Policies
2	AS 2 (Revised)	Valuation of Inventories
3	AS 3 (Revised)	Cash Flow Statements
4	AS 4 (Revised)	Contingencies and Events Occurring after the Balance Sheet Date
5	AS 5 (Revised)	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
6	AS 6(withdrawn pursuant to Revision in AS 10)	

Sl. No.	Number of the No. Accounting Standard (AS)	TITLE OF THE ACCOUNTING STANDARD
7	AS7 (Revised)	Accounting for Construction Contracts
8	AS 8 (withdrawn pursuant to AS 26 becoming mandatory)	Accounting for Research and Development
9	AS9	Revenue Recognition
10	AS 10 (Revised)	Accounting for Property, Plant and Equipment
11	AS 11 (Revised)	The Effects of Changes in Foreign Exchange Rates
12	AS 12	Accounting for Government Grants
13	AS 13	Accounting for Investments
14	AS 14	Accounting for Amalgamations
15	AS 15 (Revised)	Employee Benefits
16	AS 16	Borrowing Costs
17	AS 17	Segment Reporting
18	AS18	Related Party Disclosures
19	AS 19	Leases
20	AS20	Earnings Per Share
21	AS21	Consolidated Financial Statements
22	AS 22	Accounting for Taxes on Income
23	AS 23	Accounting for Investments in Associates in Consolidated Financial Statements
24	AS 24	Discontinuing Operations
25	AS 25	Interim Financial Reporting
26	AS 26	Intangible Assets
27	AS 27	Financial Reporting of Interests in Joint Ventures
28	AS 28	Impairment of Assets
29	AS29	Provisions, Contingent Liabilities & Contingent Assets

❖ **Indian Accounting Standard** (abbreviated as **Ind-AS**) is the Accounting standard adopted by companies in India and issued under the supervision 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 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 41 Ind AS. This shall be applied to the companies of financial year 2015-16 voluntarily and from 2016-17 on a mandatory basis.

Based on the international consensus, the regulators will separately notify the date of implementation of Ind-AS for the banks, insurance companies etc. Standards for the computation of Tax has been notified as ICDS in February 2015.

- **Applicability-** Companies shall follow Ind AS either Voluntarily or Mandatorily. Once a company follows Indian AS, either mandatorily or voluntarily, it can't revert to old method of Accounting.
- **Mandatory Applicability (1 April 16)-**Every Company with Net worth of not less than 500 crores (5 billion).
- **Mandatory Applicability from Accounting Period beginning on or after 1 April 2017**

Every Listed Company.

Unlisted Companies with Net worth greater than or equal to Rs. 250 crore (2.5 billion) but less than Rs. 500 crore (5 billion)(for any of the below mentioned periods).

Net worth shall be checked for the previous four Financial Years (2013–14, 2014–15, 2015–16, and 2016–17)

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

(1) Accounting Standards in India are issued by
- **(a)** Central Govt.
- **(b)** State Govt.
- **(c)** Institute of Chartered Accountants of India.
- **(d)** Reserve Bank of India.

(2) Accounting Standards
- **(a)** Harmonise accounting policies.
- **(b)** Eliminate the non-comparability of financial statements.
- **(c)** Improve the reliability of financial statements.
- **(d)** All of the above

(3) It is essential to standardize the accounting principles and policies in order to ensure

(a) Transparency.

(b) Consistency.

(c) Comparability

(d) All of the above.

[Ans.- 1. (c), 2. (d), 3. (d)]

CHAPTER – 1

ACCOUNTING: AN INTRODUCTION

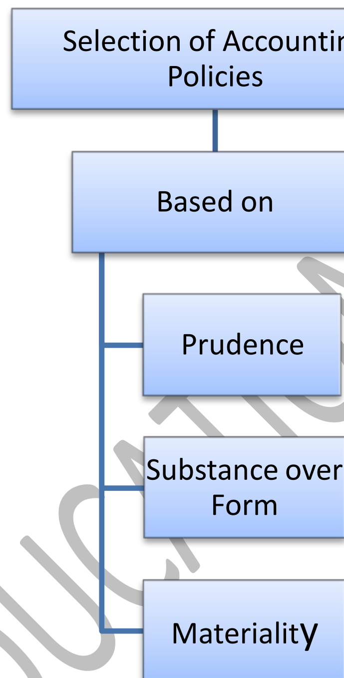
Unit 4

Accounting Policies

1- MEANING

Accounting Policies refer to specific accounting principles and methods of applying these principles adopted by the enterprise in the preparation and presentation of financial statements. The areas wherein different accounting policies are frequently encountered can be given as follows:

(1) Methods of depreciation, depletion and amortisation;
(2) Valuation of inventories;
(3) Valuation of investments.



Areas in which differing Accounting Policies are possible

The following are examples of areas in which different accounting policies may be adopted by organisations.

1. Methods of depreciation, depletion and amortisation
2. Treatment of expenditure during construction
3. Conversion or translation of foreign currency items
4. Valuation of inventories
5. Treatment of goodwill
6. Valuation of investments
7. Treatment of retirement benefits
8. Recognition of profit on long-term contracts
9. Valuation of fixed assets
10. Treatment of contingent liabilities

The above list of examples is not exhaustive.

Disclosure of Accounting Policies

To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements must be disclosed. Such disclosure should form part of the financial statements.

It would be helpful to the reader of financial statements if they are all disclosed in one place instead of being scattered over several statements, schedules and notes.
Any change in an accounting policy which has a significant effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent it can be calculated. Where such amount is not ascertainable, wholly or in part, the fact should be disclosed. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but is expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

Disclosure of accounting policies or of the changes is not a remedy for any wrong or inappropriate treatment of items in the accounts.

Points to remember

- All significant accounting policies used in the preparation and presentation of financial statements should be disclosed.
- The disclosure should form part of the financial statements, normally in one place.
- Any change in the accounting policies which has a material effect in the current period or is expected to have a material effect in later periods should be disclosed.
  In case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected should also be disclosed to the extent it can be calculated. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.
- If the fundamental accounting assumptions of Going Concern, Consistency and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices :

(1) A change in accounting policy is justified
  (a) To comply with accounting standard.
  (b) To ensure more appropriate presentation of the financial statement of the enterprise.
  (c) To comply with law.
  (d) All of the above.

(2) Accounting policy for inventories of Xeta Enterprises states that inventories are valued at the lower of cost determined on weighted average basis or not realizable value. Which accounting principle in followed in adopting the above policy?
  (a) Materiality.

(b) Prudence.
(c) Substance over form.
(d) All of the above.

(3) The areas wherein different accounting policies can be adopted are
(a) Providing depreciation.
(b) Valuation of inventories.
(c) Valuation of investments.
(d) All of the above.

(4) Selection of an inappropriate accounting policy decision may
(a) Overstate the performance and financial position of a business entity.
(b) Understate/overstate the performance and financial position of a business entity.
(c) Overstate the performance a business entity.
(d) Understate financial position a business entity.

(5) Accounting policies refer to specific accounting
(a) Principles.
(b) Methods of applying those principles
(c) Both (A) and (B).
(d) None of the above.

[Ans.- 1. (d), 2. (b), 3. (d), 4. (b), 5. (c)]

CHAPTER – 1

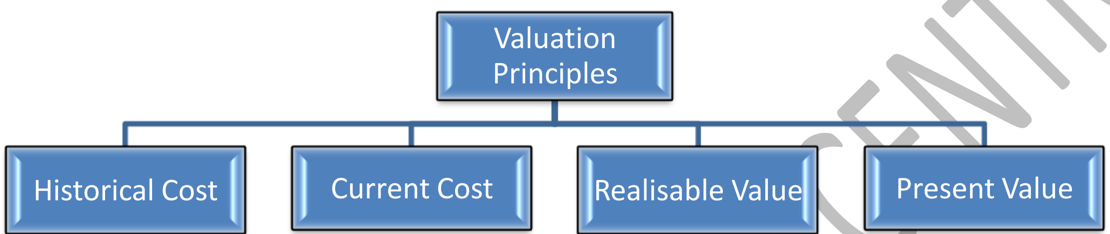
ACCOUNTING: AN INTRODUCTION

<u>Unit 5</u>

Accounting as a Measurement Discipline – Valuation Principles, Accounting Estimates

1- VALUATION PRINCIPLES

(A) *Historical Cost :* It means acquisition price. For example, the businessman paid Rs. 7,00,000 to



purchase the machine, its acquisition price including installation charges is Rs. 8,00,000. The historical cost of machine would be Rs. 7,00,000.

(B) *Current Cost :* Take that Mr. X purchased a machine on 1st January, 2000 at Rs. 7,00,000. As per historical cost base he has to record it at Rs. 7,00,000 i.e. the acquisition price.

(C) *Realisable Value :* Suppose Mr. X found that he can get Rs. 20,00,000 if he would sell the machine purchased, on 1.1.2000 paying Rs. 7,00,000 and which would cost Rs. 25,00,000 in case he would buy it currently. Take also that Mr. X found that he had no money to pay off the bank loan of Rs. 5,00,000 currently.

(D) *Present Value :* Suppose we are talking as on 1.1.2011 - take it as time for reference. Now think the machine purchased by Mr. X on 1.1.2001 can work for another 10 years and is supposed to generate cash @Rs. 1,00,000 p.a. Also take that bank loan of Rs. 5,00,000 taken by Mr. X is to be repaid as on 31.12.2015. Annual interest is Rs. 90,000.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices :

(1) All of the following are valuation principles except

- **(a)** Historical cost.
- **(b)** Present value.
- **(c)** Future value.
- **(d)** Realisable value.

(2) Book value of machinery on 31st March, 2011	10,00,000
Market value as on 31st March, 2011	11,00,000

As on 31st March, 2011, if the company values the machinery at Rs. 11,00,000 which of the following valuation principle is being followed?

- **(a)** Historical Cost.
- **(b)** Present Value.
- **(c)** Realisable Value.
- **(d)** Current Cost.

[Ans.- 1. (C), 2. (C)]

- Mohan purchased a machinery amounting Rs. 10,00,000 on 1st April, 2001. On 31st March, 2011, similar machinery could be purchased for Rs. 20,00,000 but the realizable value of the machinery (purchased on 1.4.2001) was estimated at Rs. 15,00,000. The present discounted value of the future net cash inflows that the machinery was expected to generate in the normal course of business, was calculated as Rs.12,00,000.

(1) The current cost of the machinery is

- **(a)** Rs. 10,00,000
- **(b)** Rs. 20,00,000
- **(c)** Rs. 15,00,000
- **(d)** Rs. 12,00,000

(2) The present value of machinery is

- **(a)** Rs. 10,00,000
- **(b)** Rs. 20,00,000
- **(c)** Rs. 15,00,000
- **(d)** Rs. 12,00,000

(3) The historical cost of machinery is

- **(a)** Rs. 10,00,000
- **(b)** Rs. 20,00,000
- **(c)** Rs. 15,00,000
- **(d)** Rs. 12,00,000

(4) The realizable value of machinery is

- **(a)** Rs. 10,00,000
- **(b)** Rs. 20,00,000
- **(c)** Rs. 15,00,000
- **(d)** Rs. 12,00,000

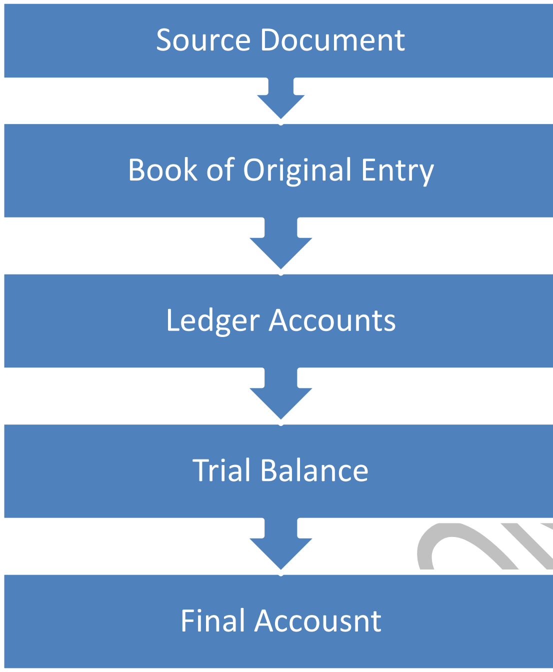
[Ans.- 1. (b), 2. (d), 3. (a), 4. (c)]

CHAPTER – 2

ACCOUNTING PROCESS

Unit 1

Basic Accounting Procedures – Journal Entries



Source Document : Represents all documents in business which contains financial records and act as evidence of the transactions which have taken place.

Book of Original Entry : These are books which are used in recording the transactions for the first time. The books are maintained for memorandum purpose only and will not form part of the double entry system. Examples includes; Purchase day book, Cash book, Sales day book and purchases return day book.

Ledger Accounts : These form part of double entry system and used to record the transactions for the period. These are accounts where information relating to a particular asset, liability, capital, income and expenses are recorded.

Trial Balance : Contains the totals from various ledger accounts and act as a preliminary check on accounts before producing final accounts.

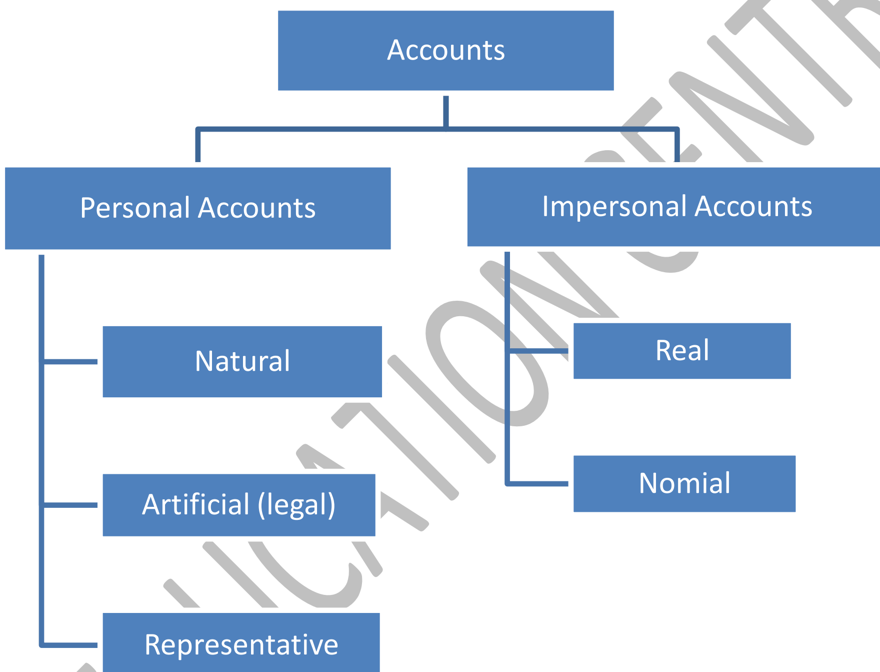
Final Accounts : Financial Statements are produced to show the financial performance and financial position of a business entity.

1- DOUBLE ENTRY SYSTEM

Double entry system of book-keeping has emerged in the process of evolution of various accounting techniques. According to it, every transaction has two-fold aspects-debit and credit and both the aspects are to be recorded in the books of accounts.

2- CLASSIFICATION OF ACCOUNTS

1- **Personal Accounts:** Personal accounts relate to persons, trade receivables or trade payables. Example would be; the account of Ram & Co., a credit customer or the account of Jhaveri & Co., a supplier of goods.



(a) **Natural personal accounts**: It relates to transactions of human beings like Ram, Rita, etc

(b) **Artificial (legal) personal account:** For business purpose, business entities are treated to have separate entity. They are recognised as persons in the eye of law for dealing with other persons. For example: Government, Companies (private or limited), Clubs, Co-operative societies etc.

(c) **Representative personal accounts:** These are not in the name of any person or organisation but are represented as personal accounts. For example: outstanding liability account or prepaid account, capital account, drawings account.

2- **Impersonal Accounts:** Accounts which are not personal such as machinery account, cash account, rent account etc. These can be further sub-divided as follows:

(a) **Real Accounts:** Accounts which relate to assets of the firm but not debt. For example, accounts regarding land, building, investment, fixed deposits etc., are real accounts. Cash in hand and Cash at the bank accounts are also real.

(b) Nominal Accounts: Accounts which relate to expenses, losses, gains, revenue, etc. Like salary account, interest paid account, commission received account. The net result of all the nominal accounts is reflected as profit or loss which is transferred to the capital account. Nominal accounts are, therefore, temporary.

2.1 GOLDEN RULES OF ACCOUNTING

1. Personal account is governed by the following two rules:
   Debit the receiver
   Credit the giver

2. Real account is governed by the following two rules:
   Debit what comes in
   Credit what goes out

3. Nominal account is governed by the following two rules:
   Debit all expenses and losses
   Credit all incomes and gains.

3- JOURNAL

Transactions are first entered in this book to show which accounts should be debited and which credited. Journal is also called subsidiary book. Recording of transactions in journal is termed as journalizing the entries.

3.1- JOURNALISING PROCESS

All transactions are first recorded in the journal as and when they occur; the record is chronological; otherwise it would be difficult to maintain the records in an orderly manner.

JOURNAL

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
(1)	(2)	(3)	(4)	(5)

- **List of Account- Personal , Real and Nominal**

S,No.	Name of Accounts	Types of Account
1.	Machinery A/c	Real A/c
2.	Capital A/c	Personal A/c
3.	Stock A/c	Real A/c
4.	Bad Debts A/c	Nominal A/c
5.	Goodwill A/c	Real A/c
6.	Sales A/c	Nominal A/c
7.	Drawings A/c	Personal A/c
9.	Salary A/c	Nominal A/c
10.	Outstanding Salary A/c	Personal A/c
11.	Insurance A/c	Nominal A/c
12.	Prepaid Insurance A/c	Personal A/c
13.	Interest Received A/c	Nominal A/c
14.	Cash A/c	Real A/c
15.	Bank A/c	Real A/c
16.	Trademarks A/c	Real A/c
17.	Debtors A/c	Personal A/c
18.	Creditors A/c	Personal A/c
19.	Commission Received A/c	Nominal A/c
20.	Accrued Commission A/c	Personal A/c
21.	Commission Received in Advance A/c	Personal A/c
22.	Capital A/c	Natural Personal A/c
23.	Tata Steel Company A/c	Artificial Personal A/c

24.	Haryana Education Board A/c	Artificial Personal A/c
25.	Shri Ram College of Commerce A/c	Artificial Personal A/c
26.	Commission Paid A/c	Nominal A/c
27.	Commission Received A/c	Nominal A/c
28.	Commission Accrued A/c	Personal A/c
29.	Prepaid Salaries A/c	Personal A/c
30.	Leasehold Property A/c	Real a/c
31.	Discount Allowed A/c	Nominal A/c
32.	Carriage Inward A/c	Nominal A/c
33.	LIC A/c	Personal A/c
34.	Drawings A/c	Personal A/c
35.	Rent received in Advance A/c	Personal A/c
36.	Rent paid in Advance A/c	Personal A/c
37.	Bank Overdraft A/c	Personal A/c

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1- The rent paid to landlord is credited to
- **(a)** Landlord's account.
- **(b)** Rent account.
- **(c)** Cash account.
- **(d)** None of the above

2- In case of a debt becoming bad, the amount should be credited to
- **(a)** Trade receivables account.
- **(b)** Bad debts account.
- **(c)** Cash account.
- **(d)** Sales account

3- Which account is the odd one out?
- **(a)** Office furniture & Equipment.
- **(b)** Freehold land and Buildings.
- **(c)** Inventory of materials.
- **(d)** Plant and Machinery.

4- The debts written off as bad, if recovered subsequently are

(a) Credited to Bad Debts Recovered Account.
(b) Credited to Trade receivables Account.
(c) Debited to Profit and Loss Account.
(d) None of the above.

[Ans.- 1.(c), 2.(a), 3.(c), 4.(a)]

From the given information, choose the most appropriate answer.

A- Classify each of the following items under:

(1) Prepaid salary account.
- **(a)** Personal
- **(b)** Real
- **(c)** Nominal
- **(d)** None of the above

(2) Patents account.
- **(a)** Personal
- **(b)** Real
- **(c)** Nominal
- **(d)** None of the above

[Ans. - A-1. (a), 2. (b)]

B- Classify each of the following items under:

(1) Salaries.
- **(a)** revenue (R)
- **(b)** expense (E)
- **(c)** asset (A)
- **(d)** liability (L) or

(2) Equipment.
- **(a)** revenue(R)
- **(b)** expense (E)
- **(c)** asset (A)
- **(d)** liability (L) or

(3) Membership fees earned.
- **(a)** revenue(R)
- **(b)** expense (E)
- **(c)** asset (A)
- **(d)** liability (L) or

(4) Accounts receivable.
- **(a)** revenue(R)

(b) expense (E)
(c) asset (A)
(d) liability (L)

[Ans. B- 1. (b), 2. (c), 3. (a), 4. (c)]

CHAPTER – 2
ACCOUNTING PROCESS

Unit 2

Ledgers

1- INTRODUCTION

After recording the transactions in the journal, recorded entries are classified and grouped into by preparation of accounts and the book, which contains all set of accounts (viz. personal real and nominal accounts), is known as Ledger. It is known as principal books of account in which account-wise balance of each account is determined.

2- SPECIMEN OF LEDGER ACCOUNTS

Dr. **Account** **Cr.**

Date	Particular	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
1	2	3	4	5	6	7	8

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1- The process of transferring the debit and credit items from a Journal to their respective accounts in the ledger is termed as
(a) Posting
(b) Purchase
(c) Balancing of an account
(d) Arithmetically accuracy test

2- 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
(a) Posting
(b) Purchase
(c) Balancing of an account
(d) Arithmetically accuracy test

(a) Journal and ledger records transactions in
(b) A chronological order and analytical order respectively.
(c) An analytical order and chronological order respectively.
(d) A chronological order only
(e) An analytical order only.

3- At the end of the accounting year all the nominal accounts of the ledger book are
(a) Balanced but not transferred to profit and loss account
(b) Not balanced and also the balance is not transferred to the profit and loss account
(c) Balanced and the balance is transferred to the balance sheet
(d) Not balanced and their balance is transferred to the profit and loss account.

[Ans.- 1. (a), 2. (c), 3. (a), 4. (d)]

CHAPTER – 2

ACCOUNTING PROCESS

Unit 3

Trial Balance

1- INTRODUCTION

Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the trial balance. It may also be prepared by listing each and every account and entering in separate columns the totals of the debit and credit sides.

2- OBJECTIVES OF PREPARING THE TRIAL BALANCE

The preparation of trial balance has the following objectives:

A) Trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical error.

B) Financial statements are normally prepared on the basis of agreed trial balance; otherwise the work may be cumbersome.

C) The trial balance serves as a summary of what is contained in the ledger; the ledger may have to be seen only when details are required in respect of an account.

TRIAL BALANCE

as at...................

S. No (1)	Ledger Accounts (2)	L.F. (3)	Dr. Amount (Total or Balance) (4) Rs.	Cr. Amount (Total or Balance)(5) Rs.

3- METHODS OF PREPARATION OF TRIAL BALANCE

1- TOTAL METHOD

Under this method, every ledger account is totalled and that total amount (both of debit side and credit side) is transferred to trial balance. In this method, trial balance can be prepared as soon as ledger account is totalled.

2- BALANCE METHOD

Under this method, every ledger account is balanced and those balances only are carry forward to the trial balance. This method is used commonly by the accountants and helps in the preparation of the financial statements. Financial statements are prepared on the basis of the balances of the ledger accounts.

3- **TOTAL AND BALANCE METHOD**
Under this method, the above two explained methods are combined. Under this method statement of trial balance contains seven columns instead of five column.

4- **Adjusted trial Balance(Through Suspense Account**
If the trial balance do not agree after transferring the balance of all ledger accounts including cash and bank balance and also errors are not located timely, then the trial balance is tallied by transferring the difference of debit and credit side to an account known as suspense account.

5- **Rules of preparing The Trial Balance**
While preparing the trial balance from the given list of ledger balances, following rules should be taken into care

1. The balances of all
   a. Assets Accounts
   b. Expenses Account
   c. Losses
   d. Drawings
   e. Cash and bank balances are placed in the debit column of the trial Balance.
2. The balances of all
   a. Liabilities Account
   b. Income Account
   c. Profits
   d. Capitals are placed in the credit column of the trial balance.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1- A trial balance will not balance if
(a) Correct journal entry is posted twice.
(b) The purchase on credit basis is debited to purchases and credited to cash.
(c) Rs. 500 cash payment to creditor is debited to Trade payables for Rs. 50 and credited to cash as Rs. 500
(d) None of the above.

2- Rs. 1,500 received from sub-tenant for rent and entered correctly in the cash book is posted to the debit of the rent account. In the trial balance
(a) The debit total will be greater by Rs. 3,000 that the credit total.
(b) The debit total will be greater by Rs. 1,500 than the credit total.
(c) Subject to other entries being correct the total will agree.
(d) None of the above.

3- After preparing the trial balance the accountant finds that the total of debit side is short by Rs. 1,500 This difference will be
(a) Credited to suspense account

(b) Debited to suspense account
(c) Adjusted to any of the debit balance account
(d) Adjusted to any of the credit balance account

[Ans. – 1. (c), 2. (a), 3. (b)]

CHAPTER – 2
ACCOUNTING PROCESS

Unit 4

Subsidiary Book

1- SUBSIDIARY BOOKS AND THEIR ADVANTAGES

In a Business most of the transactions generally relate to receipts and payments of cash, sale of goods and their purchase. It is convenient to keep a separate register for each such class of transactions one for receipts and payments of cash, one for purchase of goods and one for sale of goods. A register of this type is called a book of original entry or of prime entry. These books of original or prime entry are also called subsidiary books.

2- IMPORTANCE OF JOURNAL

(i) **Opening entries :** When books are started for the new year, the opening balance of assets and liabilities are journalised.

(ii) **Closing entries:** At the end of the year the profit and loss account has to be prepared. For this purpose, the nominal accounts are transferred to this account.

(iii) **Rectification entries:** If an error has been committed, it is rectified through a journal entry.

(iv) **Transfer entries:** If some amount is to be transferred from one account to another, the transfer will be made through a journal entry.

(v) **Adjusting entries:** At the end of the year the amount of expenses or income may have to be adjusted for amounts received in advance or for amounts not yet settled in cash. Such an adjustment is also made through journal entries.

(a) Outstanding expenses, i.e., expenses incurred but not yet paid;

(b) Prepared expenses, i.e., expenses paid in advance for some period in the future;

(c) Interest on capital, i.e., the interest which the proprietor thinks proper to allow on his investment; and

(d) Depreciation, i.e., fall the value of the assets used on account of wear and tear.

(vi) **Entries on dishonour of Bills :** If someone who accepted a promissory note (or bill) and is not able to pay in on the due date a journal entry will be necessary to record the non-payment or dishonour.

(vii) **Miscellaneous entries :** The following entries will also require journalising:

(a) Credit purchase of things other than goods dealt in or materials required for production of good e.g. credit purchase of furniture or machinery will be journalised.

(b) An allowance to be given to the customers or a charge to be made to them after the issue of the invoice.

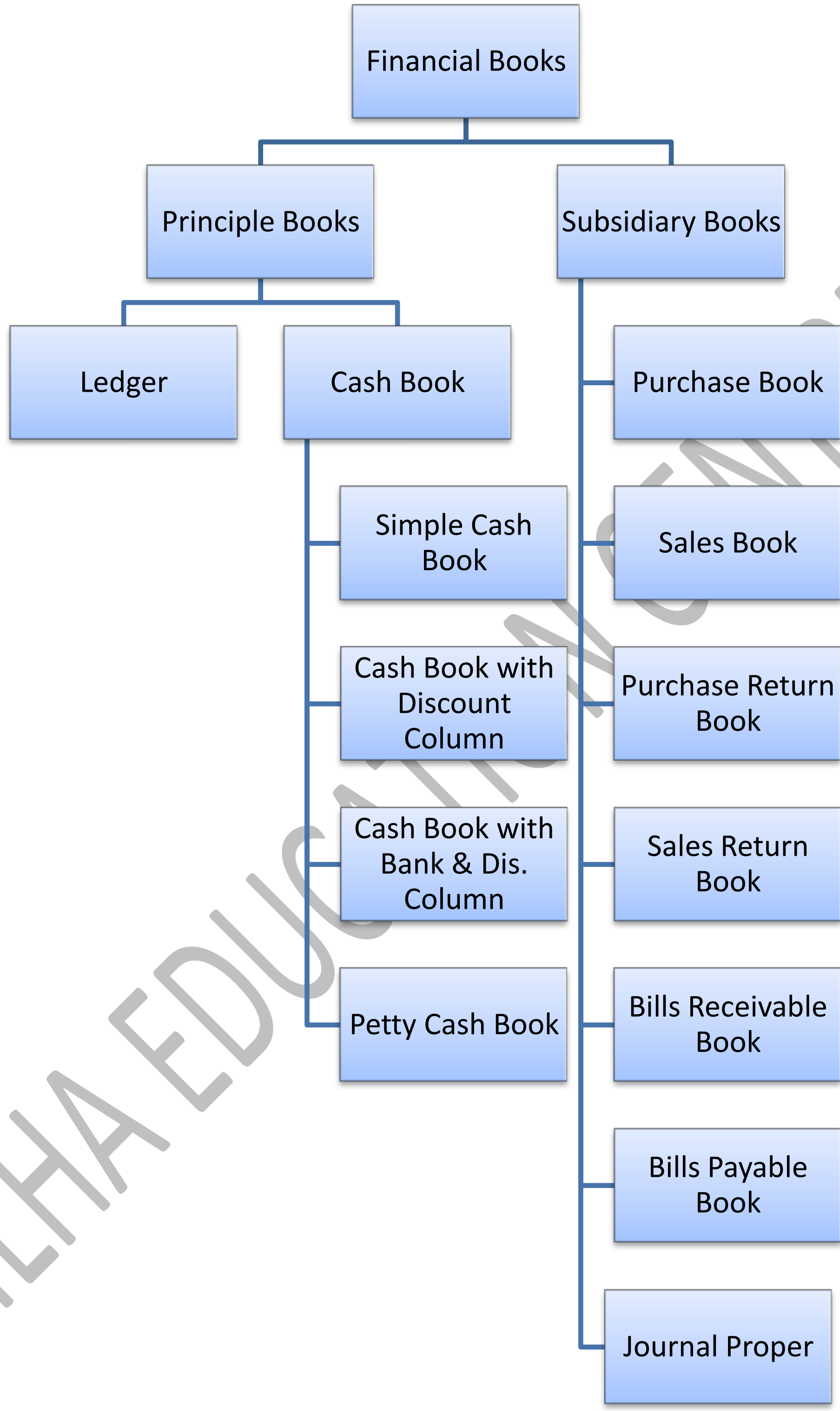
(c) Receipt of promissory notes or issue to them if separate bill books have not been maintained.

(d) On an amount becoming irrecoverable, say, because of the customer becoming insolvent.

(e) Effects of accidents such as loss of property by fire.

(f) Transfer of net profit to capital account.

3- DISTICTION BETWEEN SUBSIDIARY BOOKS AND PRIMARY BOOKS



SELF EXAMINATION QUESTIONS

A) In which book of original entry, will you record the following transactions?

(1) The debit note issued are used to prepare
   (a) Sales return book.
   (b) Purchase return book.
   (c) Sales book.
   (d) Purchases book.

(2) A second hand motor car was purchased on credit from B Brothers for Rs. 10,000.
   (a) Journal Proper (General Journal)
   (b) Sales Book
   (c) Cash Book
   (d) Purchase Book

(3) Accounting for partial recovery from Mr. C of an amount of Rs. 2,000 earlier written off as bad debt.
   (a) Journal Proper (General Journal)
   (b) Sales Book
   (c) Purchase Book
   (d) Cash Book

(4) A bills receivable of Rs. 1,000, which was received from a debtor in full settlement for a claim of Rs. 1,100, is dishonoured.
   (a) Purchase Return Book
   (b) Bills Receivable Book
   (c) Purchases Book
   (d) Journal Proper (General Journal)

(5) Unpaid salary for Rs. 340 is to be provided for in the accounts.
   (a) Bills Receivable Book
   (b) Purchases Book
   (c) Journal Proper (General Journal)
   (d) Purchases Return

(6) Goods Outward Journal is meant for recording all returns of goods
   (a) Sold on credit
   (b) Purchased on credit
   (c) Purchased on cash
   (d) None of the above

[Ans.- 1.(b), 2. (a), 3. (d), 4. (d), 5. (c), 6. (b)]

CHAPTER – 2

ACCOUNTING PROCESS

Unit 5

Cash Book

1- CASH BOOK-A SUBSIDIARY BOOK AND A PRINCIPAL BOOK

Cash transactions are straightaway recorded in the Cash Book and on the basis of such a record, ledger accounts are prepared. Therefore, the Cash Book is a subsidiary book. But the Cash Book itself serves as the cash account and the bank account.

2- KINDS OF CASH BOOK

The main Cash Book may be of the three types:

1) Simple Cash Book;
2) Two-column Cash Book;
3) Three-column Cash Book.

3- PETTY CASH BOOK

In a business house a number of small payments, such as for telegrams, taxi fare, cartage, etc. have to be made. If all these payments are recorded in the cash book, it will become unnecessarily heavy. Also, the main cashier will be overburdened with work. Therefore, it is usual for firms to appoint a person as 'Petty Cashier'.

3.1- IMPREST SYSTEM OF PETTY CASH

This convenient to entrust a definite sum of money to the petty cashier in the beginning of a period and to reimburse him for payments made at the end of the period. Thus, he will have again the fixed amount in the beginning of the new period. Such a system is known as the imprest system of petty cash.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1- The total of discounts column on the debit side of the cash book, recording cash discount deducted by customers when paying their accounts, is posted to the
   (a) Credit of the discount allowed account.
   (b) Debit of the discount received account.
   (c) Credit of the discount received account.
   (d) Debit of the discount allowed account.

2- Cash book is a type of_____but treated a_______of accounts.
   (a) Subsidiary book, principal book
   (b) Principal book, subsidiary book
   (c) Subsidiary book, subsidiary book
   (d) Principal book, principal book

3- Which of the following is not a column of three-Column cash book?
   (a) Cash column
   (b) Bank column
   (c) Petty cash column
   (d) Discount column

4- Contra entries are passed only when
   (a) Double-column cash book is prepared
   (b) Three-column cash book is prepared
   (c) Simple cash book is prepared
   (d) None of the above

5- The balance in the petty cash book is
   (a) An Expense
   (b) A profit
   (c) An asset
   (d) A liability.

[Ans.- 1. (d), 2. (a), 3. (c),4.(b), 5. (c)

CHAPTER – 2

ACCOUNTING PROCESS

Unit 6

Capital and Revenue Expenditures and Receipts

"Revenue Expense relates to the operations of the business of an accounting period or to the revenue earned during the period or the items of expenditure, benefits of which do not extend beyond that period. capital Expenditure, on the other hand, generates enduring benefits and helps in revenue generation over more than one Accounting period."

"capital expenditure contributes to the revenue earning capacity of a business over more than one accounting period whereas revenue expense is incurred to generate revenue for a particular accounting period. The revenue expenses either occur in direct relation with the revenue or in relation with accounting periods."

"Deferred revenue expenditure is that expenditure for which payment has been made or a liability incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods. Deferred revenue expenditure should be revenue expenditure by nature in the first instance. But its matching with revenue may be deferred considering the benefits to be accrued in future."

"Receipts which are obtained in course of normal business activities are revenue receipts (e.g. receipts from sale of goods or services, interest income etc.) Revenue and capital receipts are recognised on accrual basis as soon as the right of receipt is established. Revenue receipts should not be equated with the actual cash receipts. Revenue receipts are credited to the Profit and Loss Account."

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

A- Classify the following expenditures and receipts as capital or revenue:

(1) Money spent Rs. 10,000 as travelling expenses of the directors on trips abroad for purchase of capital assets is
- (a) Capital expenditures
- (b) Revenue expenditures
- (c) Deferred revenue expenditures
- (d) None of the above

(2) Amount of Rs. 5,000 spent as lawyers' fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land is
- (a) Capital expenditures
- (b) Revenue expenditures
- (c) Deferred revenue expenditures
- (d) None of the above

(3) Entrance fee of Rs. 2,000 received by Ram and Shyam Social Club is
- (a) Capital receipt
- (b) Revenue receipt
- (c) Capital expenditures
- (d) Revenue expenditures

(4) Subsidy of Rs. 40,000 received from the government for working capital by a manufacturing concern is
   (a) Capital receipt
   (b) Revenue receipt
   (c) Capital expenditures
   (d) Revenue expenditures

(5) Insurance claim received on account of machinery damaged completely by fire is
   (a) Capital receipt
   (b) Revenue receipt
   (c) Capital expenditures
   (d) Revenue expenditures

(6) Interest on investments received from UTI is
   (a) Capital receipt
   (b) Revenue receipt
   (c) Capital expenditures
   (d) Revenue expenditures

(7) Amount received from IDBI as a medium term loan for augmenting working capital is
   (a) Capital expenditures
   (b) Revenue expenditures
   (c) Capital receipt
   (d) Revenue receipt

(8) A bad debt recovered during the year will be
   (a) Capital expenditures
   (b) Revenue expenditures
   (c) The Capital receipt
   (d) Revenue receipt

[Ans.- 1.(a), 2.(b), 3.(a), 4.(b), 5.(a), 6.(b), 7.(c), 8.(d)]

B- Out of the following which are (1) capital expenditure; (2) revenue expenditure; and (3) deferred revenue expenditure?

(1) Rs. 2,500 spent on the overhaul of machines purchased second-hand is
   (a) Capital expenditure;
   (b) Revenue expenditure;
   (c) Deferred revenue expenditure
   (d) None of the above.

(2) Whitewashing expense are
   (a) Capital expenditure;
   (b) Revenue expenditure;
   (c) Deferred revenue expenditure

(d) None of the above.

(3) Paper purchased for use as stationery is
   (a) Capital expenditure;
   (b) Revenue expenditure;
   (c) Deferred revenue expenditure
   (d) None of the above.

[Ans.- 1. (a), 2. (b), 3. (b)]

CHAPTER – 2
ACCOUNTING PROCESS

Unit 7

Contingent Assets and Contingent Liabilities

1- CONTINGENT ASSETS

A contingent asset may be defined as a possible asset that arises from past events and whose existence will be confirmed only after occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. A contingent asset need not be disclosed in the financial statements.

2- CONTINGENT LIABILITIES

The term 'Contingent liability, can be defined as

(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) a reliable estimate of the amount of the obligation cannot be made.

	Provision	Contingent liability
1.	Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation.	A contingent liability is a possible obligation that may or may not crystallise depending on the occurrence or non-occurrence of one or more uncertain future event.
2.	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
3.	Provision is recognised when (a) an enterprise has a present obligation arising from past events; an outflow of resources embodying economic benefits is probable, and (b) a reliable estimate can be made of the amount of the obligation.	Contingent liability includes present obligations that do not meet the recognition criteria because either it is not probable that settlement of those obligations will require outflow of economic benefits, or the amount cannot be reliably estimated.
4.	If the management estimates that it is probable that the settlement of an obligation will result in outflow of economic benefits, it recognises a provision in the balance sheet.	If the management estimates, that it is less likely that any economic benefit will outflow the firm to settle the obligation, it discloses the obligation as a contingent liability.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1- Contingent asset usually arises from unplanned or unexpected events that give rise to
   (a) The possibility of an inflow of economic benefits to the business entity.
   (b) The possibility of an outflow of economic benefits to the business entity
   (c) Either (a) or (b)
   (d) None of the above.

2- If an inflow of economic benefits is probable then a contingent asset is disclosed
   (a) In the financial statements.
   (b) In the report of the approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise).
   (c) In the cash flow statement.
   (d) None of the above.

3- In the case of____________either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.
   (a) Liability
   (b) Provision
   (c) Contingent liabilities.
   (d) Contingent assets.

4- Present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation is termed as_____
   (a) Provision
   (b) Liability
   (c) Contingent liability.
   (d) None of the above.

[Ans.- (1).(a), (2). (b), (3). (c), (4). (a)]

CHAPTER – 2

ACCOUNTING PROCESS

Unit 8

Rectification of Errors

"Unintentional omission or commission of amounts and accounts in the process of recording the transactions are commonly known as errors."

Wrong Entry: Let us start from the first phase in the accounting process. Wrong entry of the value of transactions and events in the subsidiary books, Journal Proper and Cash Book may occur.

Wrong positing from subsidiary books: Subsidiary books are totalled periodically and posted to the appropriate ledger accounts. There may arise totalling errors. Totalling errors may arise due to wrong entry or simply these may be independent errors.

Wrong casting of subsidiary book: For example, wrong castings of the Cash Book result in balancing error.

Wrong casting of ledger balances: Likewise Cash Book, any ledger account balance may be cast wrongly. Obviously wrong postings make the balance wrong; but that is not wrong casting of balances. Whenever there arises independent casting error as in the case of bank column in the Cash Book then, that is called wrong casting of ledger balances.

1- STAGES OF ERRORS

1.1 AT THE STAGE OF RECORDING THE TRANSACTIONS IN JOURNAL

Following types of errors may happen at this stage

(1) Errors of principle,
(2) Errors of omission,
(3) Errors of commission.

1.2 AT THE STAGE OF POSTING THE ENTRIES IN LEDGER

(1) Errors of omission:
  (a) Partial omission,
  (b) Complete omission.

(2) Errors of commission
  (a) Posting to wrong account,
  (b) Posting on the wrong side,
  (c) Posting of wrong amount.

1.3 AT THE STAGE OF BALANCING THE LEDGER ACCOUNTS

(1) Wrong Totalling of accounts,
(2) Wrong Balancing of accounts,

1.4 AT THE STAGE OF PREPARING THE TRIAL BALANCE

(1) Errors of omission,
(2) Errors of commission:
  (a) Taking wrong account,
  (b) Taking wrong amount,

(c) Taking to the wrong side.

On the above basis, we can classify the errors in four broad categories:

(1) Errors of Principles,
(2) Errors of Omission,
(3) Errors of Commission,
(4) Compensating Errors.

2- TYPES OF ERRORS

(1) Errors of principle: When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong account. Suppose on the purchase of a typewriter, the office expenses account is debited; the trial balance will still agree.

(2) Clerical errors: These errors arise because of mistake committed in the ordinary course of the accounting work. These are of three types:

(i) *Errors of Omission:* If a transaction is completely or partially omitted from the books of account, it will be a case of omission. Examples would be: not recording a credit purchase of furniture or not posting an entry into the ledger.

(ii) *Errors of Commission:* If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is struck, it will be a case of "errors of commission."

(iii) *Compensating Errors:* If the effect of errors committed cancel out, the errors will be called compensating errors. The trial balance will agree. Suppose an amount of Rs. 10 received from A is not credited to his account and the total of the sales book is Rs. 10 in excess. The omission of credit to A's account will be made up by the increased credit to the Sales Account.

ERRORS

- Errors of Principle (Treating a revenue expense as capital expenditure or vice versa or the sale of a fixed asset as ordinary sale). Trial Balance will agree.
- Clerical Errors
  - Errors of Omission
    - Omitting an entry completely from the subsidiary books. Trial Balance will agree.
    - Omitting to post the ledger account from the subsidiary books. Trial Balance will not agree.
  - Errors of Commission
    - Writting the wrong amount in the subsidiary books. Trial Balance will agree.
    - Wrong casting of subsidiary books. Trial Balance will not agree.
    - Posting the wrong amount in the ledger. Trial Balance will not agree.
    - Posting an amount on the wrong side. Trial Balance will not agree.
    - Wrong balancing of an account. Trial Balance will not agree.
  - Compensating Errors Trial Balance will agree.

Error

- 1.Errors Affecting Trial Balance (or Errors Disclosed by Tral Balance)
  - (i) Wrong Casting
  - (ii) Posting to the Wrong side
  - (iii) Posting of wrong Amount
  - (iv) Omission of posting of one side of an Entry
  - (v) Double posting in a Single Account
  - (vi) Errors of Totalling and Balancing of Accounts in the ledger
- 2.Errors not Affecting Trial Bala (or Errors Not Disclosed by Tr Balance)
  - (i) Errors of Omission
  - (ii) Errors of Commission
  - (iii) Compensating Errors
  - (iv) Errors of Princip
    - (a) When a capital expenditur as revenue expenditu
    - (b).When a revenue expenditu as capital expenditur
  - (v) Errors of Posting in Wrong

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

1. Classify the under mentioned errors into:-

a. Error of Omission,
b. Error of Commission
c. Compensating Error
d. Error of Principle

i. Purchased goods from Bhardwaj on credit for Rs.600, but were recorded in the purchase book as Rs. 6,000
ii. Amount paid for the proprietor's life insurance premium was debited to 'General Expenses Account'.
iii. Goods amounting to Rs.2,000 have been returned to Chakravarti, but no entry has been made in the books.
iv. An excess debit of Rs. 4,500 has been made in the account of X, whereas Y's account has been credited by Rs.5,000 instead of Rs.500.
v. Goods sold to Suresh for Rs. 650 were recorded as Rs.560 in the Sales Book.
vi. Typewriter purchased for office use has been debited to purchases account.
vii. Wages paid for the construction of building Rs.15,000 were recorded in 'Wages Account'.
viii. Goods for Rs.500 have been taken by the proprietor for his personal use, for which no entry has been passed in the books.

2. Which of the following errors will affect the trial balance?

i. The total of the Sales Book has not been posted to the Sales Account.
ii. Rs.1,000 paid as Installation charges of a new machine has been debited to Repairs Account.
iii. Goods costing Rs.4,000 taken by the proprietor for personal use have been debited to Debtors Account.
iv. Rs.1,000 paid for repairs to building have been debited to Building Account.

3. Which of the following is not an error of commission:

a. A sales of Rs.560 not recorded in Books at all.
b. Rent paid to landlord was posted to landlord's Account
c. A purchase of Rs.480 was wrongly posted to sales account.
d. Instead of creditng Shyam credited the other creditor Sham.

4. Which of the following errors will not affect the trial balance:

a. Wrong balancing of an account
b. Wrong totalling of an account
c. Omission of an account from the trial balance

d. Writing an amount in the wrong account but on the correct side.

5. Rs.10,000 received from Apoorva is credited in the account of Prachi. It is an error of
   a. Principle
   b. Omission
   c. Commission
   d. Compensatory

6. Which of the following is the error of principle?
   a. The purchase book was overcastted by Rs.500
   b. Credit sales to Arjun Rs.700 recorded as purchase from Arun
   c. Goods returned to Charu Rs.4,000, posted in Chinoo's A/c
   d. Wages paid for installation of machinery debited to wage A/c

7. A machine is purchased for Rs.10,000 which was wrongly recorded in purchase account. Due to this error.............
   a. Trial Balance will show difference of Rs.10,000
   b. Trial Balance will not show any difference
   c. Trial Balance will show the difference of Rs.20,000
   d. Trial Balance will show a difference of Rs.5,000

8. Goods purchased from A for Rs. 10,000 passed through the sales book. The error will result in
   a. Increase in gross profit.
   b. Decrease in gross profit.
   c. No effect on gross profit.
   d. Either (a) or (b).

9. If a purchase return of Rs. 1,000 has been wrongly posted to the debit of the sales returns account, but has been correctly entered in the suppliers' account, the total of the
   a. Trial balance would show the debit side to be Rs. 1,000 more than the credit.
   b. Trial balance would show the credit side to be Rs. 1,000 more than the debit.
   c. The debit side of the trial balance will be Rs. 2,000 more than the credit side.
   d. The credit side of the trial balance will be Rs. 2,000 more than the debit side.

10. If the amount is posted in the wrong account or it is written on the wrong side of the account, it is called
   a. Error of omission.
   b. Error of commission.
   c. Error of principle.
   d. Compensating error.

11. Errors of commission do not permit;
   a. Correct totalling of the balance sheet;
   b. Correct totalling of the trial balance;
   c. The trial balance to agree.
   d. None of the above.

12. The preparation of a trial balance is for:
   a. Locating errors of commission;
   b. Locating errors of principle;
   c. Locating clerical errors.
   d. All of the above.

13. Purchase of office furniture Rs. 1,200 has been debited to General Expense Account. It is :
   a. A clerical error;
   b. An error of principle;
   c. An error of omission.
   d. Compensating error.

14. Which of the following errors will not be revealed by the Trial Balance
   a. Compensating errors;
   b. Errors of principle;
   c. Wrong balancing of an account;
   d. Wrong totalling of an account;

15. Which of the following errors will be revealed by the Trial Balance:
   a. Compensating errors;
   b. Errors of principle;
   c. Wrong balancing of an account;
   d. Wrong totalling of an account;

[Ans.-

1. Errors of Omission III, VIII Errors of Commission I, V; Compensating Error IV; Errors of Principle II, Vi, VII.
2. Only Item No. (i) will affect the trial balance because it is error of posting in one account . Item No. (ii),(iii) and(iv) will not affect the trial balance because these are error of principle .
3. (a)
4. (d)
5. (c)
6. (d)
7. (b)

8. (a), 9. (c), 10. (b), 11. (c), 12. (c), 13. (b), 14. (a) and (b) will not be revealed, 15. (e) and (d) will be revealed

1. Which of the following errors will affect agreement of trial balance?
   a. Repairs on building have been debited to building account.
   b. The total of purchase book is short by ₹ 10
   c. Freight paid on new machinery has been debited to freight account.
   d. A sale of ₹ 500 to Ram has been debited to Shyam's account.
2. After preparing the Trial Balance, the accountant finds that the total of the debit side of Trial Balance is short by ₹ 1,000. This difference will be:
   a. Credited to suspense account
   b. Debited to suspense account
   c. Adjusted to any of account having debit balance
   d. Adjusted to any of account having credit balance
3. Overcasting of sales book by ₹ 1,000 is a type of:-
   a. One sided error
   b. Two sided error
   c. Compensating error
   d. Error of principle
4. Which one of the following is correct about errors?
   a. Errors always have impact on profits
   b. Errors do not have any impact on profits
   c. Errors may or may not have impact on profits
   d. Errors always lead to decrease in profit.
5. Whitewash charges of building ₹ 500 have been wrongly debited to building account. It is an example of:
   a. Compensating error
   b. Error of principle
   c. Error of omission
   d. Error of commission
6. If the effect of an error is cancelled by the effect of some other errors, the errors are known as:
   a. Error of principle
   b. Compensating Error
   c. Error of omission
   d. Error of commission
7. Which of the following errors will not cause the disagreement of Trial Balance?
   a. ₹ 821 received from Ravi has been debited to Kavi
   b. A purchase of ₹ 281 from Sanju has been debited to his account as ₹ 281
   c. An invoice for ₹ 480 is entered in the Sales Book as ₹ 840
   d. All of the above.
8. Error of principle will not permit:
   a. Correct total of the balance sheet
   b. Correct total of the trial balance
   c. The trial balance to agree
   d. None of the above.
9. Which of the following errors is an error of omission-
   a. Sale of ₹ 1,000 was recorded in the purchase journal

b. Salary paid to Mohan and Vikas have been debited to their personal accounts
c. The total of sales journal has not been posted to the sales account
d. Repairs to building have been debited to building account.

10. Which of the following errors are revealed by the trial balance-
a. Errors of principle
b. Errors of omission
c. Errors of commission
d. None of the above.

11. ₹ 1,000 was paid as rent to the landlord Krishna. This amount was debited to Krishna's personal account. This error will –
a. Affect agreement of the trial balance.
b. Not affect agreement of the trial balance
c. Affect the suspense account
d. None of the above.

12. If Sales is done and by mistake A's account is transferred to Purchase A/c in such a case which accounts are affected?
a. Purchase a/c
b. A's a/c
c. Both (a) and (b)
d. None of the above

13. A sold goods of ₹ 500/- to Z which is entered in purchase book as ₹ 5,000. What will be the entry after rectification?

a.	Z's A/c	Dr.	5,500
	To Purchase A/c		5,000
	To Sales A/c		500
b.	Z's A/c	Dr.	5,500
	To A		5,500
c.	Purchase A/c	Dr.	4,500
	To A		4,500
d.	Z's A/c	Dr.	5,500
	To Sales A/c		5,500

14. "Wrong Casting of subsidiary book" is which type of error?
a. Error of Omission
b. Error of Commission
c. Error of Principle
d. Compensating Errors.

15. When two or more errors are committed in such a way that effect of one error is compensated by another error. Which type of error is this?
a. Error of Commission
b. Compensating Error
c. Error of Principle
d. None of these.

16. A Sale of ₹ 100 to 'A' recorded in the Purchase Book would affect:
a. Purchases Account and A's Personal Account Only

b. Sales Account and A's Personal Account Only
c. A's Personal Account Only
d. Sales Account, Purchases Account & A's Personal Account

17. If a credit sale of ₹ 15,400 to Prem had been entered as ₹ 14,500. The Journal entry for rectifying the error would be:
a. Debit Cash Account and Credit Sales Account with ₹ 900
b. Debit Prem Account and Credit Sales Account with ₹ 900
c. Debit Sales Account and Credit Prem Account with ₹ 900
d. Debit Prem, Account and Credit Sales Account with ₹ 15,400

18. Legal expenses paid to Mohan are debited to his personal account. This is an example of error …………
a. Duplication
b. Omission
c. Commission
d. Principle

19. Commission received ₹ 2,500 correctly entered in the cash book but posted to the debit side of commission account. In the Trial Balance:
a. The credit total will be greater by ₹ 5,000 than the debit total
b. The debit total will be greater by ₹ 2,500 than the credit total
c. The debit total will be greater by ₹ 5,000 than the credit total
d. The credit total will be greater by ₹ 2,500 than the debit total

20. Which of the following errors are revealed by the trial balance?
a. Errors in balancing account
b. Errors of principle
c. Errors of complete omission
d. Compensatory Errors.

21. Which type of error is there in trial balance?
a. Compensating error
b. Error of Principal
c. Error of omission/partial omission
d. All are applicable

22. When an entry is passed correctly but on wrong A/c:
a. Compensating error
b. Error of commission
c. Error of principle
d. Error of omission

23. Which of the following types of errors affect only one account? (I)Error casting (II) Errors of carry forward (III) Error of posting
a. (I) and (II)
b. (I) and (III)
c. (II) and (III)
d. (I), (II) and (III)

24. Which of the following is not a Clerical error?

a. Error of Partial Omission
b. Error of Commission
c. Error of Principle
d. Error of Omission

25. Whitewashing charges ₹ 50,000 were debited to building A/c, it is-

a. Error of omission
b. Error of commission
c. Error of principle
d. Compensating error

26. An invoice from a supplier of office equipment has been debited to the stationary account. This error is known as:

a. An error of commission
b. A compensating error
c. An error of principal
d. An error of omission

27. Charge legal expenses instead of Machinery A/c is a error of:

a. Principles
b. Commission
c. Partial commission
d. None of the above.

Answers

1. (b)
2. (b)
3. (a)
4. (c)
5. (b)
6. (b)
7. (c)
8. (d)
9. (c)
10. (c)
11. (b)
12. (c)
13. (a)
14. (b)
15. (b)
16. (d)
17. (b)
18. (c)
19. (b)
20. (a)
21. (c)
22. (b)
23. (d)
24. (c)
25. (c)
26. (a)
27. (a)

CHAPTER – 3

Bank Reconciliation Statement

1- BANK RECONCILIATION STATEMENT

Bank reconciliation statement is a statement which reconciles the bank balance as per cash book with the balance as per bank pass book by showing all causes of difference between the two. This reconciliation is prepared and presented in the form of a statement commonly known as Bank Reconciliation Statement.

2- ASCERTAINING THE CAUSES OF DIFFERENCE OF BANK BALANCE IN BANK COLUMN OF THE CASH- BOOK AND IN PASS-BOOK

1. Timing differences,
2. Differences arising due to errors in recording the entries.

2.1- TIMING DIFFERENCES

1. Cheques issued but not presented for payment.
2. Cheques paid into the bank but not cleared.
3. Interest allowed by bank.
4. Interest and expenses charged by the bank.
5. Interest and dividends collected by the bank.
6. Direct payments by the bank.
7. Direct payment into the bank by a customer.
8. Dishonour of a bill discounted with the bank.
9. Bills collected by the bank on behalf of the customer.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

(1) A Bank Reconciliation Statement is a
- (a) Part of Cash Book;
- (b) Part of Bank Account;
- (c) Part of financial statements,
- (d) None of the above.

(2) Debit balance as per Cash Book of ABC Enterprises as on 31.3.2011 is Rs. 1500. Cheques deposited but not cleared amounts to Rs. 100 and Cheques issued but not presented of Rs. 150. The bank allowed interest amounting Rs. 50 and collected dividend Rs. 50 on behalf of ABC Enterprises. Balance as per pass book should be
- (a) Rs. 1,600
- (b) Rs. 1,450
- (c) Rs. 1,850
- (d) Rs. 1,650

(3) When drawing up a Bank Reconciliation Statement, if you start with a debit balance as per the Bank Statement, the unpresented cheques should be:
(a) Added;
(b) Deducted;
(c) Not required to be adjusted.
(d) None of these

(4) When the balance as per Pass Book is the starting point, direct payment by bank are:
(a) Added in the bank reconciliation statement
(b) Subtracted in the bank reconciliation statement
(c) Not required to be adjusted in the bank reconciliation statement.
(d) Neither of the above.

(5) When the balance as per Pass Book is the starting point, uncollected cheques are:
(a) Added in the bank reconciliation statement
(b) Subtracted in the bank reconciliation statement
(c) Not required to be adjusted in the bank reconciliation statement.
(d) Neither of the above

(6) A Bank Reconciliation Statement is prepared by
(a) The Bank
(b) The Government
(c) The Bank Account holder
(d) The user of financial statements

(7) The difference in the balances of both the cash-book and the pass-book can be because of
(a) Errors in recording the entries either in the cash book or pass-book.
(b) Omission of same entry in both cash-book and pass-book.
(c) Debit balance of cash book is the credit balance of pass-book.
(d) None of the above.

(8) Direct payment to the third party on behalf of the account holder is entered in
(a) The cash-book when the amount is paid by the bank
(b) The cash-book when the entry is posted in the pass-book
(c) The pass-book when the entry is posted in the pass-book
(d) None of the above

(9) Which of the following is not the salient feature of bank reconciliation statement?
(a) Any undue delay in the clearance of cheques will be shown up by the reconciliation
(b) Reconciliation statement will help in finding the person doing any fraud

(c) Reconciliation is done by the bankers
(d) It helps in finding out the actual position of the bank balance

[Ans. : 1.(d), 2.(d), 3.(a), 4.(a), 5.(a), 6.(c), 7.(a), 8.(b), 9.(c) .

1. Who prepares Bank Reconciliation Statement?
   a. Bank employee
   b. Customer of bank or his representative or his accountant
   c. Both (a) and (b)
   d. None of the above.
2. For the purpose of bank reconciliation statement, only the ………. column of the cash book is to be considered.
   a. Cash
   b. Bank
   c. Cash and Bank
   d. Discount
3. Bank balance as per cash book of ABC Enterprises as on 31st March, 2013 is ₹ 1,500. Cheques deposited with bank but not cleared amount to ₹ 100 and cheque issued but not presented for payment amount to ₹ 150. The bank allowed interest amounting to ₹ 50 and collected dividend ₹ 50 on behalf of ABC Enterprises. Balance as per pass book should be:
   a. ₹ 1,600
   b. ₹ 1,450
   c. ₹ 1,850
   d. ₹ 1,650.
4. Which of the following is true about bank reconciliation statement –
   a. Bank reconciliation statement need not to be prepared where the balance of cash book and pass book matches
   b. Bank reconciliation statement is to be prepared necessarily as per the Income tax Act, 1961
   c. Bank reconciliation statement is prepared on yearly basis
   d. Bank reconciliation statement is to be prepared and supplied by bank
5. Cash book shows Dr. balance ₹ 10,000, cheque issued ₹ 4,000 and cheques presented ₹ 3,000. Calculate the balance as per pass book.
   a. 13,000
   b. 7,000
   c. 6,000
   d. 10,000.
6. If the cheque is not presented for the payment upto the date of the preparation of the Bank Reconciliation Statement then the balance as per pass book will be:
   a. Higher than the balance shown by the cash book by the amount of unpresented cheque
   b. Same as shown by the cash book
   c. Twice the balance shown by the cash book
   d. Lower than the balance shown by the cash book by the amount of unpresented cheque

7. The pass book shows and overdraft of ₹ 2,000. It was discovered that cheques of ₹ 200, ₹ 40 and ₹ 37 respectively has not been presented for payments and a cheque of ₹ 100 paid into account had not been cleared. The balance as per the cash book will be:
   a. ₹ 2,177 (Cr.)
   b. ₹ 1,977 (Cr.)
   c. ₹ 1,977 (Dr.)
   d. ₹ 2,177 (Dr.)
8. A credit balance in the bank statement indicates:
   a. Cash at bank
   b. Cash in hand
   c. Bank overdraft
   d. Overpayment to creditors.
9. If cash book balance (Dr.) is given there dividend collected by bank is:
   a. Added on Dr. side of cash book
   b. Added on Cr. side of cash book
   c. Subtracted in cash book
   d. None of the above
10. Cash Book (Dr.) Balance is ₹ 54,000. If cheque issue but not presented for payment. What will be the effect in cash book:
   a. Added
   b. Subtracted
   c. Add ₹ 5,000
   d. Subtracted ₹ 5,000
11. Dr. Balance as per Cash Book ₹ 20,000. Cheque collected of ₹ 5,000 but credited only ₹ 4,000. Balance of pass book:
   a. ₹ 13,000
   b. ₹ 17,000
   c. ₹ 19,000
   d. ₹ 10,000
12. The differences arising between bank statement and cash book is reconciled by the preparation of:
   a. Bank Reconciliation Statement
   b. Cash Flow Statement
   c. Funds Flow Statement
   d. Working Capital Statement.
13. In which of the following type of accounts, money is generally deposited periodically at a regular interval?
   a. Recurring Deposit Account
   b. Saving Bank Account
   c. Fixed Deposit Account
   d. Current Account
14. Credit balance as per Cash Book ₹ 10,000, Bank charged Interest of ₹ 150, cheques issued but not presented for payment ₹ 2,500. Overdraft as per Pass Book will be:
   a. ₹ 12,650
   b. ₹ 12,350
   c. ₹ 12,500
   d. ₹ 7,650

15. Some of the transaction that is dependent on bank statement are
   a. Collection charges
   b. Rent received
   c. Dividend received
   d. All of above

16. Bank Reconciliation Statement is prepared by
   a. Accountant of business
   b. Manager of business
   c. Controller of bank
   d. Accountant of the bank.

17. If you start with a debit balance as per the Cash Book, cheques that have been issued by a company but have not been shown in pass book are ………… while preparing bank reconciliation statement.
   a. Not to be adjusted
   b. Added twice
   c. Subtracted
   d. Added

18. Cheque issued but not presented for payment are ………….. in passbook.
   a. Less
   b. Add
   c. Both (a) and (b)
   d. None of the above

Answers

1. (b)	10. (d)
2. (b)	11. (c)
3. (d)	12. (a)
4. (a)	13. (a)
5. (b)	14. (d)
6. (a)	15. (d)
7. (d)	16. (a)
8. (a)	17. (d)
9. (a)	18. (d)

CHAPTER – 4

Inventories

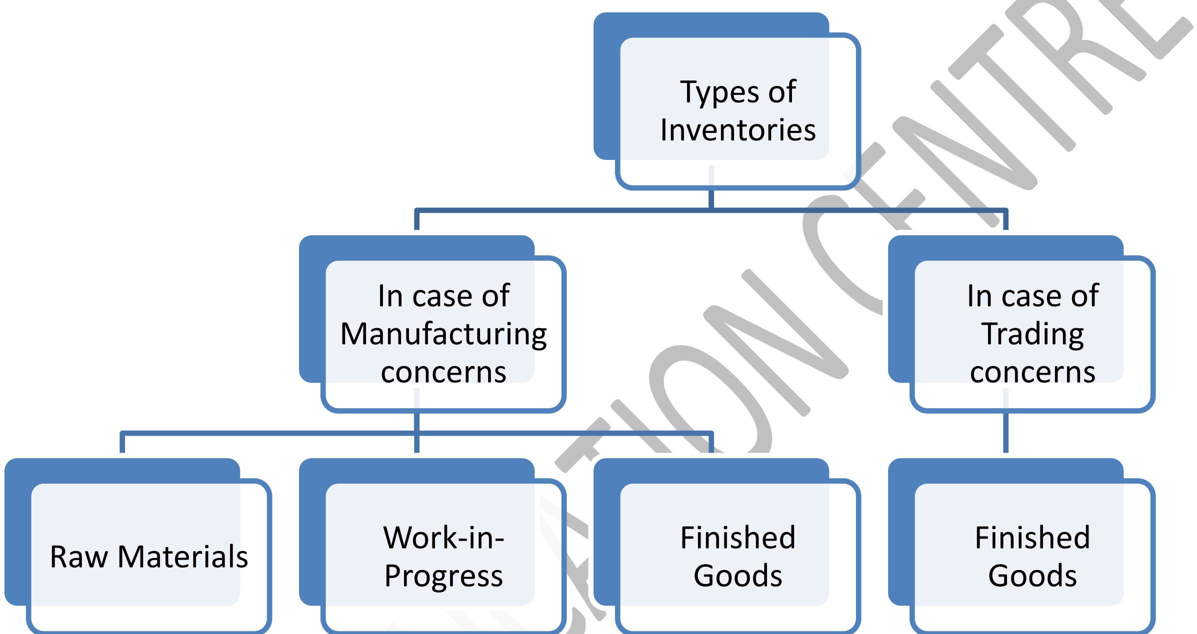
1- MEANING

Inventory can be defined as tangible property held for sale in the ordinary course of business, or in the process of production for such sale, or for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares.

Inventories are assets:

(a) Held for sale in the ordinary course of business;

(b) In the process of production for such sale;(c) in the form of materials or supplies to be consumed in the production process or in the rendering of service.



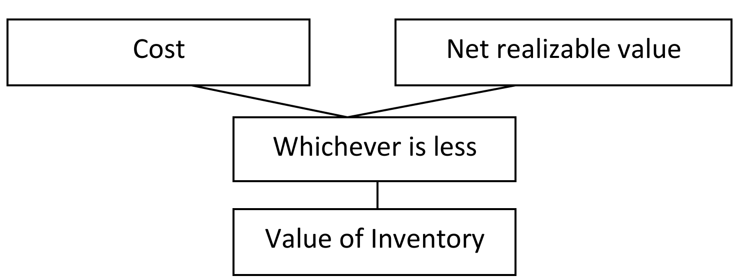
2- BASIS OF INVENTORY VALUATION

Inventories should be generally valued at the lower of cost or net realizable value.

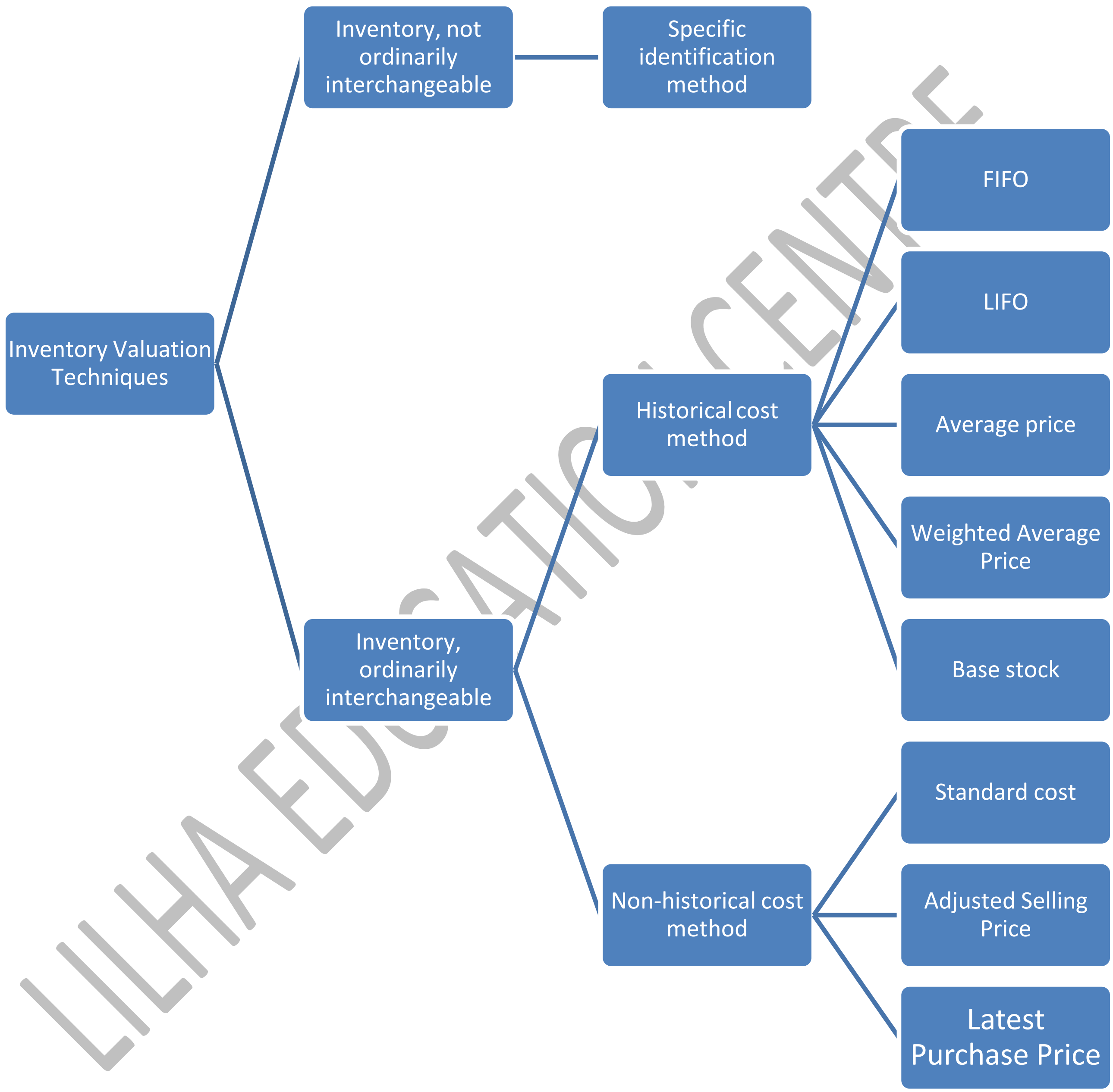
Cost: The amount of expenditure incurred on acquisition of goods.

Net realizable value: This is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale.

Basis of Inventory Valuation



3- TECHNIQUES OF INVENTORY VALUATION



3.1- HISTORICAL COST METHOD

Under historical cost methods, cost of goods refers to the historical cost of acquisition of goods. "cost of purchase and other costs incurred in bringing the inventories up to their present location and condition."

The different techniques for valuation of inventory have been discussed below:

(1) Specific Identification Method

Pricing under this method is based on actual physical flow of goods. It attributes specific costs to identified goods and requires keeping different lots purchased separately to identify the lot out of which units in inventories are left. The historical costs of such specific purpose inventories may be determined on the basis of their specific purchase price or production cost.

(2) FIFO (First in first out) Method

The actual issue of goods is usually from the earliest lot on hand. The inventory of goods on hand therefore, consists of the latest consignments. Thus, the closing inventory is valued at the price paid for such consignments.

(3) LIFO (Last in first out) Method

Though actual issues are made out of the earliest lot on hand to prevent unnecessary deterioration in value, it is sometimes assumed that the issue to be valued is to be according to the price paid for the latest consignments on hand.

LIFO method is based on an irrational assumption that inventories entering last in the stores are issued or consumed first

(4) Average Price Method

Average price for computing value of inventory is a very simple approach. (All the different prices are added together and then divided by the number of prices). The closing inventory is then valued according to the price ascertained.

(5) Weighted Average Price Method

However, it is more logical to compute weighted average price using the quantities purchased in a lot as weights.

$$\text{weighted average price per unit} = \frac{\text{Total Cost of goods available for sale during the period}}{\text{Total number of units available for sale during the period}}$$

Closing inventory = No. of units in inventory X Weighted average price per unit
Cost of goods sold= No. Of units sold X Weighted average price per unit

(6) HIFO

Highest in, first out (HIFO) is an inventory distribution and accounting method in which the inventory with the highest cost of purchase is the first to be used or taken out of stock. This will impact the company's books such that for any given period of time, the inventory expense will be the highest possible for the cost of goods sold (COGS), and the ending inventory will be the lowest possible.

HIFO usage is rare to non-existent and is not recognized by GAAP.

3.2- NON-HISTORICAL COST METHODS

Non-historical cost methods do not consider the historical cost incurred to acquire the goods. Non-historical cost methods include Adjusted Selling Price method, Standard Cost and Latest Purchase Price method. Adjusted Selling Price method can be explained as follows:

Adjusted selling price method

This method is also called retail inventory method. It is used widely in retail business or in business where the inventory comprises of items, the individual costs of which are not readily ascertainable. The use of this method is appropriate for measuring inventories of large numbers of rapidly changing items that have similar margins and for which it is impracticable to use other costing method.

SELF EXAMINATION QUESTIONS

Pick up the correct answer from the given choices:

(1) Average Inventory = Rs. 12,000. Closing Inventory is Rs. 33,000 more than opening Inventory. The value of closing Inventory =
- (a) Rs. 12,000
- (b) Rs. 24,000
- (c) Rs.10,500
- (d) Rs. 13,500.

(2) If the profit is 25% of the cost price then it is
- (a) 25% of the sales price
- (b) 33% of the sales price
- (c) 20% of the sales price
- (d) 15% of the sales price

(3) Goods purchased Rs. 1,00,000. Sales Rs. 90,000. Margin 20% on cost. Closing Inventory = ?
- (a) Rs. 20,000
- (b) Rs. 10,000
- (c) Rs. 25,000
- (d) Rs. 28,000

(4) A company is following weighted average cost method for valuing its inventory. The details of its purchase and issue of raw materials during the week are as follows:
1.12.2011 opening Inventory 50 units value Rs. 2,200.
2.12.2011 purchased 100 units @Rs.47.
4.12.2011 issued 50 units.
5.12.2011 purchased 200 units @Rs.48.
The value of inventory at the end of the week and the unit weighted average costs is
(a) Rs. 14,200 – Rs. 47.33
(b) Rs. 14,300 – Rs. 47.67
(c) Rs. 14,000 – Rs. 46.66
(d) Rs. 14,400 – Rs. 48.00

(5) C Ltd. recorded the following information as on March 31, 2011:

Inventory as on April 01, 2010	Rs. 80,000
Purchases	Rs. 1,60,000
Sales	Rs. 2,00,000

It is noticed that goods worth Rs. 30,000 were destroyed due to fire. Against this, the insurance company accepted a claim of Rs. 20,000.

The company sells goods at cost plus 33 1/3%. The value of closing inventory, after taking into account the above transactions is,
(a) Rs. 10,000
(b) Rs. 30,000
(c) Rs. 1,00,000
(d) Rs. 60,000

(6) E Ltd., a dealer in second-hand cars has the following five vehicles of different models and makes in their Inventory at the end of the financial year 2010-2011:

Car	Fiat	Ambassador	Maruti Esteem	Maruti 800	Zen
Cost (Rs.)	90,000	1,15,000	2,75,000	1,00,000	2,10,000
Net realizable value (Rs.)	95,000	1,55,000	2,65,000	1,25,000	2,00,000

The value of Inventory included in the balance sheet of the company as on March 31, 2011 was
(a) Rs. 7,62,500
(b) Rs. 7,70,000
(c) Rs. 7,90,000
(d) Rs. 8,70,000

(7) While finalizing the current year's profit, the company realized that there was an error in the valuation of closing Inventory of the previous year. In the previous year, closing Inventory was valued more by Rs. 50,000. As a result

(a) Previous year's profit is overstated and current year's profit is also overstated
(b) Previous year's profit is understated and current year's profit is overstated
(c) Previous year's profit is understated and current year's profit is also understated
(d) Previous year's profit is overstated and current year's profit is understated

(8) The total cost of goods available for sale with a company during the current year is Rs. 12,00,000 and the total sales during the period are Rs. 13,00,000. If the gross profit margin of the company is 33 1/3% on cost, the closing inventory during the current year is

(a) Rs. 4,00,000
(b) Rs. 3,00,000
(c) Rs. 2,25,000
(d) Rs. 2,60,000.

(9) Consider the following data pertaining to H Ltd. for the month of March 2011:

Particulars	As on March 01, 2011 (Rs.)	As on March 31, 2011 (Rs.)
Inventory	1,80,000	90,000

The company made purchases amounting Rs. 3,30,000 on credit. During the month of March 2011, the company paid a sum of Rs. 3,50,000 to the suppliers. The goods are sold at 25% above the cost. The sales for the month of March 2011 were

(a) Rs. 4,12,500
(b) Rs. 5,25,000
(c) Rs. 90,000
(d) Rs. 3,15,000.

(10) Consider the following data pertaining to a company for the month of March 2011:

Particulars	Rs.
Opening inventory	22,000
Closing inventory	25,000
Purchases less returns	1,10,000
Gross profit margin (on sales)	20%

The sales of the company during the month are

(a) Rs. 1,41,250
(b) Rs. 1,35,600
(c) Rs. 1,33,750
(d) Rs. 1,28,400

(11)Consider the following for Q Co. for the year 2010-11:

Cost of goods available for sale	Rs.1,00,000
Total sales	Rs. 80,000
Opening inventory of goods	Rs.20,000
Gross profit margin	25%

Closing inventory of goods for the year 2010-11 was

(a) Rs. 80,000
(b) Rs. 60,000
(c) Rs. 40,000
(d) Rs. 36,000

[Ans.- 1. (d), 2. (c), 3. (c),4. (a), 5. (d), 6. (b), 7. (d), 8. (c), 9. (b), 10. (c), 11. (c)

From the given information, answer questions.

Bharat Indian Oil is a bulk distributor of petrol. A periodic inventory of petrol on hand is taken when the books are closed at the end of each month. The following summary of information is available for the month :

Sales	Rs. 9,45,000
General administration cost	Rs. 25,000
Opening inventory: 1,00,000 litres @ 3 per litre	Rs. 3,00,000
Purchases (including freight inward):	

June 1 2,00,000 litres @Rs. 2.85 per litre
June 30. 1,00,000 litres @Rs. 3.03 per litre
June 30 Closing inventory 1,30,000 litres

(1) Compute the value of inventory on June 30 using FIFO method of inventory costing.
 (a) Rs. 3,88,500
 (b) Rs. 4,18,500
 (c) Rs. 2,58,000
 (d) Rs. 3,60,500

(2) Using the information given in problem, compute the amount of cost of goods sold for the month of June using FIFO basis.
 (a) Rs. 7,84,500
 (b) Rs. 6,85,000
 (c) Rs. 3,88,500
 (d) Rs. 7,58,000

(3) Compute net profit or loss for the month of June using FIFO method of inventory costing.

(a) Rs. 1,60,000
(b) Rs. 1,15,500
(c) Rs. 1,25,000
(d) Rs. 1,35,500

(4) Compute the value of inventory on June 30 using weighted average method of inventory costing.
(a) Rs. 3,75,000
(b) Rs. 3,81,225
(c) Rs. 2,80,000
(d) Rs. 4,10,000

(5) Using the information given in problem, compute the amount of cost of goods sold for the month of June using weighted average method.
(a) Rs. 8,15,000
(b) Rs. 7,52,000
(c) Rs. 7,91,775
(d) Rs. 6,79,000

(6) Compute gross profit or loss for the month of June using weighted average method of inventory costing.
(a) Rs. 1,20,000
(b) Rs. 2,15,000
(c) Rs. 1,53,225
(d) Rs. 1,29,000

(7) Compute the value of inventory on June 30 using LIFO method of inventory costing.
(a) Rs. 3,85,500
(b) Rs. 3,69,000
(c) Rs. 2,97,000
(d) Rs. 4,18,000

(8) Using the information given in the problem, compute the amount of cost of goods sold for the month of June using LIFO principle.
(a) Rs. 787,500
(b) Rs. 6,75,000
(c) Rs. 8,15,000
(d) Rs. 7,95,000

(9) Compute gross profit or loss for the month of June using LIFO method of inventory costing.
(a) Rs. 1,95,500
(b) Rs. 1,65,000
(c) Rs. 1,57,500
(d) Rs. 1,95,000

10. Which method of Inventory valuation is used at the time of Inflation?
    a. HIFO
    b. LIFO
    c. FIFO
    d. Weighted Average Price Method

11. Which method of Inventory valuation is used at the time of Deflation?
    a. HIFO
    b. LIFO
    c. FIFO
    d. Weighted Average Price Method

[Ans.- 1. (a), 2. (a), 3. (d), 4. (b), 5. (c), 6. (c), 7. (a), 8. (a), 9. (c), 10.(b),11(c)]

Chapter- 5

Depreciation Accounting

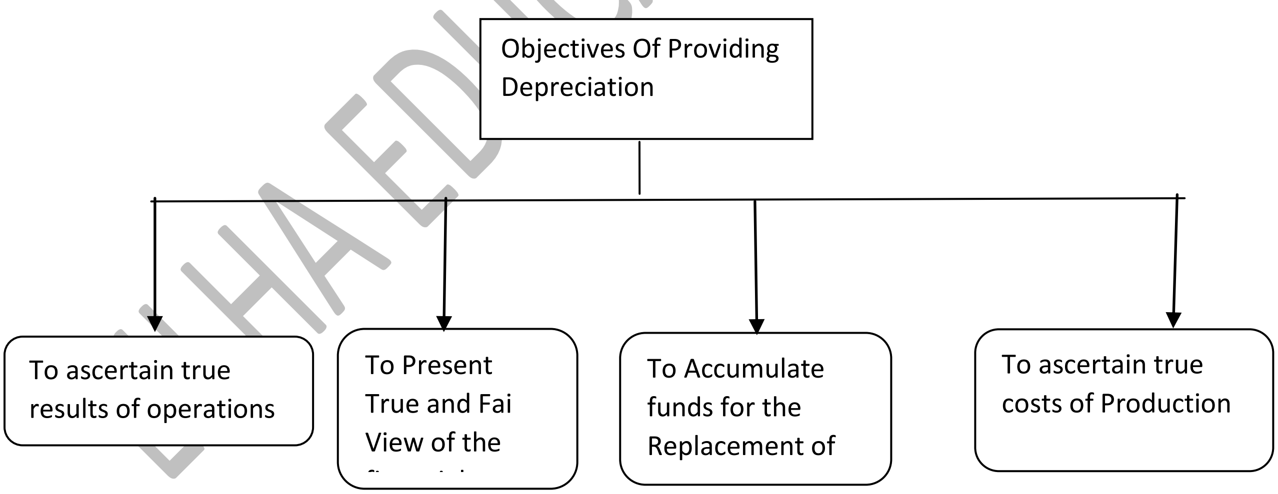
1-Concept Of Depreciation

Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset.
The loss in the value of assets employed for carrying on a business being an essential element of business expenditure, it is necessary to calculate the amount of such loss and to make a provision, and therefore, arrive at the amount of profit or loss made by the business.

2- Objective For Providing Depreciation

(i) Correct Income Measurement
(ii) True Position Statement
(iii) Funds for replacement
(iv) Ascertainment of true cost of production



Factors Affecting the Amount of Depreciation

- Cost Of Asset
- Expected useful life
- Estimated Residual Value

3- <u>Straight Line Method</u>

According to this method ,an equal amount is written off every year during the working life of an asset so as to reduce the cost of the asset to nil or its residual value at the end of its useful life.

$$\textbf{Straight Line Depreciation} = \frac{\textbf{Cost of Asset – Scrap Value}}{\textbf{Useful Life}}$$

$$\textbf{Straight Line Depreciation Rate} = \frac{\textbf{Straight Line Depreciation}}{\textbf{Cost Of Asset}} \times 100$$

4-<u>Reducing Balance Method</u>

Under this system , a fixed percentage of the diminishing value of the asset is written off each year so as to reduce the asset to its break-up value t the end of its life , repairs and small renewal s being charged to revenue . This method is commonly used for plant fixture, etc.

$$1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Cost of asset}}} \times 100$$

Where, n= Useful life

5-<u>Sum Of Years Of Digits Method</u>

It is Variation of the "Reducing Balance Method " In this case, the annual deprecation is calculated by multiplying the original cost of the asset less its estimated scrap value by the fraction represented by:

$$\frac{\textbf{The number of years (including the present year) of remaining life of the asset}}{\textbf{Total of all digits of the life of the asset (in year)}}$$

6-Annuity Method

This is a method of depreciation which also takes into account the element of interest on capital outlay and seeks to write off the value of the asset as well as the interest lost over the life of the asset. It assumes that the amount laid out in acquiring asset, if invested elsewhere, would have earned interest which must be reckoned as part of the cost of asset. On that basis, the amount of depreciation to be annually provided in the accounts is ascertained from the Annuity Tables.

7-Sinking Fund Method

If a large sum of money is required for replacement of property, plant and equipment at the end of its effective life, it may not be advisable to leave in the amount of depreciation set apart annually, for it may or may not be available in the form of the readily realisable assets to the concern at the time it is required.

8-Machine Hour Method

Where it is practicable to keep a record of the actual running hours of each machine, depreciation may be calculated on the basis of hours that the concerned machine worked. The machine hour rate of the depreciation, is calculated after estimating the total number of hours that machine would work during its whole life

9-Production Units Method

The Amount of Depreciation is computed by the use of following method Depreciation for the Period=

$$\frac{\text{Depreciation Amount} \times \text{Production during the period}}{\text{Estimated total Production}}$$

10-Depletion Method

This method is used in case of mines, quarries etc. containing only a certain quantity of product. The depreciation rate is calculated by dividing the cost of the asset by the estimated quantity of product likely to be available. Annual depreciation will be the quantity extracted multiplied by the rate per unit.

Self Examination Question

1. Original Cost= 1,26,000; Salvage Value=Nil; Useful Life= 6 year. Depreciation for the first year under sum of year digits method will be
   - **a)** 36,000
   - **b)** 12,000
   - **c)** 18,000
   - **d)** 10,000

2. Obsolescence of a Depreciable asset may be caused by

1-Technological Changes
2-Improvement in Production method.
3-Change in Market demand for the Product or service output.
4-Legal or Other restrictions.

a) Only(1)
b) Both (1)and (2)above
c) All (1)(2)(3)And (4)above
d) Only (4) above

3. The Number Of Production of Similar units expected to be obtained from the use of an asset by an enterprise is called as

a) Unit Life
b) Useful life
c) Production Life
d) Expected Life

4. If a concern Proposes to discontinue its business From March 2015 and decides to dispose of all its plants within a period of 4 month, the Balance Sheet as on March 31,2015 Should indicate the plants at their

a) Historical Cost
b) Net realizable Value
c) Cost Less depreciation
d) Cost Price or Market Value, whichever is lower

5. In the case of downward revaluation of a plant which is for the first time revalued, the account to be debited is

a) Plant account
b) Revaluation Reserve
c) Profit& Loss Account
d) General Reserve

6. The Portion of the acquisition cost of the tangible asset, yet to be allocated is known as

a. Written down Value
b. Accumulated Value
c. Realisable Value
d. Salvage Value

7. The WDV of an asset after three years of depreciation on the reducing balance method @ 15% per annum is Rs.49,130.What was its original value?

a. Rs.40,000
b. Rs.80,000
c. Rs.45,000
d. Rs.70,250

8. Original cost =Rs 1,00,000,life = 5 years, expected salvage value = Rs 5,000 rate of depreciation per annum=?
   - **a.** 20.0%
   - **b.** 19.5%
   - **c.** 19%
   - **d.** 19.4%
9. A Ltd purchased a machine on 01.01.2003 for Rs.1,20,000 installation expenses were Rs.30,000 .Residual value after 5 years was Rs.5,000. On 01.07.2003expenses for repair were incurred to the extent of Rs.2,000. Depreciation is provided @10 % per annum under written down value method. Total depreciation after 2 years will be
   - **a.** Rs25,000
   - **b.** Rs.13,000
   - **c.** Rs.10,500
   - **d.** Rs.28,500
10. Which method of depreciation is effective if repairs and maintains cost of an asset increase as it grows old ?
   - **a.** Straight line method
   - **b.** Sinking fund method
   - **c.** Annuity Method
   - **d.** Reducing balance method
11. A Machine was bought at a cost of Rs. 5,00,000 on 1.1.2002.During its life time of 10 years, it will be depreciated on SLM basis. On 31.12.2009, the machine was sold for Rs.1,50,000. Find out the profit / loss.
   - a. Loss of Rs. 1,50,000
   - b. Profit of Rs.50,000
   - c. Profit of Rs.1,00,000
   - d. Profit of Rs.1,50,000
12. Ram Purchased a computer on 1.04.2010 for Rs.6,00,000. He is charging depreciation on written down value method. On 31.03.2011, he sold the computer for Rs. 1,65,000 and incurred a loss of Rs. 75,000. The rate of depreciation per annum is
   - a. 10%
   - b. 15%
   - c. 60%
   - d. 25%
13. Depletion method of depreciation is normally applied in the case of ………………….. assets.
   - a. Wasting
   - b. Intangible

c. Tangible
d. Current

14. A Machinery is purchased for Rs. 15,000 on 1st April 2005 and depreciation @10% per annum is provided .Calculate the amount of difference as per SLM and WDV basis in the year 206-07.
a. Rs.150
b. Rs.1,000
c. Nil
d. Rs.200

15. Amortisation refers to writing-off
a. Depleting Assets
b. Wasting Assets
c. Intangible Assets
d. Fictitious Assets

16. Cost of machine = Rs.5,00,000
Salvage Value = Rs.20,000
Useful Life =Rs. 5 Years
Depreciation for the last year using the sum of digits method will be
a. Rs.32,000
b. Rs.20,400
c. Rs.34,000
d. Rs.27,200

17. According to Income tax Act, which method of providing depreciation should be followed?
a. Reducing balance method
b. Sinking fund method
c. Annuity method
d. Straight line method

18. Which of the following is depleted?
a. Land
b. Goodwill
c. Machinery
d. Quarries

19. Which method of depreciation takes into account the element of interest on capital outlay?
a. Depletion method
b. Annuity method
c. SLM method
d. WDV method

20. Annuity method is designed for which of the following?
a. Leases
b. Intangibles
c. Fixed Assets

d. Any of these

21. A Machine of Rs.3,000 was sold for Rs.4,200. Depreciation provision to date was Rs 400 and commission paid to selling agent was Rs.420 and wages paid to worker for removing the machine was Rs.30. Profit on sale of machine will be

a. Rs.1,200
b. Rs.1,000
c. Rs.1,150
d. None of these

Answer.

1. (a)
2. (c)
3. (b)
4. (b)
5. (c)
6. (a)
7. (b)
8. (c)
9. (d)
10. (d)
11. (b)
12. (c)
13. (a)
14. (a)
15. (c)
16. (a)
17. (a)
18. (d)
19. (b)
20. (a)
21. (c)

Chapter- 6

Consignment

1.Meaning Of Consignment Account

To consign means to send. In Accounting, the term "consignment account" relates to accounts dealing with a situation where one person (or firm) sends goods to another person (or firm) on the basis that the goods will be sold on behalf of and at the risk of the former.

The party which sends the goods (consignor) is called principal.

The party to whom goods are sent (consignee) is called agent

2.Distinction Between Consignment And Sale

S.No.	Consignment	Sale
1-	Ownership of the goods rests with the consignor till the time they are sold by the consignee, no matter the goods are transferred to the consignee.	The ownership of the goods transfers with the transfer of goods from the seller to the buyer.
2-	The consignee can return the unsold goods to the consignor.	Goods sold are the property of the buyer and can be returned only if the seller agrees.
3-	Consignor bears the loss of goods held with the consignee.	It is the buyer who will bear the loss if any, after the delivery of goods.
4-	The relationship between the consignor and the consignee is that of a principal and agent.	The relationship between the seller and the buyer is that of a creditor and a debtor.
5-	Expenses done by the consignee to receive the goods and to keep it safely is borne by the consignor	Expenses incurred by the buyer are to be borne by the buyer itself after the delivery of goods.

3.Valuation of Inventories

The principle is that inventories should be valued at cost or net realisable value whichever is lower, the same principle as is practiced for preparing final accounts. In the case of consignment, cost means not only the cost of the goods as such to the consignor but also all expenses incurred till the goods reach the premises of the consignee.

Commission

Commission is the remuneration paid by the consignor to the consignee for the services rendered to the former for selling the consigned goods.

Three Types of Commission

(i) Ordinary Commission

The term commission simply denotes ordinary commission. It is based on fixed percentage of the gross sales proceeds made by the consignee. It is given by the consignor regardless of whether the consignee is making credit sales or not. This type of commission does not give any protection to the consignor from bad debts and is provided on total sales.

(ii) Del- Credere Commission

To increase the sale and to encourage the consignee to make credit sales, the consignor provides an additional commission generally known as del-credere commission which is generally calculated on credit sales. This additional commission when provided to the consignee gives a protection to the consignor against bad debts. In other words, after providing the del-credere commission, bad debts are no more the loss of the consignor.

(iii)Over Riding Commission

It is an extra commission allowed by the consignor to the consignee to promote sales at higher price then specified or to encourage the consignee to put hard work in introducing new product in the market. Depending on the agreement it is calculated on total sales or on the difference between actual sales and sales at invoice price or any specified price.

Self Examination Questions

1. Which of the following statement is not true :
   a) If del- credere commission is allowed ,bad debt will not be recorded in the book of consignor
   b) If del- credere commission is allowed ,bad debt will be debited in consignment account
   c) Del – Credere commission is allowed by consignor to consignee
   d) Del – Credere commission is generally relevant for credit sales
2. Which Of the following statement is wrong
   a) Consignor is the owner of the consignment Inventories
   b) Del – Credere commission is allowed by consignor to protect himself from bad debt
   c) Proportionate Consignor's expenses is added up with consignment Inventorie
   d) All Proportionate Consignee's expenses will be added up for valuation of consignment inventories
3. .In the book of consignor, the profit of consignment will be transferred to:
   a) General Trading A/C
   b) General P/L A/C
   c) Drawings A/C

d) None of these

4. Out of the following at which point the treatment of ‘Sales’and ‘Consignment’ is same
   a) Ownership Transfer
   b) Money Receive
   c) Inventories outflow
   d) Risk
5. If del-credere commission is allowed for bad debts, consignee will debt the bad debt amount to:
   a) Commission Earned A/c
   b) Consignor’s A/c
   c) Trade receivables (Customers)A/c
   d) General Trading A/c
6. A Proforma invoice is sent by :
   a) Consignee to Consignor
   b) Consignor to Consignee
   c) Customer/Debtors to Consignee
   d) Customer /Debtors to Consignor
7. Which of the following statement is correct
   a) Consignee will pass a journal entry in his books at the time of receiving goods from consignor
   b) Consignee will not pass any journal entry in his books at the time of receiving goods from consignor
   c) The ownership of goods will be transferred to consignee at the time of receiving the goods.
   d) Consignee will treat consignor as creditors at the time of receiving goods
8. Consignment A/c is prepared in the books of:
   a) Consignor
   b) Consignee
   c) Third Party
   d) None
9. Consignment Inventories will be recorded in the balance sheet of consignor on asset side at
   a) Invoice Value
   b) At Invoice Value Less Inventories reserve
   c) At Lower than Cost Price
   d) At 10% Lower than Invoice Value
10. Which Of The Following expenses of consignee will be considered as non-selling expenses
    a) Advertisement

b) Insurance

c) Selling Expenses

d) None Of the above

11. The Consignment Accounting is made on the following basis

a) Accrual

b) Realisation

c) Cash Basis

d) None

12. Which Of the following item is not credited to consignment account?

a) Cash sale made by consignee

b) Credit sales made by consignee

c) Consignment Inventories

d) Inventories Reserve on closing consignment Inventories

13. The Commission received from consignor will be transferred to which account?

a) General Trading
b) Genera P/L
c) Balance sheet
d) None Of these

14. If del –credere commission is allowed by consignor to consignee the bad debts treatment in the books of Consignor will be:

a) Will not be recorded in consignor's books
b) Bad debts will be debited in consignor's A/c
c) Bad debt will be charged t General P/L A/c
d) Bad Debt will b recoverable along with credit sales

15. The Owner of the Consignment Inventories is

a) Consignor

b) Consignee

c) Trade Receivables

d) None

16. The Nature of the Consignment account is:

a) Capital in Nature

b) Nominal in Nature

c) Realisation A/C in Nature

d) Bank A/c in Nature

17. The Balance of goods sent out on Consignment will be transferred to:

a) General P/L

b) General Trading

c) Balance sheet

d) Capital A/c

18. In the books of Consignee, the profit on Consignment will be transferred to :

a) General Trading A/c

b) General profit & loss A/c

c) Drawings A/c

d) None of Above

19. Over –riding Commission is a Commission payable to consignee for

a) For protecting himself from bad debt

b) For making sales above specific price

c) As good fried

d) As Loyalty payment

20. Consignment account is

a) Real Account

b) Personal Account

c) Nominal Account

d) None Of the above

21. In the Books of Consignor, the loss on the consignment business will be charged to:

a) Consignee A/c

b) General Trading A/c

c) General P/L A/c

d) Bank A/c

22. If Consignor draws a bill on consignee and discounted it with the banker the discounting charges will be debited in:

a) General P/L

b) Trade Payable

c) Consignee

d) Trade Receivables

23. Commission will be shared by.

a) Consignor & Consignee

b) Only Consignee

c) Only Consignor

d) Third Party

ANSWER

1. (b)
2. (d)
3. (b)
4. (b)
5. (c)
6. (a)
7. (b)
8. (b)
9. (a)
10. (b)
11. (b)
12. (a)
13. (d)
14. (b)
15. (a)
16. (a)
17. (b)
18. (b)
19. (d)
20. (b)
21. (c)
22. (c)
23. (a)

Chapter -7

Joint Ventures

1. Meaning Of joint Venture

A joint Venture is a very short duration "Business"(generally, confined to a single transaction, like buying some surplus stores and selling them) entered into by two or more persons jointly.

Joint Venture may be Described as a temporary partnership between two or more person without use of the firm name, for limited purpose.

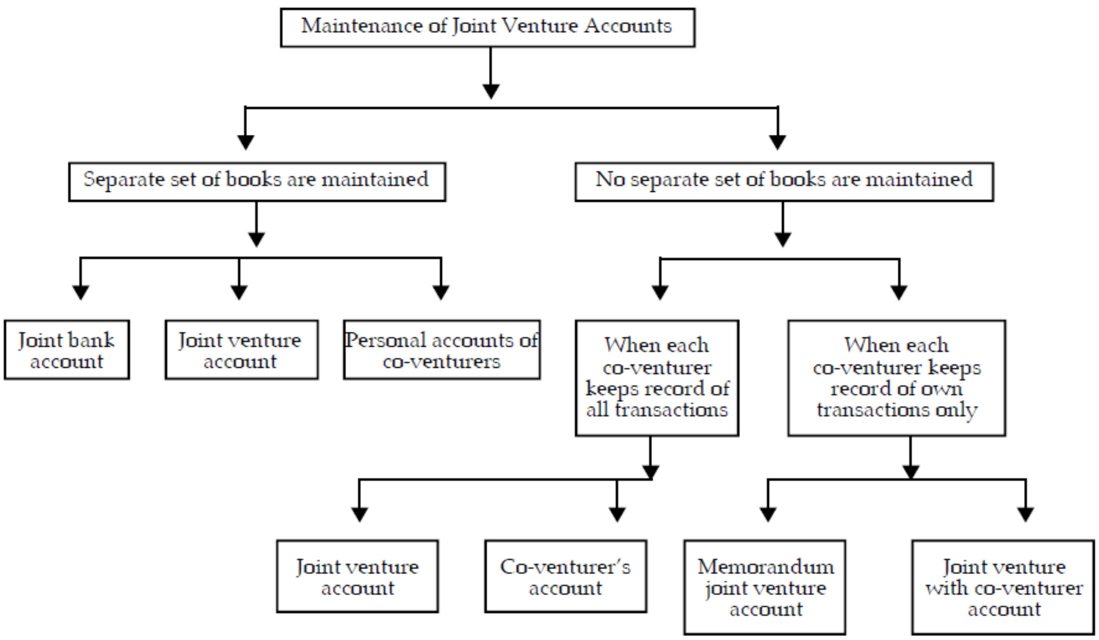
Distinction Of Joint Venture with Partnership

S. No.	Basis of Distinction	Joint Venture	Partnership
1-	**Scope**	It is Limited to a specific venture	It is not Limited to a specific venture
2-	**Persons Involve**	The Person carrying on business are called co -ventures	The Person carrying on business are called partners.
3-	**Ascertainment of Profit & Loss**	The profits/losses are ascertained at the end of specific venture(If venture continues for a short period)or on interim basis annually(if Venture Continues for a longer period)	The profits/losses are ascertained on an annual basis
4-	**Act Governing**	No specific Act is there.	Partnership Firms are governed by the Indian Partnership Act,1932.
5-	**Name**	There is no need for firm Name.	A Partnership firm always has a name
6-	**Separate set of Books**	There is n need for a separate set of books. The accounts can be maintained even in one of the Co-Venture's books only.	Separate set of books have to be maintained.
7-	**Admission of Minor**	A minor cannot be a co-venture as he is incompetent to Contract	A Minor can be admitted to the benefits of the firm.
8-	**Accounting**	Accounting for joint venture is done on liquidation basis.	Accounting for Partnership is done on going concern basis.
9-	**Competition**	It is a rule rather than exception that chances of co-ventures in the competing business are very high.	Partners generally do not involve in competing business

2. Methods of Maintaining Joint Venture Accounts

Two ways to keeps records of Joint Venture

- **I.** When separate set of books are maintained
- **II.** When no separate set of books are maintained



1. Joint Bank Account

The co-ventures' open a separate bank account for the venture transactions by making initial contributions. The bank account is generally operated jointly. Expenses are met from this Joint Bank Account. Also sales or collections from transactions are deposited to this account

2. Joint Venture Account

This Account is prepared for measurement of venture profit. This account is debited for all venture expenses and is credited for all sales or collections. Venture Profit & Loss is transferred to co- Ventures' accounts.

3. Co-Venture's Account

Personal accounts of the ventures are maintained to keep record of their contributions of cash, goods or meeting venture expenditure directly and direct payment received by them on venture transactions. This account is also closed simultaneously with the closure of joint bank account.

4. **Memorandum Joint Venture Account-**It is rough statement prepared by the ventures for determination of venture profits when they do not maintain full records of venture

transactions in the books of accounts. Unless this memorandum account is prepared, the venturer cannot compute venture profit.

Chapter -8

Bills of Exchange and Promissory Notes

- **Negotiable Instrument**

A **Negotiable Instrument** is that document that includes a 'promise to pay' a certain amount of money to the bearer of the document. Its a mode of transferring a debt from one person to another.

Examples of **Negotiable instruments** are- a cheque, a promissory note, a bill of exchange.

1-Bills of Exchange

A Bill of Exchange has been defined as an "instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument". When such an order is accepted in writing on the face of the order itself, it becomes a valid bill of exchange.

2-Promissory Notes

A promissory note is an instrument in writing, not being a bank note or currency note containing an unconditional undertaking signed by the maker to pay a certain sum of money only to or to the order of a certain person. Under Section 31(2) of the Reserve Bank of India Act a promissory note cannot be made payable to bearer. A promissory note has the following characteristics.

1. It must be in writing.
2. It must contain a clear promise to pay. Mere acknowledgement of a debt is not a promissory note.
3. The promise to pay must be unconditional "I promise to pay ` 500 as soon as I can" is not an unconditional promise.
4. The promiser or maker must sign the promissory note.
5. The maker must be a certain person.
6. The payee (the person to whom the payment is promised) must also be certain.
7. The sum payable must be certain. "I promise to pay ` 500 plus all fine" is not certain.
8. Payment must be in legal currency of the country.
9. It should not be made payable to the bearer.
10. It should be properly stamped.

3-Term Of A Bill

The term of bill of exchange may be of any duration. Usually the term does not exceed 90 days from the date of the bill. When a bill is drawn after sight, the term of the bill begins to run from the date of 'sighting', i.e., when the bill is accepted. When a bill is drawn 'after date', the term of the bill begins to run from the date of drawing the bill.

4-<u>Expiry/ Due Date of A bill</u>

The date on which the term of the bill terminates is called as 'Expiry/Due Date of the bill'.

<u>5-Days of Grace</u>

Every instrument payable otherwise than on demand is entitled to three days of grace.

<u>6-Date of Maturity of Bill</u>The date which comes after adding three days to the expiry/due date of a bill, is called the date of maturity.

The maturity of a promissory note or bill of exchang is the date at which it falls due. Every promissory note or bill of exchange which is not expessed to be payable on demand, at sight or on presentment is at maturity on the third day after the day on which it is expressed to be payable.

7-<u>Bill At Sight</u>

Bill at Sight means the instruments in which no time for payment is mentioned. A cheque is always payable on demand. A promissory note or bill of exchange is payable on demand-

a) when no time for payment is specified, or
b) when it is expressed to be payable on demand, or at sight or on presentment.

8-<u>Bill After Date</u>

Bill after date means the instrument in which time for payment is mentioned. A promissory note or bill of exchange is a time instrument when it is expressed to be payable-

a) after a specified period.
b) on a specific day
c) after sight
d) on the happening of event which is certain to happen

9-<u>Noting Charges</u>

If there is dishonour, or fear of dishonour, the bill will be given to a public official known as "Notary Public". These officials present the bill for payment and if the money is received, they will hand over the money to the original party. But if the bill is dishonoured they will note the fact of dishonuour, with the reasons and give the bill back to their client. For this service they charge a small fee. This fee is known as noting charges.

10-Renewal Of Bill Sometimes the acceptor is unable to pay the amount and he himself moves that he should be given extension of time. In such a case a new bill will be drawn and the old bill will be cancelled. If this happens entries should be passed for cancellation of the old bill. This is done exactly as already explained for dishonour. When the new bill is received entries for the receipt of the bill will be repeated.

11-Accommodation Bills

The bill will be discounted with the bank and the proceeds divided between the two parties according to mutual agreement. The discounting charges must also be borne by the two parties in the same ratio in which the proceeds are divided. On the due date the acceptor will receive from the other party his share. The bill will then be met. When bills are used for such a purpose, they are known as accommodation bills.

Entries are passed in the books of two parties exactly in the way already pointed out for ordinary bills. The only additional entry to be passed is for sending the remittance to the other party and also debiting the other party with the shared amount of discount.

12-Insolvency

Insolvency of a person means that he is unable to pay his liabilities. This means that bills accepted by him will be dishonoured. Therefore when it is known that a person has become insolvent, entry for dishonour of his acceptance must be passed.

13- Bill Of Collection

When a person received a bill of exchange he may decide to retain the bill till the date of maturity. But in order to ensure safety, he may send it to bank with instructions that the bill should be retained till maturity and should be realised on that date.

14-Retirment Of Bill of Exchange

We have seen that renewal of a bill exchange is made when a person does not have sufficient fund to pay for the bill of exchange on the due date and he requires a further period of credit.

15-Bills Receivable and Bills Payable Books

Bills receivable and bills payable books are journals (Day Books) to record in a chronological order the details of bills receivable and bills payable. When large number of bill transactions take place in an organisation, it is convenient to maintain these books.Bills receivable book and bills payable book are very useful for following up the status of outstanding bills.

Self Examination Questions

1. Calculate the due dates of the bills in the following cases:-

S.No.	Date of Bill	Period
1.	1st January,2017	2 months
2.	28th January, 2017	1 months
3.	30th January, 2017	1 months
4.	30th April,2017	2 months
5.	30th April,2017	3 months
6.	30th April,2017	30 days
7.	1st December, 2016	60 days
8.	28th December, 2015	2 months

2. Calculate the due date of the bill in the following cases:-

S.No.	Date of Bill	Period
1.	23rd November,2016	2 months
2.	27th November,2015	3 months
3.	29th May, 2016	4 months
4.	23rd May, 2016	60 days
5.	13th July, 2016	30 days
6.	31st May, 2016	1 months

Emergency Holiday: 25th July, 2016.

3. Noting Charges are ultimately borne by:
   - **a.** Drawer
   - **b.** Drawee
   - **c.** Payee
   - **d.** Bank
4. If the due of a bill falls on a public holiday then the bill is due on:
   - **a.** One day after the due date
   - **b.** Public Holiday
   - **c.** One day before the due date
   - **d.** None of the above

5. On 29th August, 2017 Mudit draws a bill on Paresh for one month, the due date will be.......
    a. 2nd October,2017
    b. 29th September, 2017
    c. 3rd October, 2017
    d. 1st October, 2017
6. Bill is drawn on 20th January, 2010 for 2 month. After sight date of acceptance is 29th January,2010.The maturity date of bill will be:
    a. 1 April, 2010
    b. 23 March, 2010
    c. 20 March, 2010
    d. 29 March, 2010

Answer- 1

(1) 4th March, 2017
(2) 3rd March 2017
(3) 3rd March, 2017
(4) 3rd July, 2017
(5) 2nd August2017
(6) 2nd June,2017
(7) 2nd February,2017
(8) 2nd March , 2016

2-
(1) 25th January, 2017
(2) 1st March,2016
(3) 1st October,2016
(4) 26th July, 2016
(5) 14th August, 2016
(6) 3rd July,2016
3-(b)
4-(c)
5-(d)
6-(a)

1. The Purpose of accommodation bill is:
   a) To finance actual purchase or sale of goods
   b) To facilitate trade transmission
   c) When both parties are in need of funds
   d) None of the above

2. Fees paid in cash to Notary public is charged by:
   a) Drawer
   b) Drawee
   c) Holder of the bill of exchange
   d) None
3. The Promissory note should be signed by:
   a) Drawer
   b) Drawee
   c) Payee
   d) Promiser
4. Kuntal draws a bill on Shyam for Rs.3,000 Kuntal endorsed it to Ram. Ram endorsed it to Rahim. The payee of the bill will be
   a) Kuntal
   b) Ram
   c) Shyam
   d) Rahim
5. Mr. Rex accepted a bill drawn by Mr.Rabin endorsed the bill to Shekar .On the due date, the bill is dishonored as Mr.Rex became insolvent. To record the dishonor of the bill in the books of Mr. Rabin, which of the following accounts should be credited?
   a) Mr. Rex's account
   b) Bills Receivable account
   c) Mr. Shekar's account
   d) Bills payable account
6. Which of Following statement is true
   a) A bill cannot be endorsed more than two times
   b) A bill is drawn by purchaser
   c) A bill contains an unconditional promise to pay
   d) Nothing charges are borne by the drawee in the event of dishonor of bill.
7. Which of the following instrument is not a negotiable instrument:
   a) Bearer Cheque
   b) Promissory note
   c) Bill of Exchange
   d) Account payee Crossed cheque
8. Which of the following is not a foreign bill:

a) A bill drawn in India, on a person resident outside India and made payable outside India.

b) A bill drawn outside India, on a person resident outside India

c) A bill drawn outside India, made payable in India

d) A bill drawn on a person resident in India made payable in India

9. From the following information, find out who can draw the bill if Mr A sold goods to B:

a) A will draw a bill on B

b) B will draw a bill on A

c) None of these

d) Third party will draw a bill on A

10. When the bill are to be Produced to notary public

a) At the timing of drawing the bill

b) At the timing of acceptance of the bill

c) At the timing of dishonour of the bill

d) At the timing of "Bill for Collection"

11. Which of the following statement is false:

a) B/R is a negotiable instrument

b) B/R must be accepted by drawee

c) There can be three parties in respect of bills of exchange-Drawer,Drawee & Payee

d) Oral bill of exchange is also valid

12. Under which circumstances drawer and payee is same person

a) When drawer discounted the bill with banker

b) When drawer endorse the bill to the third party

c) When drawer held the bill till maturity

d) When drawee rejects to accept the bill

13. Which of the following statement is true

a) Noting charge is an expenses to be borne by drawer

b) Noting charge is an expenses to be borne by drawee

c) Noting charge is an expenses to be borne by payee

d) Noting charge is an expenses to be borne by bank

14. Which of the following statement is true

a) Account payables can draw a bill on account receivables.

b) Account Receivable can draw a bill on account receivables.

c) Bank will draw a bill on customer at the time of overdraft.

- **d)** One can draw the bill on another under any circumstances

15. If due date is a public holiday, what will be the due date of the bill:

- **a)** Following day
- **b)** Preceding day
- **c)** The same day only
- **d)** One month later

ANSWER

1. (c)
2. (c)
3. (d)
4. (d)
5. (c)
6. (d)
7. (d)
8. (d)
9. (a)
10. (c)
11. (d)
12. (c)
13. (b)
14. (a)
15. (b)

Chapter-9

Unit-1

Financial Statement of Sole Proprietorship

1. Meaning of Financial Statement

Financial Statement refers to such statements which report the profitability and the financial position of the business at the end of accounting period. The term financial statements include at least two basic statements which are as under:

- **i.** Income Statement (or Trading and Profit & Loss Account) which shows results of business operations during an accounting period, and
- **ii.** Statement of Financial Position (or Balance Sheet) which shows financial position of an enterprises at a specified point of time.

In the words of **John N. Mayer,** "The financial statement provide a summary of the accounts of a business enterprises, the balance sheet reflecting the assets, liabilities and capital as on a certain date and the income statement showing the results of operations during a certain period."

2. Objectives of preparing Financial Statements

- **i.** To Present a true and fair view of the financial performance(*i.e.* Profit/ loss) of the business
- **ii.** To present a true and fair view of the financial position *(i.e.* Assets/Liabilities) of the business.

3. Income Statement-It is divided into two parts

- **i.** The First part is called 'Trading Account'. It shows the gross profit or gross loss,
- **ii.** The Second part is called 'Profit & Loss Account'. It shows the net profit or net loss.

4. Trading Account

According to J.R.Batliboi:- "The Trading Account shows the results of buying and selling of goods. In preparing this account, the general establishment charges are ignored and only the transactions in goods are included."

5. Need and Importance Of Trading Account

i. It provides information of Gross Profit and Gross loss.
ii. It provides information of the direct expenses.
iii. Comparison of closing stock with those of the previous years.
iv. It provides safety against possible losses

Format of a Trading Account

ABC Co.
Trading Account
For the year ended 31st Dec. 2019

		$			$
Opening Stock		xxxx	Sales	xxxx	
Purchases	xxxx		Less: Sales Return	xxxx	
Add: Omission	xxxx		Less: Goods sold on Sale or return basis	xxxx	xxxx
	xxxx		Closing stock		xxxx
Less: Purchases Return	xxxx		Gross Loss (Transfer to P&L A/c		xxxx
Less: Private Purchases	xxxx				
Less: Goods taken away by the proprietor	xxxx				
Less: Goods Distributed as free samples	xxxx	xxxx			
Carriage Inwards		xxxx			
Cartage		xxxx			
Freight		xxxx			
Railway Charges		xxxx			
Octroi Duty		xxxx			
Landing and Wharf Charges		xxxx			
Import Duty		xxxx			
Clearing Charges		xxxx			
Dock Charges		xxxx			
Custom Duty		xxxx			
Excise Duty		xxxx			
Motive Power		xxxx			
Gas, Water, Fuel		xxxx			
Coal, Coke		xxxx			
Factory electricity		xxxx			
Wages		xxxx			
Manufacturing expenses		xxxx			
Factory rent, rates and insurance		xxxx			
Stores Consumed		xxxx			
Oil, Tallow Grease		xxxx			
Cotton, Waste, Jute, Oilseeds		xxxx			
Raw Material		xxxx			
Royalty		xxxx			
Gross Profit (Transfer to P&L A/c		xxxx			
		xxxx			xxxx

6. **Profit & Loss Account**
According to Prof. Carter- "A Profit & Loss Account is an account into which all gains and losses are collected, in order to ascertain the excess of gains over the losses or *vice-versa*"
7. **Need and Importance Of Profit & Loss Account**

i. To ascertain the Net Profit or Net Loss.
ii. Comparison with previous Year's Profits.
iii. Control on Expenses.
iv. Helpful in the preparation of the Balance Sheet.

Format of a Profit & Loss Account

ABC Company
Profit and Loss Account
For the year ended 31st Dec. ....

	$		$
Gross Loss (Transferred from Trading A/c)	xxxx	Gross Profit (Transferred from Trading A/c)	xxxx
Office and Administration Expenses:		Commission Received	xxxx
Salaries	xxxx	Rent Received	xxxx
Rent, Rates and Taxes	xxxx	Interest received	xxxx
Postage and Telegram	xxxx	Discount received	xxxx
Telephone Charges	xxxx	Discount from Creditors	xxxx
Printing and Stationery	xxxx	Discount on Purchases	xxxx
Office Electricity	xxxx	Dividend Received	xxxx
Insurance	xxxx	Interest on Drawings	xxxx
Legal Charges	xxxx	Reserve for Discount on Creditors	xxxx
Marketing and Selling Expenses		Interest on Renewal of bills	xxxx
Carriage outwards	xxxx	Bad Debts Recovered	xxxx
Freight Outwards	xxxx	Provision for Bad Debts (Cr.)	xxxx
Sales Salaries	xxxx	Royalty Received	xxxx
Advertisement	xxxx	Apprentice Premium	xxxx
Godown Rent	xxxx	Miscellaneous Income	xxxx
Commissions	xxxx	Sundry Income	xxxx
Discount Allowed	xxxx		
Bad Debts	xxxx		
Financial and Other Expenses:			
Bank Charges	xxxx		
Interest	xxxx		
Depreciation	xxxx		
Repairs and Maintenance	xxxx		
Audit Fees	xxxx		
Loss by Theft, Accident and Fire	xxxx		
Miscellaneous and Sundry Expenses	xxxx		
Net Profit Transferred to Capital	xxxx	Net Loss (Transferred to Capital)	xxxx

8. Balance Sheet

A Balance Sheet has been defined as Follows

In the words of Karlson

"A Business from showing what is owned and what the proprietor is worth, is called a Balance Sheet".

"A balance sheet is a Statement prepared with a view to measure the exact financial position of a business on a certain fixed date.

9. **Need and Importance Of Preparing a Balance Sheet.**

i. The Main purpose of preparing a Balance Sheet is to ascertain the true financial position of the business at a particular point of time.

ii. It helps in ascertaining the nature and cost of various assets of the business such as the amount of closing stock, amount owing from Debtors, amount of fictitious assets etc.

iii. It helps in determining the nature and the amount of various liabilities of the business.

iv. It gives information about the exact amount of capital at the end of the year and the addition or deduction made into it in the current year.

v. It helps in finding out whether the firm is solvent or not. The firm is solvent if the assets exceed the external liabilities. It would be insolvent if opposite is the case.

vi. It helps in preparing the Opening Entries at the beginning of the next year.

Balance Sheet of ....

As at.............

Liabilities	₹	*Assets*	₹
Current Liabilities:		**Current Assets:**	
Bank Overdraft		*Cash-in hand*	
Bills Payable		*Cash at Bank*	
Sundry Creditors		*Bills Receivable*	
Outstanding Expenses		*Short Term Investment*	
Income received-in-advance		*Sundry Debtors*	
Long-term Liabilities:		*Prepaid Expenses*	
Long term loan		*Accrued Income*	
Reserve and Surplus		*Closing Stock*	
Capital		**Investment: (long term)**	
Add : Interest on Capital		**Fixed Assets:**	
Add : Net Profit		*Furniture an Fixture*	
Less : Drawings		*Plant & Machinery*	
Less : Interest on Drawings		*Building*	
Less : Income Tax		*Land*	
Less : Life Insurance Premium		*Goodwill*	
Less : Net Loss			

Self Examination Questions

1. Which of the following statement is true?
   a. Return Inwards and Return Outwards both appear in trading account
   b. Carriage Inwards and Carriage Outwards both appear in profit and loss account.
   c. Carriage Inwards and Carriage Outwards both appear in trading account.
   d. Neither Carriage Inwards nor Carriage Outwards appear in the trading account.
2. Prakash sells goods at 20% on sales. His sales were ₹ 10,00,000. The amount of gross profit is:
   a. ₹ 1,70,000
   b. ₹ 2,50,000
   c. ₹ 2,40,000
   d. ₹ 2,00,000
3. Given the following data:
   Gross profit ₹ 6,700; Carriage Inwards ₹ 250; Rent received ₹ 575 and other expenses ₹ 3,600. The net profit of the firm would be:
   a. ₹ 3,275
   b. ₹ 3,025
   c. ₹ 3,425 2
   d. ₹ 3,675
4. Ram has been running business from the year 2002. He has paid ₹ 1,650 as rent upto February, 2012 (for financial year 2011-12). Total rent to be debited to profit and loss A/c of financial year 2011-12 will be:
   a. ₹ 1, 650
   b. ₹ 1,800
   c. ₹ 2,000
   d. ₹ 1,400
5. Income tax paid by the sole-proprietor from the business bank account is debited to:
   a. Income tax account
   b. Bank account
   c. Capital account
   d. Provision for taxation account
6. Debtors as appearing in Trial Balance are ₹ 25,000. Provision for doubtful debts is to be provided @ 5% and 2% of amount is to be provided for discount. What is the amount of debtors to be shown in balance sheet?

a. ₹ 23,750
b. ₹ 23,250
c. ₹ 23,275
d. ₹ 1,750

7. The net profit of a sole proprietorship firm is ₹ 1,320 (before commission). The manager of the firm gets 10% commission on the net profit after charging such commission. Manager's commission would be:
   a. ₹ 120
   b. ₹ 132
   c. ₹ 1,188
   d. ₹ 1,200.
8. Which of the following is correct about trade discount?
   a. It is synonymous with cash discount
   b. It is shown by way of deduction in invoice itself
   c. It is calculated on account paid or received
   d. It is allowed to engage the prompt payment
9. Which of the following items would fall under the category of a liability?
   a. Cash
   b. Debtors
   c. Capital
   d. Land
10. If a piece of furniture's list price is ₹ 28,000 and it is sold at 10% trade discount and 2% cash discount. The cash sale price of furniture would be:
   a. ₹ 25,200
   b. 24,640
   c. ₹ 24,696
   d. None of the above
11. What is shown in a balance sheet?
   a. Only those assets which are expressed in monetary terms
   b. Only those liabilities which are expressed in monetary terms
   c. Assets and liabilities expressed in non- monetary terms
   d. Assets and liabilities expressed in monetary terms
12. The correct sequence of the following in the preparation of periodical final statements would be:
   1. Preparation of Balance Sheet
   2. Preparation of Cash Flow Statement
   3. Preparation of Trial Balance
   4. Preparation of Profit / Loss Statement

   The correct option is:

   a. 4, 2, 1, 3
   b. 3, 4, 1,2

c. 2, 4, 3, 1
d. 1, 3, 2, 4

13. Match list I with list II and select the correct answer using the codes given below the list:

List I	List II
X. Discount on Debentures Y. Forfeited Capital Z. Income tax payable W. Debtors acceptance	1. Current Liability 2. Non-Current Assets 3. Current Assets 4. Non Current Liability

The correct option is:

	X	Y	Z	W
(a)	2	4	1	3
(b)	4	2	3	1
(c)	2	4	3	1
(d)	4	2	1	3

14. The total cost of goods available for sale with a company during the ₹ 12,00,000 and the total sates during the period are current year is ₹ 13,00,000 . Gross profit margin of the company is 33 1/3% on cost . The closing inventory for the current year would be:
- **a.** ₹ 4,00,000
- **b.** ₹ 3,00,000
- **c.** ₹ 2,25.000
- **d.** ₹ 2,60,000.

15. How does an overcastting of purchases day book affect the cost of sales and profit?
- **a.** Cost of sales is decreased while profit is increased
- **b.** Cost of sales is increased while profit is decreased
- **c.** Both cost of sales and profit are increased
- **d.** Cost of sales is increased; gross profit is decreased but net profit remains unaffected.

16. If outstanding wages appear in the trial balance, while preparing the final accounts, it will be shown in
- **a.** Asset side of the balance sheet
- **b.** Liability side of the balance sheet
- **c.** Profit and Loss A/c and asset side of the balance sheet
- **d.** Profit and Loss A/c and Liability side of balance sheet.

17. Fire insurance premium paid on 1st October, 2011 for the year ended on 30th September, 2012 was ₹ 2,400 and Fire Insurance premium paid on 1st October, 2012 for the year ending on 30th September, 2013 was ₹ 3,200. Fire Insurance premium paid as shown in the profit and loss account for the accounting year ended 31st December, 2012 would be:
- **a.** ₹ 2,600
- **b.** ₹ 3,200

c. ₹ 2,800
d. ₹ 3,000

18. Income earned which is yet to be collected results in:
- **a.** Increase in capital and increase in liability
- **b.** Decrease in liability and increase in capital
- **c.** Increase in asset and increase in liability
- **d.** Increase in capital and increase in asset.

19. The expired cost of a deferred revenue expense is known as
- **a.** Asset
- **b.** Expense
- **c.** Liability
- **d.** Provision.

20. If prepaid rent appears in the trial balance, while preparing the final accounts it will be shown in
- **a.** Assets side of the balance sheet
- **b.** Liabilities side of the balance sheet
- **c.** Profit and Loss A/c and asset side of the balance sheet
- **d.** Profit and Loss A/c and liabilities side of balance sheet.

21. Gauri paid ₹ 1,000 towards a debt of ₹ 1,050, which was written-off as bad debt in the previous year. Which of the following account will be credited for this amount –
- **a.** Gauri's personal account
- **b.** Bad debts account
- **c.** Bad debts recovered account
- **d.** None of the above.

22. While finalising the current years profit, the company realised that there was an error in the valuation of closing stock of the previous year. In the previous year, closing stock was valued more by ₹ 50,000. As a result –
- **a.** Previous year's profit was overstated and current year's profit is also overstated
- **b.** Previous year's profit was understated and current year's profit is overstated
- **c.** Previous year's profit was understated and current year's profit is also understated
- **d.** Previous year's profit was overstated and current year's profit is understated

23. P/L A/c balance (before commission) is ₹ 1,320; manager's commission is 10%. Find the amount of manager's commission.
- **a.** 120
- **b.** 0
- **c.** 132
- **d.** 110.

24. Adjusted closing entry affects:
- **a.** Trading A/c
- **b.** P/L A/c
- **c.** Balance Sheet
- **d.** All of the above.

25. The purpose of making trading account:

a. To know the financial position of business
b. To ascertain the gross profit/ loss
c. To ascertain the net profit/loss
d. None of the above.

26. Prepaid Rent is shown as:
- **a.** Current Asset
- **b.** Current Liability
- **c.** Intangible Asset
- **d.** Fictitious Asset.

27. Trial balance of a trader shows the following balances:
Opening Stock ₹ 9,600, Purchases ₹ 11,850, Wages and Salaries ₹ 3,200, Carriage on Purchases ₹ 200, Carriage Outwards ₹ 300, Sales ₹ 24,900, Closing Stock ₹ 3,500 Gross Profit will be:
- **a.** ₹ 3,550
- **b.** ₹ 6,750
- **c.** ₹ 6,500
- **d.** ₹ 6,550

28. Assets that a company expects to convert to cash to use up within one year are called:
- **a.** Property plant and equipment
- **b.** Intangible assets
- **c.** Long term investments
- **d.** Current assets

29. Closing Stock of a Company, if given is adjustment, appears in:
- **a.** Balance Sheet only
- **b.** Trading Account only
- **c.** Profit and loss account only
- **d.** Trading account and balance sheet

30. Financial data of an entity is given below:
Gross Profit ₹ 6,700, Carriage outwards ₹ 250, Rent received ₹ 575 and Other expenses 3,600. The net profit would be:
- **a.** ₹ 3,025
- **b.** ₹ 2,850
- **c.** ₹ 3,425
- **d.** ₹ 3,275

31. Liability in respect of a pending suit is an example of:
- **a.** Current liability
- **b.** Long term liability
- **c.** Contingent liability
- **d.** Current asset.

32. Which of the following item appears in trading account of a business?
- **a.** Wages and Salaries

b. Depreciation on buildings
c. Freight outward
d. Salaries.

33. Generally, in a balance sheet, fixed assets are shown at:
- **a.** Realisable value
- **b.** Market value
- **c.** Written down value
- **d.** Cost price.

34. In order to prepare the final accounts all ……….. accounts are transferred to Trading and Profit and Loss Account:
- **a.** Personal
- **b.** Nominal and Real
- **c.** Nominal
- **d.** Real.

35. Cost of floating a company is an example of:
- **a.** Wasting assets
- **b.** Intangible assets
- **c.** Fictitious assets
- **d.** Liquid assets

36. If salaries paid appearing in the trial balance for the year ending 2015 is ₹ 7,500 and it is given in the adjustment that the salary unpaid for the year ending 2015 is ₹ 2,500. The total amount to be debited to the profit and loss account under the head salaries will be:
- **a.** ₹ 7,500
- **b.** ₹ 2,500
- **c.** ₹ 5,000
- **d.** ₹ 10,000

37. Which of the following transactions would have no impact on owner's capital?
- **a.** Withdrawal of profit
- **b.** Investment of cash by owner
- **c.** Net loss
- **d.** Purchase of land from the proceeds of a bank loan.

38. A Trader is able to get a margin of about 20% on sales. During the previous year he purchased goods worth ₹ 1,00,000 and sales were ₹ 80,000. The value of closing stock for the previous year will be:
- **a.** ₹ 20,000
- **b.** ₹ 40,000
- **c.** ₹ 36,000
- **d.** ₹ 50,000

39. The closing entry for transfer of commission received, appearing in the trial balance will be:
- **a.** Debit Commission Received A/c,
  Credit P&L A/c

b. Debit Trading A/c,
   Credit Commission Received A/c
c. Debit P&L A/c,
   Credit Commission Received A/c
d. Debit Commission Received A/c,
   Credit Trading A/c

40. Which of the following statement is correct in respect to adjusting entries?

- **a.** Adjusting entries will effect only trading account
- **b.** Adjusting entries will effect only balance sheet
- **c.** Adjusting entries may effect Balance Sheet, Trading A/c or Profit & Loss A/c
- **d.** Adjusting entries will effect only Profit & Loss A/c

41. The purchase as shown in books of accounts of a firm is ₹ 28,000. It includes the goods lost by fire for ₹ 2,800. The insurance claim received on account of this is ₹ 2,500. The amount of net purchases to be shown in Trading A/c will be:

- **a.** ₹ 28,000
- **b.** ₹ 30,500
- **c.** ₹ 27,700
- **d.** ₹ 25,200

42. Balance sheet is prepared from-

- **a.** Real A/c
- **b.** Saving A/c
- **c.** Personal A/c
- **d.** Both (a) & (b).

43. Which is an unearned income

- **a.** Insurance premium received by insurance company
- **b.** Rent received
- **c.** Depreciation
- **d.** Both (a) & (b).

44. Every day office expenses are charged to

- **a.** Selling expenses
- **b.** Administrative expenses
- **c.** Marketing expenses
- **d.** Financial expenses.

45. The net assets of a firm at a beginning of 2007 were ₹ 1,07,700. What were the net assets in the year 2007 if the profit earned by the business in 2007 was ₹ 72,500 and owner withdrew goods for his own private use that had cost ₹ 2,500?

- **a.** 1,77,200
- **b.** 1,07,700
- **c.** 1,77,700
- **d.** 1,76,700

46. The closing entry for transfer of Net profit ₹ 6,300 will be:

- **a.** Debit P&L A/c ₹ 6,300; Credit Capital A/c ₹ 6,300

b. Debit Trading A/c ₹ 6,300; Credit P&L A/c ₹ 6,300
c. Debit Capital A/c ₹ 6,300; Credit P&L A/c ₹ 6,300
d. Debit Capital A/c ₹ 6,300; Credit Trading A/c ₹ 6,300

47. Assume following items in an accounting equation, cash is ₹ 1,000, Inventories ₹ 4,000, debtors ₹ 5,000, creditors ₹ 4,000 and capital is ₹ 25,000, if there are no other assets than fixed assets then the amount of fixed assets will be:
- **a.** ₹ 29,000
- **b.** ₹ 15,000
- **c.** ₹ 25,000
- **d.** ₹ 19,000

48. Which of the following statements describes a fixed asset?
- **a.** It can be converted into cash quickly without any loss in value
- **b.** It is purchased specifically for resale.
- **c.** It is likely to be used within the business in the year of purchase itself.
- **d.** It is likely to be used for more than one accounting period.

49. If outstanding wages appear in the trial balance while preparing the final accounts, it will be shown in:
- **a.** Assets side of the balance sheet
- **b.** Liability side of the balance sheet
- **c.** Profit and Loss A/c and Assets side of the balance sheet
- **d.** Profit and Loss A/c and Liability side of balance sheet

50. Contingent liability is shown in
- **a.** Balance Sheet
- **b.** Profit & Loss
- **c.** Footnotes
- **d.** None of the above.

51. Prepaid expense is shown in
- **a.** Balance Sheet
- **b.** Income & Expenditure
- **c.** Both (a) and (b)
- **d.** None of the above.

52. Outstanding expenses are shown in
- **a.** Balance Sheet
- **b.** Trial Balance
- **c.** Profit & Loss A/c
- **d.** None of the above.

Answer

1. (a)	11. (d)	19. (b)	25. (b)	34. (c)	42. (d)	45. (c)
2. (d)	12. (b)	20. (a)	26. (a)	35. (c)	43. (d)	46. (a)
3. (d)	13. (a)	21. (c)	27. (a)	36. (d)	44. (b)	47. (d)
4. (b)	14. (c)	22. (d)	28. (d)	37. (d)		48. (d)
5. (a)	15. (b)	23. (c)	29. (d)	38. (c)		49. (b)
6. (c)	16. (b)	24. (c)	30. (c)	39. (a)		50. (c)

7. (a)	17. (a)	31. (c)	40. (c)	51. (a)
8. (b)	18. (d)	32. (a)	41. (d)	52. (c)
9. (c)		33. (a)		
10. (c)				

Unit-2

Financial Statement of Not-for –Profit Organisations

1. **Meaning of Not-for –Profit Organisations**
   There are certain organisations which are formed not to earn profits but to render services to its members and to the public. Such organisation includes clubs, hospitals, libraries, school, religious institution, charitable institution and literary societies etc. These non-profit seeking entities exist with a primary motive of providing services.

   As the main aim of these organisations is not to earn profits, they do not prepare Trading and Profit & loss A/c. But still they have maintain proper accounts. This is a also a legal requirement and they would also like to know whether their current incomes are sufficient to meet their current expenses. For this purpose they prepare an "Income and Expenditure Account' which is similar to a profit & loss Account of a profit seeking entity. A Balance Sheet is also prepared in order to show the financial position of the organisation on the last date of the accounting year.

2. **Main Features(or Characteristics) of Not-for–profit Organisation**
   (i) **Main aim is service**-Such organisations are set up to provide service to a specific group or the public at large such as education, health care, sports, entertainment etc. The main aim of these organisations is to provide service either free of cost or at nominal rates and not to earn profit.
   (ii) **Form-**These organisation are set up as charitable trusts or societies and subscribers to these organisations are called members.
   (iii) **Separate Entity-** Not for profit organisations are treated as a separate entity distinct from its members.
   (iv) **Managed by Elected Members-** These organisations are usually managed by a managing or executive committee elected by its members.
   (v) **Major Source of Income-** The major sources of their incomes usually are: (a) subscription from their members, (b)donations, (c)financial assistance from Government in the form of grant-in-aid, (d)income from investments etc.

(vi) **Surplus not distributed among its members-** Current year' surplus in the form of excess of income over expenditure is not distributed amongst its member. It is added to Capital Fund.

(vii) **Accounts-** These organisations also have to maintain proper accounts to meet the legal requirement and to exercise proper control over utilisation of their funds.

(viii) **Forms of Accounts-** They prepare their financial statements at the end of each accounting period (usually a financial year) in the form of Receipts and Payments Account; Income and Expenditure Account and a Balance Sheet.

3. **Receipts and Payment Account**

This Account is merely a summary of the transaction appearing in the Cash Book.
According to William Pickles: "Receipts and payments Account is nothing more than a summary of the Cash Book(Cash and Bank transactions) over a certain period, analysed and classified under suitable headings. It is the from of account most commonly adopted by the treasurers of societies, clubs association etc. when preparing the results of the year's working."
As such, a receipt and payment account is prepared at the end of the year from the Cash Book. All Receipt and Payment which are entered in the Cash Book are also entered in the receipt and payments account, of course, in a summary from.

4. **Distinction between Receipt and Payment Account and Cash Book**

S.No.	Basic of Distinction	Receipts & Payment Account	Cash Book
1.	**Basis**	It is prepared on the basis of Cash Book.	It is prepared on the basis of each cash receipt and cash payment.
2.	**Period**	It is prepared at the end of accounting year. In other words, it is a summary of cash book.	It is prepared on daily basis.
3.	**Part of Double Entry System**	It is merely a summary of cash book, it is not deemed to be a part of the double entry system.	It from part of double entry system.
4.	**Debit & Credit Sides**	It has receipts and payments side instead of debit and credit sides.	It has debit and credit sides.
5.	**Ledger folio Column**	It has no ledger folio(L.F.) Columns.	It has ledger folio(L.F.) Columns.
6.	**Institutions**	It is prepared by not-for-profit organisations.	It is prepared by all organisations whether profit seeking or not-for –profit

			organisation.

5. **Income & Expenditure Account**

   It is similar to the Profit & loss Account of a profit seeking entity and is prepared to ascertain whether the current incomes are in excess of current expenditure or *vice-versa.* The End product of this account is surplus or deficit. If credit side of this account exceeds the debit, it is known as excess of income over expenditure (surplus) and the contrary, if the debit side exceeds the credit, it is excess of expenditure over income (deficit).

6. **Balance Sheet**

   Just as in profit seeking concerns, a Balance Sheet is to be prepared even by non-profit organisation to show the financial position on the last date of the accounting year. It is prepared from the balance remaining after the transfer of all revenue income and expenditure to the Income & Expenditure Account.

   In the absence of a trial balance, the following point should be kept in consideration while preparing a Balance Sheet:-

Assets

i. Fixed Assets appearing in the previous year's Balance Sheet (also known as the Opening Balance Sheet) Should be adjusted for the assets purchased, sold and depreciation during the year. Only the adjusted amount will appear in the closing Balance sheet.
ii. Prepared Expenses, accrued incomes and investments should be shown on the asset side.
iii. The closing balance of cash and bank as shown by the Receipt and Payment Account should be shown on the assets side. However, if there is overdraft balance of bank, it will be shown on the liabilities side.

Liabilities

i. The loan appearing on the liabilities side of the previous year's Balance Sheet Should be seen and the Receipt and Payment Account should be scanned to find out whether any new loan has been raised or the old loans have been repaid. Only the net amount of loan will be shown on the liabilities side of the Balance Sheet.
ii. If any new loan has been raised it will be fund on the debit side of the receipts and payment account. It should also be shown on the liabilities side.
iii. If there is a special receipt like donations for the building, it will be shown on the liabilities side. Similarly, special fund created for meeting expenses such as prize fund, tournament or sports fund will be shown on the liabilities side.

iv. Outstanding expenses and the income received for the next year (unearned incomes) will be shown on the liabilities side.

v. Any excess of Assets over Liabilities in case of a non-profit seeking organisation is called Capital fund. It occupies the same position which the capital account occupies in case of profit seeking entities.

7. **Some Important Item relating to Non-Profit seeking Organisations**

a. **Subscription-** It is the main source of income of a non- profit entity. It will be appearing on the debit side of Receipts and Payment Account and out of it the subscription belonging to the current year will be posted to the credit side of Income and Expenditure Account.

b. **Life-Membership Fee –** In order to become the member of an organisation for the whole of the life, some members pay the fee in lump sum, *i.e.*, once in their life time. It is a receipt of non-recurring nature (capital receipt) since the members will not be required to pay the fees annually. Hence, it is not credited to the Income and Expenditure Account but added to the capital fund or shown separately on the liabilities side.

c. **Endowment Fund-** According to Eric L.Kohler, "It is a fund arising from a bequest or gift, the income of which is devoted for a specific purpose."Thus, it is a capital receipt because it provides a permanent income to the institution. It should be shown on the liabilities side as a separate item.

d. **Entrance Fees\Admission Fees-** It is received from the new members apart from the amount of annual subscriptions. Some people favour capitalizing the entrance fee on the ground that it is collected once for all and as such it is not of the recurring nature.

e. **Donation:-** It may be classified as specific donation and general donation:

   (i) **Specific Donation-** When donation received is to be utilized for a specific purpose, i.e., donation for building, it is capitalized and is shown on the liability side of Balance Sheet.

   (ii) **General Donation-**General Donation is the donation in which the donor does not specify the purpose for which the donation has to be used. It is treated as an income and is credited to Income and Expenditure Account.

f. **Legacy:-** It is the amount which a non-profit entity receives as per the WILL of a deceased persons. It appears on the debit side of the Receipts and Payment Account. This amount is not a recurring nature, and as such it is treated as capital receipt and shown on the liabilities side.

g. **Sale of Old Assets:-** It appears on the debit side of Receipts and Payments Account. It is a capital receipt and as such should not be transferred to Income and Expenditure Account.

h. **Sales of Old Newspapers and Sports Material-**It appears on the debit side of Receipts and Payments Account and is tr5ansferred to the credit side of Income and Expenditure Account due to the fact that selling the old newspapers and used sports materials like old bats, ball, etc. is a regular feature of any non-profit seeking institution.

i. **Payment of Honorarium-**The amount paid to persons who are not the employees of the institution is called honorarium and is debited to the Income and Expenditure Account.

8. **General and Special Fund-**In case of non-profit organisations there is no Capital A/c. The difference between the assets and outside liabilities is known by the name 'Capital Fund' and the difference of Income & Expenditure is transferred to this fund every year. This 'Capital Fund' is also known as the 'General Fund'.
9. **Capital Receipts-**It includes those receipts which will yield benefits' to the entity in the current year as well as in future years. They are of non-recurring nature or in other words, they are not received at regular intervals.
   - **a.** Life Membership Fees
   - **b.** Endowment Fund Receipts
   - **c.** Donations for specific purposes such as construction of building, special contribution for Silver Jubilee Celebration, Donation for club pavilion etc.
   - **d.** Legacies, *i.e.*, the amount received under a will.

All the four receipts mentioned as above should be written on the liabilities side of the Balance Sheet.

10. **Revenue Receipts-**Remaining items appearing on the debit side of Receipts and Payments Account are treated as revenue receipt such as Subscription, Rent received, Interest received, Entrance fees, Sale of old newspapers etc. These should be posted to the credit side of Income and Expenditure Account after making necessary adjustments.

Self Examination Questions

1. Receipts and payments Account generally shows:
   - **a.** A Debit Balance
   - **b.** A Credit Balance
   - **c.** Surplus or Deficit
   - **d.** Capital Fund
2. Income and Expenditure Account records transactions of:
   - **a.** Revenue nature Only
   - **b.** Capital nature only
   - **c.** Bothe revenue and capital nature
   - **d.** Income of only revenue nature and expenditure of revenue and capital nature.

3. Donation received for a special purpose
   a. Should be credit to Income and Expenditure Account
   b. Should be credit to separate account and shown in the Balance Sheet
   c. Should be shown on the assets side
   d. Should not be recorded at all
4. Subscription received by a school for organisation annual function is treated as:
   a. Capital Receipt(*i.e.*, Liability)
   b. Revenue Receipt (*i.e.*, Income)
   c. Assets
   d. Earned Income
5. Amount received from sale of grass by a club should be treated as:
   a. Capital Receipt
   b. Revenue Receipt
   c. Assets
   d. Earned Income
6. If there is a 'Match Fund' then match expenses and income are transferred to:
   a. Income and Expenditure Account
   b. Assets side of Balance Sheet
   c. Liabilities side of Balance Sheet
   d. Both Income and Expenditure a/c and to Balance Sheet
7. Subscription received in advance during the current year is:
   a. An Income
   b. An Assets
   c. A Liability
   d. None of these
8. Subscription received in cash during the year amounted to Rs60,000; subscription received in advance for next year was Rs3,000 and received in advance during previous year was Rs2,000.Subscription in arrear at the end of current year was Rs5,400.The amount credited to Income& Expenditure Account will be:
   a. Rs53,600
   b. Rs66,400
   c. Rs55,600
   d. Rs64,400
9. The opening balance of Prize Fund wasRs32,800. During the year, donations received towards this fund amounted to Rs15,400; amount spent on prizes was Rs12,300 and interest received on prize fund investment was Rs4,000.The closing balance of Prize fund will be:
   a. Rs56,500
   b. Rs64,500
   c. Rs39,900

d. Rs31,900

10. Salary paid in cash during the current year was Rs80,000;Outstanding salary at the end was Rs4,000; Salary paid in advance last year pertaining to the current year was Rs3,200; paid in advance during current year for next year was Rs5,000. The amount debited to Income & Expenditure A\C will be :

a. Rs85,800
b. Rs77,800
c. Rs82,200
d. Rs74,200

ANSWER

1. (a)
2. (a)
3. (b)
4. (a)
5. (b)
6. (c)
7. (c)
8. (d)
9. (c)
10. (c)

Chapter-10

Unit-1

Accounting For Partnership Firms-fundamentals

1. **Definition Of Partnership-**Section 4 of the Indian Partnership Act,1932, defines partnership as follows:
   "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all."
2. **Main features or Essential or Characteristics of Partnership**
- Two or More Persons
- Agreement
- Existence of Business and Profit Motive
- Sharing of Profits
- Relationship of Principal and Agent
- Business Carried on by all or any of them acting for all
- No Separate Existence
3. **Rights of a Partner:**
- Every Partner has the right to share profits or losses with other partners in the agreed ratio.
- Every Partner has the right to take part in the conduct of the business.
- Every Partner has the right to be consulted in the matters related to partnership business.
- Every Partner has the right to inspect and have a copy of the books of accounts.
- Every Partner has the right to disallow the admission of a new partner.
- Every Partner is the joint owner of the partnership property.
- If a partner has given loan to the firm, he has a right to receive interest at agreed rate. If the rate of interest is not agreed, it is paid @6%p.a.
- If a Partner incurs expenses or makes payment on behalf of the firm, he has a right to be indemnified by the firm.

- Every partner has a right to retire from the firm after giving a proper notice.

4. **Limited Liability Partnership(LLP) –** The Limited Liability Partnerships (LLPs) in India came into existence with the enactment of 'Limited Liability Partnership Act, 2008' whi8ch lay down the law for the formation and regulation of Limited Liability Partnerships.
5. **Definition-**Limited Liability Partnership means a partnership formed and registered under this Act.
6. **Nature of limited Liability Partnership(LLP)**
   - A LLP is a Body corporate formed and incorporated under this Act.
   - It is legal entity separate from that of its partners.
   - A LLP shall have perpetual succession.
   - Any change in the partner of a LLP shall not affect the existence, right or liabilities of the LLP.

   Indian Partnership Act, 1932 shall not apply to a LLP.

7. Distinction between an Ordinary Partnership Firm and an LLP

S.No	Basis of Distinction	Partnerships	LLPs
1.	Applicable Law	Indian Partnership Act,1932	The Limited Liability Partnership Act,2008.
2.	Registration	Optional	Compulsory with Registrar of Companies.
3.	Creation	Created by an Agreement	Created by Law
4.	Body Corporate	Body Corporate cannot become a Partner.	Body Corporate can become its partner.
5.	Separate Legal Entity	It is not a separate legal entity.	It is a separate legal entity.
6.	Perpetual Succession	Partnerships do not perpetual succession.	It has perpetual succession and individual partners may come and go.
7.	Number of Partners	Minimum 2 and Maximum 50.	Minimum 2 but no Maximum limit.

8.	Ownership of Assets	Firm can not own any assets. The partners own the assets of the firm.	The LLP as an independent entity can own assets.
9.	Liability	Unlimited	Limited to the extent of their contribution towards LLP.

8. **Partnership Deed Since partnership is the outcome of an** agreement, it is essential that there must be some terms and conditions agreed upon by all the partners. Such terms and conditions may be either oral or written. The law does not make it compulsory to have a written agreement. However, in order to avoid all misunderstandings and disputes, it is always the best course to have a written agreement duly signed and registered under the Act. Such a written document which contains the terms of agreement is called 'Partnership Deed'. It is also called 'Articles of Partnership'.

9. **Rules Applicable in the Absence of Partnership Deed**
   In the absence of a Partnership Deed or Verbal agreement, or if the Partnership deed is silent on a certain point, the following provisions of partnership Act, 1932 will be applicable:-
   - Profit Sharing Ratio- Profit and Losses are to be shared equally irrespective of their capital contribution.
   - Interest on Capital- No interest on Capitals shall be allowed to the partners. If there is a provision for the interest on capitals in the partnership deed, it will be allowed only when there is a profit.
   - Interest on Drawings- No Interest is to be charged on drawings.
   - Salary to a Partner No Partner is entitled to any salary or commission for taking part in running the firm's business.
   - Interest on loan- Interest at the rate of 6% per annum is to be allowed on partner's loan to the firm. Such Interest shall be paid even if there are losses of the firm.
   - Admission of a new partner-without the consent of all existing partners no new partner can be admitted to the firm.
   - Each partner can participate in the conduct of the business.
   - Each partner can inspect the books of firm and can take a copy of the same.

10. Profit &Loss Appropriation Account

For the year ended……………..

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Salaries of Partners		By Profit & Loss A/c (Net profit transferred from P&L A/c)	
To Commission to Partners		By Interest on Drawings: A B	
To Interest on Partner's Capital A B			
To Reserve A/c			
To Profit Transferred to: A's Capital A/c (or A's Current A/c) B's Capital A/c (or B,s Current A/c)			

10. Distinction between Profit & Loss Account and Profit & Loss Appropriation Account

S.No	Basic of Distinction	Profit & Loss Account	Profit & Loss Appropriation Account
1.	Stage of Preparation	It is prepared after trading account and hence starts with the gross profit disclosed by Trading Account	It is prepared after Profit & loss account and hence starts with the net profit disclosed by Profit & loss

			Account.
2.	Objective	It is prepared to ascertain net profit or net loss.	It is prepared to distribute the net profit of the year among the partners.
3.	Opening/Closing Balance	This account has neither opening balance nor closing balance	This account may have opening as well as closing balances.
4.	Charge or Appropriation	Expenses debited to his account are charge against profit.	Items debited to this account are appropriation of profits.
5.	Partnership Agreement	This account is not prepared on the basis of partnership agreement, except for interest on loan from partners.	This account is prepared on the basis of partnership agreement.
6.	Matching Principle	Matching Principle (i.e. matching of revenue against expenses) is followed while preparing this account.	Matching principle is not followed while preparing this account.

11. Capital Accounts of Partners

a. Fixed Capital Accounts-Under this System the original capitals invested by the partners remain constant, unless additional capital is introduced or drawings are made against capital by an agreement. When fixed capital method is adopted, all entries relating to drawings against profit, interest allowed on capitals, interest charged on drawings, salary to partner, share of profit or loss etc., are made in a newly-opened account for each partners. This Account is called Current Account or Drawings Account.

b. Fluctuating Capital Accounts- When the capitals need not to be fixed, the balances of capital accounts go on changing from time to time. The reason is that no separate Current Account are maintained, but all the entries relating to drawings, interest on capital, interest on drawings, salary to partner, share of profit or loss etc., are recorded in the capital accounts itself. In the absence of any instruction, the Capital Accounts should be prepared by this method.

12. Manager's Commission on Net Profits.

a. On profit before charging such commission

b. On profit after charging such commission

13. When Appropriations are more than Profits-In case where appropriations such as interest on capital, salary of partners etc. are more than available profits, the profits will be distributed in the ratio of appropriation.

14. Methods of calculating Interest on Drawings

I. Simple Method

Interest On Drawings =Amount of Drawings$\times\frac{Rate\ of\ Interest}{100}\times\frac{Months}{12}$

II. Product Method

Interest On Drawings =Total of Products$\times\frac{Rate\ of\ Interest}{100}\times\frac{1}{12}$

15. Guarantee of profit to a Partner- Sometimes a partner is guaranteed that he shall get a certain minimum amount of profits of the firm. Such a guarantee may be given either by (I) any one of the partners, or (II) by all other partners in a particular ratio.When the profits of the firm are not adequate then the 'excess' paid to the guaranteed partner should be charged to the partner who has given the guarantee.

<u>Self Examination Questions</u>

1. Following are the essential elements of a partnership firm except:

(a) At least two persons.

(b) There is an agreement between all partners.

(c) Equal share of profits and losses.

(d) Partnership agreement is for some business

2. Following is the difference between partnership deed and partnership agreement:

(a) Partnership deed is in writing and partnership agreement is oral.

(b) Partnership deed is signed by all the partners but partnership agreement is signed by majority of the partners.

(c) Partnership deed is registered in the court of law whereas partnership agreement is not registered.

(d) Partnership deed is not subject to changes unless all partners agrees to it. Partnership agreement can be amended with the consent of more than 50% partners.

3. In the absence of any agreement, partners are liable to receive interest on their Loans @

(a) 12% p.a.

(b) 10% p.a.

(c) 8% p.a.

(d) 6% p.a.

4. Bill and Monica are partners sharing profits and losses in the ratio of 3:2 having the capital of Rs.80,000 and Rs.50,000 respectively. They are entitled to 9% p.a. interest on capital before distributing the profits. During the year firm earned Rs.7,800 after allowing interest on capital. Profits apportioned among Bill and Monica is:

(a) 4,680 and 3,120.

(b) 4,800 and 3,000.

(c) 5,000 and 2,800.

(d) None of the above.

5. The relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all is known as ....

(a) Partnership.

(b) Joint Venture.

(c) Association of Persons.

(d) Body of Individuals.

6. Firm has earned exceptionally high profits from a contract which will not be renewed. In such a case the profit from this contract will not be included in ....

(a) Profit sharing of the partners.

(b) Calculation of the goodwill.

(c) Both.

(d) None..

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

(a) Salary.

(b) Commission.

(c) Interest on Loan and Advances.

(d) Profit share in capital ratio.

8. Guarantee given to a partner 'A' by the other partners 'B & C' means

(a) In case of loss 'A' will contribute towards that loss.

(b) In case of insufficient profits 'A' will receive only the share of profit and not minimum guaranteed amount.

(c) In case of loss or insufficient profits 'A' will withdraw the minimum guaranteed amount.

(d) All of the above.

9. X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was 6,000 and X wanted interest on capital @ 20% as his capital contributions was 1,00,000 as compared to that of Y and Z which was ` 75,000 and 50,000 respectively.

(a) Profits of 6,000 will be distributed equally with no interest on either Capital.

(b) X will get the interest of 20,000 and the loss of 14,000 will be shared equally.

(c) All the partners will get interest on capital and the loss of 39,000 will be shared equally.

(d) None of the above.

10. X,Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹6000 and Z demanded minimum profit of Rs.5,000 as his financial position was not good. However, there was no written agreement. Profits to be distributed to X,Y and Z will be

(a) Other Partners will pay Z the minimum profit and will suffer loss equally.

(b) Other Partners will pay Z the minimum profit and will suffer loss in capital ratio.

(c) X & Y will take Rs.500 each and Z will take Rs.5,000

(d) Rs.2,000 to each of the partners.

11. Following are the differences between Capital Account and Current Account except:

(a) Capital Account is prepared under fixed capita method whereas current account is prepared under fluctuating capital method

(b) In capital account only capital introduced and withdrawn is recorded, all other transaction between the firms and partner is recorded in the current account.

(c) Interest is sometimes paid on capital account balance but no such interest is payable on current account balances.

(d) 'B' & 'C'

12. In a partnership firm, a partner withdraws ₹ 5,000 per month in the beginning of month for personal use. The rate of interest on drawings is 6% p.a. What is the amount of interest on drawings for the year?

(a) ₹ 1,950

(b) ₹ 1,800

(c) ₹ 300

(d) ₹ 1,650

13. Interest on capital will be paid to the partners if provided for in the partnership deed but only out of :
(a) Profits
(b) Reserves
(c) Accumulated profits
(d) Goodwill

14. In case of partnership the act of any partner is:
(a) Binding on all partners
(b) Binding on that partner only
(c) Binding on all partners except that particular partner
(d) None of the above

15. In a partnership firm, in the beginning of the year, capital of one partner is ₹ 80,000. During the year, he introduced ₹ 7,000 as additional capital. In addition to this, he withdraws ₹ 2,000 in the middle of every month. The firm does not pay any interest on capital but charges 6% interest on drawings. His share of profit after interest on drawings is ₹ 20,000. At the end of the year, his capital in the firm would be-
(a) ₹ 83,000
(b) ₹ 1,05,000
(c) ₹ 82,280
(d) ₹ 1,09,000

16. If partnership deed is not there, then profit is shared in:
(a) Old Ratio
(b) Capital Ratio
(c) Equally
(d) New Ratio

17. Under Fixed capital method …………….. A/c remains fixed and changes are made in current A/c.
(a) Partner's Capital A/c
(b) Partner's Current A/c
(c) Both (a) and (b)
(d) None of these.

18. A partner that doesn't take part in the management of business, but he/she has made investment is business and liable to creditors of the business is known as:
(a) Dormant partner
(b) Active partner
(c) Minor partner
(d) Junior partner

19. On 1st April, 2012 Raghu invested capital of ₹ 2,00,000. He withdrew ₹ 50,000 during the year . Interest on drawings is charged @ 10% per annum. The amount of interest on drawings deducted from capital at the end of financial year is:
(a) ₹ 15,000
(b) ₹ 2,500
(c) ₹ 7,500
(d) ₹ 5,000

20. Which of the following is not recorded in the partners current accounts?
(a) Interest on Drawings
(b) Administrative Expenses
(c) Drawings
(d) Partners Salaries

21. The investment of personal assets by the owner in the business will:
(a) Increase total assets and increase owners equity
(b) Increase assets and decrease liabilities
(c) Increase total assets only
(d) Has no effect on assets but increase owners equity.

22. A, B and C started a business by investing ₹ 45,000, ₹ 55,000 and ₹ 60,000 respectively and sharing profit or losses in the ratio of capital. At the end of a year they got a total profit of ₹ 11,200. How much "B" get more than "A" in the profit?
(a) ₹ 780
(b) ₹ 700
(c) ₹ 710
(d) ₹ 750

23. In the general form of partnership, liability of partner are:
(a) Limited
(b) Limited to the capital invested by them
(c) Unlimited
(d) Limited to an amount guaranteed by them.

24. In case if partnership deed is silent, profit is divided as follows?
(a) Gaining ratio
(b) Equally
(c) Sacrifice ratio
(d) Either of (a) & (b)

25. If profit is divided equally so it is necessary that loss should also be divided?
(a) Partly yes
(b) Partly no
(c) Yes
(d) No

26. As per the Partnership Act, 1932 if a partner with a capital deficiency is unable to pay the amount owed to the partnership, the deficiency is borne by other partners with credit balances:
(a) On the basis of their income ratio's
(b) On the basis of their capital balances
(c) Equally
(d) On the basis of their original investments.

27. As per Partnership Act, 1932 the following are characteristics of partnership except:
(a) Earning of profit
(b) Co-ownership of property
(c) Unlimited liability
(d) Mutual agency

28. Registration of partnership is:

(a) Voluntary
(b) Mandatory
(c) Compulsory
(d) None of the above

ANSWER

1. (c)
2. (c)
3. (d)
4. (a)
5. (a)
6. (b)
7. (c)
8. (c)
9. (a)
10. (d)
11. (a)

Answers

1. (a)
2. (a)
3. (a)
4. (c)
5. (c)
6. (a)
7. (a)
8. (b)
9. (b)
10. (a)
11. (b)
12. (c)
13. (b)
14. (c)
15. (b)
16. (c)
17. (a)

Unit-2

Change in Profit Sharing Ratio

Among the Existing Partners

1. **Reconstitution of a Partnership Firm-**Partnership is the result of an agreement between persons for sharing the profits of a business. Any change in the partnership agreement brings to an end the existing agreement and a new agreement comes into force. The change in the agreement results in changes in the relationship among the partners.

   - Changes in the profit sharing ratio among the existing partners
   - Admission of a new partner
   - Retirement of an Existing partner
   - Death of a Partner
   - Amalgamation of two partnership firms

2. **Adjustment required at the time of change in the profit sharing ratio-**Various matters that need to be considered at the time of change in profit sharing ratio are:

   - Determination of Sacrificing Ratio and Gaining Ratio
   - Accounting For Goodwill
   - Accounting Treatment Of Reserve and Accumulated Profits
   - Accounting for Revaluation of Assts and Liability
   - Adjustment of Capitals

3. **Sacrificing Ratio-**Whenever there is a change in the profit sharing ratio, one or more of the existing partners have to surrender some of their old share in favor of one or more of other partners. The ratio surrender of profit sharing ratio is called Sacrificing Ratio.

   Sacrificing Ratio =Old Ratio – New Ratio

4. **Gaining Ratio-**As a result of change in profit sharing ratio,one or more of the existing partners gain some portion of other partners share of profit. The ratio of the gain of profit sharing ratio is called gaining ratio.

   Gaining Ratio = New Ratio – Old Ratio

5. **Goodwill-**Goodwill means the 'good-name' or the reputation earned by a firm through the hard work and honesty of its owners. Goodwill is the value of the reputation of a firm which enables it to earn higher profits in comparison to the normal profit earned by other firms in the same trade.
   "The term goodwill is generally used to denote the benefit arising from connections and reputation"--------*Lord Lindley*

I. **Characteristics or Features of Goodwill**
- It is an intangible Assets
- It is a valuable Assets
- It is helpful in earning excess profits
- Its value is liable to constant fluctuations
- It is valuable only when entire business is sold
- It is difficult to place an exact value on goodwill

II. **Classification of Goodwill:**

Goodwill can be classified into two categories:

(i) **Purchased Goodwill-** Purchased goodwill is the goodwill which is acquired by making a Payment.

(ii) **Self– General Goodwill or Inherent Goodwill-**It is internally generated goodwill which arises from a number of characteristics or attributes which an on-going business possesses.

6. **Methods of Valuation of Goodwill**

i. **Average Profit Method-** This is a very simple and widely followed method of valuation of goodwill. In this method, goodwill is calculated on the basis of the number past year profits. Average of such profits is multiplied by the agreed number of the year(such as two or three) to find out the value of goodwill.
Value of Goodwill = Average Profit × Number of years of purchase

a. **Weighted Average Profit Method-**This method is a modified version of average profit method. As per this method each year's profit is assigned a weight. The highest weight is attached to the profit of the most recent year.
Thereafter, each year's profit is multiplied by the weight assigned to it in order to find out the products and the total of products is then divided by the total of weights in order to calculate the weight average profits. After this, the weighted average profit is multiplied by the agreed number of the year's purchase to find out the value of goodwill.
Thus, the formula is:

Weighted Average Profit $=\frac{Total\ of\ Products\ of\ Profits}{Total\ of\ \ Weight}$

Goodwill = Weight average Profit × Number of the year's of Purchase

ii. **Super Profit Method-**In this Method goodwill is calculated on the basis of the surplus (excess) profit earned by the firm in comparison to average profits earned by other firms. If a business has no anticipated excess earnings, it will have no goodwill. Such excess profits are called super profits and the goodwill is calculated on the basis of super profits.

- **Normal Profit** = $\frac{Capital\ Invested \times Normal\ rate\ of\ return}{100}$

- **Super Profit = Actual or Average Profit – Normal Profit**

- **Goodwill = Super Profit × No. of years purchase**

iii. Capitalization Method

A. By capitalizing the average profits, or

B. By capitalizing the super profits.

A. Capitalization of average profits method.-Under this method first of all we calculate the average profits and then we asses the capital needed for earning such average profits on the basis of normal rate of return. Such capital is also called capitalized value of average profits.

Capital Value of Average Profits = Average Profit$\times\frac{100}{Normal\ Rate\ of\ Return}$

B. Capitalisation of Super Profit Method-Under this method first of all we calculate the super profits and then we assess the capital needed for earning such super profits on the basis of normal rate of return . Such capital is actually the amount of goodwill.

Goodwill = Super Profit $\times\frac{100}{Normal\ Rate\ of\ Return}$

Super profits are calculated in the same manner as calculated in super profits method.

Self Examination Question

1. The profits of last five years are 85,000; 90,000; 70,000; 1,00,000 and 80,000. Find the value of goodwill, if it is calculated on average profits of last five years on the basis of 3 years of purchase

a. Rs.85,000.

b. Rs.2,55,000.

c. Rs.2,75,000.

d. Rs.2,85,000.

2. Find the goodwill of the firm using capitalization method from the following information :

Total Capital Employed in the firm ₹8,00,000

Reasonable Rate of Return 15%

Profits for the year₹12,00,000

a) Rs.82,00,000

b) Rs.12,00,000

c) Rs.72,00,000

d) Rs.42,00,00

3. A& B are partners with capitals of Rs.10,000 and 20,000 respectively and sharing profits equally. They admitted C as their partner with one fourth profits of the firm o the payment of Rs. 12,000 .The amount of hidden goodwill is.

   a. 6,000
   b. 10,000
   c. 8,000
   d. None of the above

4. Under capitalization basis goodwill is calculated by:

   a. No. of years purchased multiplied with average profits
   b. No. of years purchased multiplied with super profits
   c. Summation of the discounted value of expected future benefits
   d. Super Profit divided with expected rate of return

5. The profits and losses for the last years are 2007-08 Losses ` 10,000; 2008-09 Losses Rs.2,500; 2009-10 Profits Rs.98,000 & 2010-11 Profits RS. 76,000. The average capital employed in the business is Rs. 2,00,000. The rate of interest expected from capital invested is 12%. The remuneration of partners is estimated to be Rs 1,000 per month not charged in the above losses/profits. Calculate the value of goodwill on the basis of two years purchase of super profits based on the average of four years.

   a. Rs.9,000
   b. Rs.8,750
   c. Rs.8,500
   d. Rs.8,250

6. Goodwill brought in by incoming partner in cash for joining in a partnership firm is taken away by the old partners in their ……… ratio.

   a. Capital
   b. New Profit Sharing
   c. Sacrificing.
   d. Old Profit Sharing.

7. A & B are partners sharing profits and losses in the ratio 5:3. On admission, C brings Rs.70,000 cash and Rs48,000 against goodwill. New profit sharing ratio between A, B and C are 7:5:4. Find the sacrificing ratio of A:B.

a. 3:1
b. 4:7
c. 5:4
d. 2:1

8. In the absence of any provision in the partnership agreement, profits and losses are shared
   a. In the ratio of capitals.
   b. Equally
   c. In the ratio of loans given by them to the Partnership firm
   d. None of the above
9. Following are Factors affecting goodwill except:
   a. Nature of business.
   b. Efficiency of Management.
   c. Technical Know how.
   d. Location of the Customers
10. Capital employed by a partnership firm is ₹ 5,00,000. Its average profit is ₹ 60,000. The normal rate of return in similar type of business is 10%. What is the amount of super profits?
   a. ₹ 50,000
   b. ₹ 10,000
   c. ₹ 6,000
   d. ₹ 56,000
11. A and B are partners in a firm having capital balances of ₹ 54,000 and ₹ 36,000 respectively. They admit C in partnership for 1/3d share and C is to bring proportionate amount of capital. The capital amount of C would be:
   a. ₹ 90,000
   b. ₹ 45,000
   c. ₹ 5,400
   d. ₹ 36,000
12. If the new partner brings any additional amount in cash other than his capital contribution then, it is termed as:
   a. Capital
   b. Reserves
   c. Profits
   d. Goodwill
13. A firm earns profit of ₹ 1,10,000. The normal rate of return in a similar type of business is 10%. The total assets (excluding goodwill) and total outside liabilities are ₹ 11,00,000 and ₹ 1,00,000 respectively. The value of goodwill as per capitalisation method will be:
   a. ₹ 1,00,000
   b. 10,00,000

c. 10,000
d. None of the above

14. A firm earns a profit of ₹ 1,10,000. The normal rate of return in a similar type of business is 10%. The value of total assets (excluding goo and total outside liabilities are ₹ 11,00,000 and ₹ 1,00,000 respectively. The value of goodwill is
    - **a.** ₹ 1,00,000
    - **b.** ₹ 10,00,000
    - **c.** ₹ 10,000
    - **d.** None of the above.
15. A firm of X, Y and Z has a total capital investment of ₹ 2,25,000. The firm earned net profit during the last four years ₹ 35,000, 40,000, 60,000, 50,000. The fair return on the net capital employed is 15%. Find the value of goodwill if it is based on 3 years purchase of average super profit of past 4 years.
    - **a.** ₹ 35,000
    - **b.** ₹ 36,500
    - **c.** ₹ 40,000
    - **d.** ₹ 37,500
16. Sona purchased Simmi's business from 1st Jan, 1981. The profit disclosed by Simmi's business for last 3 years:
    1985 - ₹ 40,000 [including abnormal gain of ₹ 5,000]
    1986 - ₹ 50,000 [after charging abnormal loss of ₹ 10,000]
    1987 - ₹ 45,000 [excluding ₹ 5,000 for insurance premium of firms property now to be insured] Calculate the goodwill on the basis of 2 years purchase of average profit of last 3 years.
    - **a.** ₹ 80, 000
    - **b.** ₹ 90,000
    - **c.** ₹ 1,20,000
    - **d.** ₹ 1,00,000
17. The goodwill of a business is to be valued at 3 years purchase of the average profits of the last three years. The profits of the last three years are ₹ 5,000, ₹ 6,000 and ₹ 7,000 respectively. Hence, the goodwill be valued at:
    - **a.** ₹ 12,000
    - **b.** ₹ 15,000
    - **c.** ₹ 18,000
    - **d.** ₹ 6,000
18. Find the average profit of last 3 years and the goodwill of the firm for 2 years of purchase. If the profit for last 2 years is 2010- ₹ 50,000, 2011- ₹ 30,000, 2012- ₹ 1,00.000:
    - **a.** ₹ 80,000, 1.20,000
    - **b.** ₹ 60,000, 1,20,000
    - **c.** ₹ 60,000, 1,00,000
    - **d.** ₹ 70,000, 80,000
19. Find the goodwill by super profit method where capital is ₹ 1,00,000, Rate 20%, Average profit is ₹ 25,000:
    - **a.** ₹ 7,000

b. ₹ 4,000
c. ₹ 2,000
d. ₹ 5,000

20. The profit of last five years are ₹ 85,000, ₹ 90,000, ₹ 70,000, ₹ 1,00,000 and ₹ 80,000. Find the goodwill if it is calculated on average profit of last five years on the basis of 3 years of purchase.
    a. ₹ 2,85,000
    b. ₹ 85,000
    c. ₹ 2,55,000
    d. ₹ 2,75,000
21. A firm has total investment of ₹ 2,25,000. The firm earned net profit for the last 4 years as ₹ 35,000, ₹ 40,000; ₹ 60,000 and ₹ 50,000. The fair return on capital employed is 15%. The value of goodwill on the basis of 3 years purchase of average super profits of past 4 years will be:
    a. ₹ 37,500
    b. ₹ 12,500
    c. ₹ 46,250
    d. ₹ 33,750
22. Yales and Wells were in partnership sharing profits and losses equally. They admit Sparks as a partner and decide to share profits equally between the three partner. Goodwill is valued at ₹ 60,000 but is to be immediately written off. What will be the effect of this on Yale's capital?
    a. Will increase by ₹ 20,000
    b. Will increase by ₹ 30,000
    c. Will increase by ₹ 10,000
    d. Will decrease by ₹ 10,000
23. The profits of last three years are ₹ 43,000, ₹ 38,000 and ₹ 45,000. Find out the goodwill of two years purchase of average profits.
    a. ₹ 84,000
    b. ₹ 42,000
    c. ₹ 36,000
    d. ₹ 1,26,000

ANSWER

1. (b)
2. (c)
3. (a)
4. (d)
5. (b)
6. (c)
7. (a)
8. (d)
9. (b)

Answers

1. (b)
2. (b)
3. (d)
4. (a)
5. (a)
6. (d)
7. (b)
8. (c)
9. (b)
10. (d)
11. (c)
12. (a)
13. (c)
14. (a)

Unit-3

Admission of a Partner

1. Admission of a Partner

Admission of a partner is one of the modes of reconstitution of a partnership firm, under which existing agreement comes to an end and a new one comes into existence.

A new partnership deed is prepared at the time of admission of a new partner, as the old partnership deed comes to an end.

1. Following Adjustment are needed at the time of the admission of a new partner:

(i) Calculation of new profit sharing ratio

(ii) Accounting treatment of Goodwill;

(iii) Accounting treatment for revaluation of assets and liabilities

(iv) Accounting treatment of reserve and accumulate4d profits

(v) Adjustment of Capitals on the basis of new profit sharing ratio.

(i) Calculation of New Profit Sharing Ratio-When a new partner is admitted, he acquires his share of profit from the old partners. This reduces the old partner's shares of profits, hence the calculation of new profit sharing ratio becomes necessary. Following types of problems may arise for the calculation of new profit sharing ratios, at the time of admission of a new partner.

A. When only the ratio of the new partner is given in the question, then in the absence of any other agreement, it is presumed that the old partners will continue to share the remaining profits in the same ratio in which they were sharing before the admission of new partner.

B. Sometimes the new partner 'purchases' his share of profit from the old partners equally. In such cases the new profit sharing ratios of the old partners will be ascertained by deducting the sacrifice made by them from their existing share of profit.

C. Sometimes the new partner 'Purchases' his share from the old partners in a particular ratio. In such cases the new profit sharing ratio of the old partners will be calculated after deducting the sacrifice made by a partner from his existing share of profit.

D. Sometimes the old partners surrender a particular fraction of their share in favour of the new partners. In such cases the new partner's share is calculated by adding the surrendered portion of share by the old partners. Old partner's share are calculated by deducting the surrendered share from their old shares.

(iii) Accounting treatment of Goodwill on the admission of a new partner-They may be three situation related to treatment of goodwill (premium) at the time of admission of a new partner:

A. When the amount of goodwill (premium) is paid privately.
B. When the new partner brings his share of goodwill (premium) in cash.
C. When the new partner does not bring his share of goodwill (premium) in cash

(iv) When Goodwill Already Appears in the Books and new partner bring his share of goodwill/ premium in cash- If new partner brings, his share of goodwill in cash, and if the Goodwill Account already appears in the books of the firm, first of all the existing Goodwill Account will have to be written off.

Old Partner's Capital A/cs Dr.
To Goodwill A/c
(Goodwill written off in old ratio)

(v) When Goodwill Already Appears in the Books and new partner does not bring his share of goodwill/ premium in cash-If goodwill account already exists in the books of the firm, and if the new partner does not bring in his share of goodwill in cash, even then, as already discusses, the amount of goodwill already existing is written off by debiting the capital accounts of old partners in their old ratio.

2. **Revaluation of Assets and Liabilities-**Whenever a New partner is admitted, it become necessary to revalue the assets and liabilities of the firm to their true and fair values. Thus, the entire profit or loss arising from revaluation is divided between the old partners in their old profit sharing ratio
Revaluation of assets and liabilities is done with the help of a new account called 'Revaluation Account'. Sometime this account is called as 'Profit & Loss Adjustment Account' This account is a nominal account in nature.
Proforma of Revaluation Account is given below

Dr. **Cr.**

Particular	Rs.	Particular	Rs.
To Decrease in the value of assets		By Increase in the value of assets	
To Increase in the value of Liabilities		By Decrease in the value of Liabilities	
To Unrecorded Liabilities		By Unrecorded Assets	
To Profit of Revaluation transferred to old partner's capital/ current accounts (in old ratio)		By loss on Revaluation transferred to old partner's capital/ current accounts (in old ratio)	

3. Accounting Treatment of reserve and Accumulated Profits or Losses

(i) For Distributing Reserve and Accumulated Profits

General Reserve A/c Dr.
Reserve Fund A/c Dr.
Profit &loss A/c (Credit Balance) Dr.
To Old Partner's capital A/cs or Current A/cs

(ii) For Distributing accumulated losses among old partners in old ratio.

Old Partner's Capital A/cs or Current A/cs Dr.
To Profit &loss A/c (Debit Balance)
To Advertisement Suspense A/c
To Deferred Revenue Expenditure A/c

(iii) For the distributing surplus of specific reserves

Workmen's Compensation Reserve A/c Dr.

Investment Fluctuation Reserve A/c Dr.

To Old Partner's Capital A/cs or Current A/cs

Employee's Provident fund or employee's Saving Account appearing on the liabilities side of the balance Sheet are not distributed among old partners as they are not reserves but are the outside liabilities payable by the firm.

Self Examination Questions

1. A and B are partners sharing profits and losses in the ratio 5:3. They admitted C and agreed to give him 3/10th of the profit. What is the new ratio after C's admission?
(a) 35:42:17
(b) 35:21:14
(c) 49:22:29
(d) 34:20:12

2. A and B are partners sharing profits in the ratio 5:3, they admitted C giving him 3/10th share of profit. If C acquires 1/5 from A and 1/10 from B, new profit sharing ratio will be:
(a) 5:6:3

(b) 2:4:6
(c) 18:24:38
(d) 17:11:12

3. A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring Rs.25,000 against capital and ` 10,000 against goodwill. New profit sharing ratio is 1:1:1. C is able to bring Rs.30,000 only. How this will be treated in the books of the firm.
(a) A and B will share goodwill brought by C as Rs.4,000:Rs.1,000.
(b) Goodwill not brought, will be adjusted to the extent of Rs.5,000 in scarifying ratio.
(c) Both.
(d) None.

4. A and B are partners sharing the profit in the ratio of 3:2. They take C as the new partner, who is supposed to bring Rs.25,000 against capital and Rs.10,000 against goodwill. New profit sharing ratio is 1:1:1. C brought cash for his share of Capital and agreed to compensate to A and B outside the firm. How this will be treated in the books of the firm.
(a) Cash Brought in by C will only be credited to his capital account.
(b) Goodwill will be raised to full value in old ratio.
(c) Goodwill will be raised to full value in new ratio.
(d) Cash brought by C will be credited on his account and debited with his share of goodwill, which will be debited to A and B's account sacrificing ratio

5. Profit or loss on revaluation is shared among the partners in………………….ratio
(a) Old Profit Sharing
(b) New Profit Sharing
(c) Capital.
(d) Equal.

6. Amit and Anil are partners of a partnership firm sharing profits in the ratio of 5:3 with capital of Rs.2,50,000 & Rs.2,00,000 respectively. Atul was admitted on the following terms: Atul would pay Rs.50,000 as capital and Rs.16,000 as Goodwill, for 1/5th share of profit. Find the balance of capital accounts after admission of Atul.
(a) Rs.2,60,000:Rs.2,06,000:Rs.50,000.
(b) Rs.2,20,00:Rs.1,82,000:Rs.66,000
(c) Rs.2,92,500:Rs.2,25,500:Rs.50,000
(d) Rs.2,82,500:Rs2,19, 500:Rs.66,000.

7. Balance sheet prepared after the new partnership agreement, assets and liabilities are recorded at:
(a) Original Value

(b) Revalue Figure
(c) At realizable value
(d) At current cost

8. P and Q are partners sharing Profits in the ratio of 2:1. R is admitted to the partnership with effect from 1st April on the term that he will bring Rs.20,000 as his capital for 1/4th share and pays `9,000 for goodwill, half of which is to be withdrawn by P and Q. How much cash can P & Q withdraw from the firm (if any).
(a) Rs.3,000:Rs.1,500.
(b) Rs.6,000:Rs.3,000
(c) NIL.
(d) None of the above

9. Adam, Brain and Chris were equal partners of a firm with goodwill ` 1,20,000 shown in the balance sheet and they agreed to take Daniel as an equal partner on the term that he should bring Rs.1,60,000 as his capital and goodwill, his share of goodwill was evaluated at Rs.60,000 and the goodwill account is to be written off before admission. What will be the treatment for goodwill?
(a) Write off the goodwill of Rs.1,20,000 in old ratio.
(b) Cash brought in by Daniel for goodwill will be distributed among old partners in sacrificing ratio.
(c) Both (a)&(b)
(d) None of the above

10. Which of the following asset is compulsory to revalue at the time of admission of a new partner:
(a) Inventory.
(b) Fixed Assets.
(c) Investment.
(d) Goodwill.

11. X and Y are partners sharing profits in the ratio of 3 : 1. They admit Z as a partner who paysRs.4,000 as Goodwill the new profit sharing ratio being 2 : 1 : 1 among X, Y and Z respectively. The amount of goodwill will be credited to :
(a) X and Y as Rs.3,000 and Rs.1,000 respectively.
(b) X only
(c) Y only
(d) None of the

12. A and B are partners sharing profits in the ratio of 3:2 respectively. C is admitted in the firm for 1/3rd share in profits. The new profit sharing ratio amongst A, B and C will be:-
a. 12: 08: 05
b. 08: 12: 05
c. 05: 05: 12
d. None of these

13. Ramesh and Suresh are partners sharing profits in the ratio of 2: 1 respectively. (Ramesh Capital is ₹ 1,02,000 and Suresh Capital is ₹ 73,000). They admit Mahesh and agree to give him 1/5th share in future profit. Mahesh brings ₹ 14,000 as his share of goodwill. He agrees to contribute capital in the new profit share ratio. How much capital will be brought by Mahesh?
    a. ₹ 43,750
    b. ₹ 45,000
    c. ₹ 47,250
    d. ₹ 48,000
14. M and N are partners sharing profit and loss in equal ratio. Their capital balances stood at ₹ 23,000 and ₹ 27,000 respectively. They wanted to grow their business and admitted P as a working partner for 1/3d share. P is to bring capital in the proportion of his share of profit and besides capital, he is to bring ₹ 9,000 as goodwill. What will be the amount of capital to be brought in by P –
    a. ₹ 27,000
    b. ₹ 23,000
    c. ₹ 36,000
    d. ₹ 29,500
15. A & B are sharing profits and loss in ratio of 3:2. C was admitted for 1/5th share, which he takes equally from A & B, i.e. 1/10h from A and 1/10 from B. New profit sharing ratio will be –
    a. 5:3:2
    b. 29:19:10
    c. 9:6:5
    d. None of these
16. A & B are partners sharing profits in the ratio of 2:1 respectively (A's capital is ₹ 1,02,000 & B's capital is ₹ 73,000). They admit C & agreed to give him 1/5th share in future profit. C brings ₹ 14,000 and share of goodwill. He agreed to contribute capital in the new profit sharing ratio. How much capital will be brought by C.
    a. ₹ 43,750
    b. ₹ 45,000
    c. ₹ 47,250
    d. ₹ 48,000
17. At the time of admission of partner, amount of general reserve revaluation a/c will be transferred to –
    a. Old Partners Capital A/c
    b. New Partners Capital A/c
    c. All Partners Capital A/c
    d. None of the above.
18. If A and B are sharing profits in the ratio of 5:3 and on admission of C the new profit sharing ratio becomes 7: 5: 4. Calculate the sacrificing ratio.
    a. 3: 1
    b. 1: 3
    c. 5: 4
    d. 7: 5.

19. A and B are partners sharing profit losses in ratio 2:3. C is admitted for 1/4 share in profit find new profit share ratio:
    a. 2: 4: 5
    b. 3: 2: 6
    c. 6: 9: 5
    d. 1: 2: 3
20. A, B sharing profits and losses in the ratio of 3:5. C is admitted in the partnership and new ratio below them is 3:5:2. Sacrificing ratio below A and B is
    a. 3:1
    b. 3:5
    c. 5:3
    d. None

ANSWER

1. (b)
2. (d)
3. (c)
4. (a)
5. (a)
6. (a)
7. (b)
8. (a)
9. (c)
10. (d)
11. (b)
12. (d)
13. (c)
14. (d)
15. (a)
16. (c)
17. (a)
18. (a)
19. (c)
20. (a)

Unit-4

Retirement or Death of a Partner

1. **Retirement or Death of a Partner-**A Partner has the right to retire from the firm after giving due notice in advance. Old partnership comes to an end after the retirement of a partner, but the firm continues and a new partnership comes into existence between the remaining partners.

2. **A retiring partner is entitled to get the following**
   a.Share in Goodwill
   b. Share in Reserves
   c.Share in Revaluation of Assets and liabilities

3. **Accounting Problem-**Following accounting problems arise on the retirement of a partner:
   - Calculation of new profit sharing ratio and gaining ratio of the continuing partners.
   - Treatment of Goodwill
   - Accounting Treatment for Revaluation of Assets and Liabilities.
   - Accounting Treatment for Reserves, accumulated profits and losses.
   - Payment to retiring partner.
   - Adjustment of Capitals in proportion to profit sharing ratios.
4. **Calculation of New Profit Sharing Ratio**
   a. If the new profit sharing ratios of the remaining partners are not given in the question, it will be assumed that the remaining partners continue to share profits and losses in the old ratio.
   b. Sometimes the remaining partners purchase the share of retiring partner in some specified proportions. In such cases the fraction of share purchased by them is added to their old share and the new ratio is calculated

5. **Accounting Treatment of Goodwill-** The Retiring or deceased partner is entitled to his share of goodwill at the time of retirement or death because the goodwill earned by the firm is the result of the efforts of all the existing partners in the past. The adjustment for the goodwill will be made through partner's capital accounts

Continuing Partner's Capital A/cs Dr.(in the gaining ratio)

To Retiring/Deceased Partner's Capital A/c (with his share of goodwill)

(Retiring/deceased partner's share of goodwill adjusted to continuing partners in the gaining ratio)

6. **Revaluation of Assets and Liabilities-**As the time of retirement the assets and liabilities are revalued and a revaluation account is prepared in the same way as is done in case of admission of a new partner. The only difference is that in case of retirement any profit or loss due to revaluation is divided among all the partners, including the retiring partners.

7. **Adjustment of Accumulated Profits and Reserve.**

(i) For the distributing Reserves and Accumulated Profits

General Reserve A/c Dr.
Reserve Fund A/c Dr.
Profit &loss A/c (Credit Balance) Dr.
To All Partner's capital A/cs or Current A/cs (in old ratio)

(ii) For Distributing accumulated losses:

All Partner's Capital A/cs or Current A/cs Dr.(in old ratio)
To Profit &loss A/c (Debit Balance)

(iii) For distributing surplus of specific reserves

Workmen's Compensation Reserve A/c Dr.

Investment Fluctuation Reserve A/c Dr.

To All Partner's Capital A/cs or Current A/cs(in old ratio)

Retirement Of A Partner

Self Examination Questions

1. Retiring or outgoing partner:

- **a.** Is liable for firm's liabilities.
- **b.** Not liable for any liabilities of the firm.
- **c.** Is liable for obligations incurred before his retirement.
- **d.** Is liable for obligations incurred before and after his retirement.

2. A, B and C are partners with profits sharing ratio 4:3:2. B retires. If A & C shares profits of B in 5:3, then find the new profit sharing ratio.

- **a.** 47:25.
- **b.** 17:11
- **c.** 31:11.
- **d.** 14:21.

3. Outgoing partner is compensated for parting with firm's future profits in favour of remaining partners. In what ratio do the remaining partners contribute to such compensation amount?

- **a.** Gaining Ratio.
- **b.** Capital Ratio.
- **c.** Sacrificing Ratio.
- **d.** Profit Sharing Ratio.

4. At the time of retirement of a partner, firm gets ……… from the insurance company against the Joint Life Policy taken jointly for all the partners.

- **a.** Policy Amount.
- **b.** Surrender Value.
- **c.** Policy Value for the retiring partner and Surrender Value for the rest.
- **d.** Surrender Value for all the partners.

5. A, B and C takes a Joint Life Policy, after five years B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of Rs. 2,50,000 with the surrender value Rs.50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy premium is fully charged to revenue as and when paid?

- **a.** Rs. 50,000 credited to all the partners in old ratio.
- **b.** Rs.2,50,000 credited to all the partners in old ratio.
- **c.** Rs.2,00,000 credited to all the partners in old ratio.

d. No treatment is required.

6. A, B and C takes a Joint Life Policy, after five years B retires from the firm. Old profit sharing ratio is 2:2:1. After retirement A and C decides to share profits equally. They had taken a Joint Life Policy of Rs.2,50,000 with the surrender value Rs.50,000. What will be the treatment in the partner's capital account on receiving the JLP amount if joint life policy is maintained at surrender value along with the reserve?
   - **a.** Rs.50,000 credited to all the partners in old ratio.
   - **b.** Rs.2,50,000 credited to all the partners in old ratio.
   - **c.** Rs.2,00,000 credited to all the partners in old ratio.
   - **d.** Distribute JLP Reserve Account in old profit sharing ratio.

7. Claim of the retiring partner is payable in the following form.
   - **a.** Fully in cash.
   - **b.** Fully transferred to loan account to be paid later with some interest on it.
   - **c.** Partly in cash and partly as loan repayable later with agreed interest.
   - **d.** Any of the above method.

8. A, B and C were partners sharing profits and losses in the ratio of 3:2:1. A retired and Goodwill of the firm is to be valued at Rs.24,000. What will be the treatment for goodwill?
   - **a.** Credited to Revaluation Account at Rs.24,000.
   - **b.** Adjusted through partners' capital accounts in gaining/sacrificing ratio.
   - **c.** Only A's capital account credited with Rs.12,000.
   - **d.** Only A's capital account credited with Rs.24,000.

9. A, B and C were partners sharing profits and losses in the ratio of 3:2:1. A retired and firm received the joint life policy as Rs.7,500 appearing in the balance sheet at Rs. 10,000. JLP is credited and cash debited with Rs.7,500, what will be the treatment for the balance in Joint Life Policy?
   - **a.** Credited to partner's current account in profit sharing ratio.
   - **b.** Debited to revaluation account.
   - **c.** Debited to partner's capital account in profit sharing ratio.
   - **d.** Either (b) or (c).

10. Balances of A, B and C sharing profits and losses in proportionate to their capitals, stood as A – Rs.2,00,000; B – Rs. 3,00,000 and C – Rs.2,00,000. A desired to retire from the firm, B and C share the future profits equally, Goodwill of the entire firm be valued at Rs.1,40,000 and no Goodwill account being raised.
    - **a.** Credit Partner's Capital Account with old profit sharing ratio for Rs.1,40,000.
    - **b.** Credit Partner's Capital Account with new profit sharing ratio for Rs.1,40,000.

c. Credit A's Account with Rs.40,000 and debit B's Capital Account with Rs. 10,000 and C's Capital Account with Rs.30,000.

d. Credit Partner's Capital Account with gaining ratio for Rs.1,40,000.

11. Retiring partner is compensated for parting with the firm's future profits in favour of remaining partners. The remaining partner's contribute to such compensation amount in:
- **a.** Gaining Ratio
- **b.** Capital Ratio
- **c.** Sacrificing Ratio
- **d.** Profit sharing Ratio

12. If a partner goes insolvent and is not able to bring his share of deficiency in cash, then his deficiency should be borne by the remaining solvent partners:
- **a.** Equally
- **b.** On the basis of their profit sharing ratio
- **c.** On the basis of their adjusted capital ratio
- **d.** On the basis of their original investments.

13. A, B and C share profits and losses of a firm on 1:1:1 basis. B retired from business and his share is purchased by A and C in 40:60 ratio. New profit and loss sharing ratio between A and C would be –
- **a.** 1:1
- **b.** 2:3
- **c.** 7:8
- **d.** 3:5.

14. At the time of retirement of a partner from a partnership firm, the adjustment of goodwill is done in –
- **a.** Old profit sharing ratio
- **b.** Gaining ratio
- **c.** Sacrificing ratio
- **d.** New profit sharing ratio.

15. Which amongst the following is transferred to Partner's Executor's A/c at the time of death of the partner?
- **a.** Interest on Capital
- **b.** Share in Goodwill
- **c.** Share in Profit
- **d.** All of the above.

16. Calculate Gaining Ratio from following information:
Current Profit Sharing Ratio of A, B & C = 5:4:3
C retires and his share was taken equally by A and B.
- **a.** 1:1
- **b.** 1:3
- **c.** 13:11
- **d.** None of these.

17. On the retirement of a partner any reserve lying in the books of account:
- **a.** Should be transferred to retiring partner only
- **b.** Should be transferred to all partner in the old profit sharing ratio

c. Should not be transferred
d. Should be transferred to remaining partners in the new profit sharing ratio.

18. In a Partnership firm, the Joint Life Insurance premium is treated as an expense. Which of the following account is credited for amount received from Joint Life Insurance Policy on the death of a partner?
- **a.** Bank Account
- **b.** All Partners Capital Account
- **c.** Deceased Partners Capital Account
- **d.** Remaining Partners Capital Account.

19. A, B and C were in partnership sharing profits in the ratio of 4:2:1 respectively. A guaranteed that is no case C's share in profit should be less than ₹ 7,500. Profits of the firm for the year 2013 amounted to ₹ 31,500. A's share in profit will be:
- **a.** ₹ 15,000
- **b.** ₹ 18,000
- **c.** ₹ 16,000
- **d.** ₹ 3,000.

20. A, B and C are partners in a firm, sharing profits and losses in the ratio of 5:3:2 respectively. The balance of capital is ₹ 50,000 for A & B each and ₹ 40,000 for 'C', 'B' decides to retire from firm. The goodwill of firm is valued at ₹ 30,000 and profit on revaluation of assets at ₹ 5,000. The firm also have a balance in the Reserve A/c for ₹ 15,000 on that date. What amount will be payable to 'B'?
- **a.** ₹ 55,000
- **b.** ₹ 65,000
- **c.** ₹ 75,000
- **d.** ₹ 45,000.

21. On the death of a partner. Joint life policy amount if company treat JLP as expenses. Then amount is distributed among:
- **a.** All partner
- **b.** Gaining partner
- **c.** Deceived partner
- **d.** None of these

22. A, B, C are partners. B retires A & C. Gaining ratio, if profit sharing ratio of A, B, C is 2: 3: 1?
- **a.** 3: 1
- **b.** 2: 4
- **c.** 2: 1
- **d.** 3: 2

23. According to Garner Vs. Murray rule in case of fixed capital, loss arising due to insolvency of a partner is:
- **a.** Divided among all partner in capital ratio
- **b.** Divided among all partner in profit and loss ratio
- **c.** Divided among all solvent partner in capital ratio
- **d.** Divided among all solvent partner in profit sharing ratio.

24. X, Y and Z are partner and sharing profit and losses equally. Y died, X and Z decided to continue with the partnership and Y's share is purchased by X and Z in 2: 3 ratio. Goodwill of the firm was valued for ₹ 18,000. The firm also booked revaluation loss of ₹ 9,000. If at the time of death of Y, his capital was ₹ 20,000 the amount payable to Y's executors would be:

- **a.** ₹ 23,000
- **b.** ₹ 20,000
- **c.** ₹ 38,000
- **d.** ₹ 29,000

25. A, B and C are partners sharing profits in the ratio of 4:3:2. B retires. A and C decide to share profits in future in the ratio of 5:3. Gaining ratio between A and C will be

- **a.** 13:11
- **b.** 12:10
- **c.** 10:12
- **d.** 11:13

26. A, B and C share profits and losses of a firm on 1:1:1 basis. B retired from business and his share is purchased by A and C is 70: 90. New profit sharing ratio below A and C would be

- **a.** 1: 1
- **b.** 11: 13
- **c.** 1: 3
- **d.** 5: 3

ANSWER

1. (c)
2. (a)
3. (a)
4. (b)
5. (a)
6. (d)
7. (d)
8. (b)
9. (d)
10. (c)
11. (a)
12. (c)
13. (c)
14. (b)
15. (d)
16. (a)
17. (b)
18. (b)
19. (a)
20. (b)
21. (a)
22. (c)
23. (c)
24. (a)
25. (a)
26. (c)

Death Of A Partner

Self Examination Question

1. On the death of a partner, his executor is paid the share of profits of the dying partner for the relevant period. This Payment is recorded in Profit & loss…………Account.
   (a) Adjustment.
   (b) Appropriation.
   (c) Suspense.
   (d) Reserve.

2. Revaluation account is prepared at the time of
   (a) Admission of a partner
   (b) Retirement of a partner
   (c) Death of a partner
   (d) All of the above

3. In the absence of proper agreement, representative of the deceased partner is entitled to the Dead partner's share in
   (a) Profits till date, goodwill, joint life policy, share in revalued assets and liabilities.
   (b) Capital, goodwill, joint life policy, interest on capital, share in revalued assets and liabilities.
   (c) Capital, profits till date, goodwill, interest on capital, share in revalued assets and liabilities.
   (d) Capital, profits till date, goodwill, joint life policy, share in revalued assets and liabilities.

4. As per Section 37 of the Indian Partnership Act, 1932, the executors would be entitled at their choice to the interest calculated from the date of death till the date of payment on the final amount due to the dead partner at …… percent per annum.
   (a) 7.
   (b) 4.
   (c) 6.
   (d) 12.

5. R, J and D are the partners sharing profits in the ratio 7:5:4. D died on 30th June 2011 and profits for the accounting year 2010-2011 were Rs.24,000. How much share in profits for the period 1st April 2011 to 30th June 2011 will be credited to D's Account.
   (a) Rs.6,000.
   (b) Rs.1,500.
   (c) Nil.
   (d) Rs.2,000.

6. If three partners A, B & C are sharing profits as 5:3:2, then on the death of a partner A, how much B & C will pay to A's executer on account of goodwill. Goodwill is to be calculated on the basis of 2 years purchase of last 3 years average profits. Profits for last three years are: Rs.3,29,000; Rs.3,46,000 and Rs.4,05,000.

- **(a)** Rs.2,16,000 & Rs.1,42,000.
- **(b)** Rs. 2,44,000 & Rs. 2,16,000.
- **(c)** Rs.3,60,000 & Rs.3,60,000.
- **(d)** Rs. 2,16,000 & Rs.1,44,000.

ANSWER

1. (c)
2. (d)
3. (d)
4. (c)
5. (a)
6. (d)

Unit-5

Dissolution of a Partnership Firm

1. **Dissolution of a partnership means** termination of the old partnership agreement and a reconstruction of the firm due to admission, retirement and death of a partner.
   Dissolution of a partnership 'firm' means that the firm closes down its business and comes to an end. On the dissolution of the firm, the assets of the firm are sold and liabilities are paid off and out of the remaining amount the accounts of partners are settled.
2. **Dissolution of Partnership-**The partnership is deemed to have been dissolved in any of the following cases:
   - In Case of change in profit-sharing ratio of the existing partners
   - In case of admission of a new partner
   - In case of a retirement of a partner
   - In case of expulsion of a partner
   - In case of death of a partner
   - In case of insolvency of a partner
   - In case of expiry of the period of partnership
3. **Dissolution of partnership firm**
   Modes of Dissolution of partnership Firm- A partnership firm can be dissolved in any of the following ways:

(i) By Mutual Agreement (Sec.40)
(ii) Compulsory Dissolution (Sec.40)
(iii) On Happening of an event (Sec.42)
(iv) By Notice (Sec.43)

4. **By Order of the Court (Sec.44)**

(i) When a Partner has become of unsound mind
(ii) When a Partner, other than the partner filling a suit, has become permanently incapable of performing his duties as a partner.
(iii) When a Partner, other than the partner filling a suit, is guilty of misconduct that may harm the partnership.
(iv) When a Partner, other than the partner filling a suit, willfully or persistently commits breach of partnership agreement
(v) When a Partner, other than the partner filling a suit, has transferred the whole of his interest in the firm to a third party.
(vi) When the court is satisfied that the firm cannot be carried on except at a loss
(vii) When the court is satisfied that the dissolution is just and equitable due to some other reasons.

5. Distinction between Dissolution of Partnership and Dissolution of firm

S.No.	Basis of Distinction	Dissolution of Partnership	Dissolution of Firm
1.	Meaning	It refers to a change in the existing agreement between the partners. The firm continues its business.	It refers to closure of the firm.
2.	Continuation of the business	The Firm continues its business.	Business of the firm comes to an end.
3.	Economic Relationship	Economic relation between the partners continues though in a changed form.	Economic relation between the partners comes to an end.
4.	Closure of Books of Accounts	Books of account need not be closed.	Books of account have to be closed.
5.	Settlement of Assets & Liabilities	Assets are revalued and liabilities reassessed and gain or loss on revaluation is distributed among the partners in their old profit sharing ratio.	Assets are sold and liabilities are paid off and balance if any, is distributed among all the partners.
6.	Effect	Dissolution of partnership does not necessarily means the dissolution of the firm.	Dissolution of firm necessarily means the dissolution of partnership also.
7.	Court's Intervention	There is no intervention by the court since the partnership is dissolved by mutual consent.	A firm can be dissolved without the intervention of the court or by order of the court.

6. Accounting Procedure on Dissolution of firm

(i) Realisation Account- A 'Realisation Account' is opened for disposing of all the assets of the firm and making payment to all the creditors. Realisation account is a nominal account and the object of such an account is to find out of the profit or loss on realisation of assets and payment of liabilities .

Format of Realisation Account

Dr. Cr.

Particular	Rs.	Particular	Rs.
To All Assets (excluding cash/bank balance, fictitious Assets ,Dr. balance of partner's capital/Current Accounts, loan to partner)		By All Liabilities (excluding Cr. balance of P& A/c, Reserve, Partner's Capital/ Current Account, Loan from partners)	
To Bank/Cash A/c (Amount paid for discharging liabilities)		By provision on any assets (such as provision for doubtful debts, provision for depreciation etc.)	
To bank/ Cash A/c (Amount paid for unrecorded liabilities)		By bank/ Cash A/c(Amount received on realisation of assets)	
To Bank/Cash A/c(Expenses on realisation)		By Bank/ Cash A/c(Amount received from unrecorded assets)	
To Partner's Capital A/c (Liabilities taken over by a partner or any expenses paid by him or remuneration/commission payable to him)		By Partner's Capital A/c (Asset taken over by a partner)	
To Partner's Capital A/cs (For transferring profit on realisation)		By partner's Capital A/cs(For transferring loss on realisation)	

(ii) Partner's Loan Accounts-If a partner has given any loan to the firm, his loan will be paid off after all the outside liabilities are paid in full Therefore, Partner's loan account is not transferred to the realisation account and his loan account is prepared separately and paid off by passing the following Entry

Partner's Loan A/c Dr.

To Cash/Bank A/c

(Payment of partner's loan)

(iii) Partner's Capital Account-After the transfer of profit or loss on realisation undistributed profits, reserve etc. to the capital account of the partners the balance of capital accounts are closed in the following manner.

a.When a partner is required to bring in cash to clear off his debit balance, the entry will be :

Cash/Bank a/c Dr.
To Partner's Capital A/c
(Required cash brought in by the partner)

b. When a Partner is a paid the credit balance of his account :

Partner's Capital A/c Dr.

To Cash/Bank A/c

(Excess cash paid to partner)

(iv) Cash or Bank Account-Opening balance of cash and bank and all the receipts are entered on the debit side of this account and all the payments are entered on the credit side of his account .This Account must be prepared and closed last of all and the total of both sides of his account must be equal. In this way this account also helps in the verification of the arithmetical accuracy of the accounts.

Chapter-11

Unit-1

Introduction to Company Accounts

Meaning of Company

The word 'Company' is derived from the Latin words "com"i.e with or together and 'panis.'i.e bread. Originally the word referred to an association of persons or merchant men discussing matters and taking food together. in law company is termed as company which is formed and incorporated under the Companies Act,2013 or an existing company formed and registered under any of the previous company laws. As per this definition of law, there must be group of persons who agree to from a company under the law and once so ,formed and registered under any of the previous company laws. As per this definition of law, there must be group of persons who agree to form a company under the law and once so formed, it becomes a separates legal entity having perpetual succession with a distinct name of its own and a common seal. Its existence is not affected by the change of members.

'Company' is that it is an association of persons created by law as a separate body for a special purpose.

Salient Features Of A Company

1. Incorporated Association
2. Separate Legal Entity
3. Perpetual Existence
4. Limited Liability
5. Distinction Between Ownership and Management
6. Not A Citizen
7. Transferability of Shares
8. Maintenance of Books
9. Periodic Audit
10. Right Of Access to information

Types Of Companies

1. **Government Company-** According to Section 2(45) of the Companies Act,2013" Government Company" means any company which not less than fifty one per cent of the paid-up share Capital is held by the central Government, or by any State Government or Governments, or partly by the Central bank and partly by one or more State Governments, and includes a company Which is a subsidiary company of such a Government company.
2. **Foreign Company-**According to section 2(42) of the Companies Act 2013,"foreign company" means any company or body corporate n corporate outside India Which-

I. has a place of business in India whether by itself or through an agent physically or through electronic mode, and

II. Conducts any business activity in India in any other manner.

3. **Private Company-**Section 2(68) of the Companies Act 2013 defines 'Private Company' as a Company which by its article,-

I. Restricts the right to transfer its shares;

II. Except in case of One Person Company, limits the number of its members to two hundred: Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purpose of this sub clause, be treated as a single member:

4. **Public Company-** Section 2(71) of the companies Act 2013 defines Public Company as a company which is not a private company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purpose of this Act even where such subsidiary company continues to be a private company in its articles

5. **One person Company-**Section 2(62) of the Companies Act,2013 defines "One Person Company" as a Company which has only one person as a member;

6. **Small Company-** Section2(85) of the Companies Act,2013 defines "Small Company" means a company ,other than a public company,

I. Paid up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five corer rupees; or

II. Turnover of which as per its last profit and loss account does not exceed two corer Rupees.

7. **Listed Company**- As per Section 2(52) of the Companies Act,2013,'listed Company' means a company which has any of its securities listed on any recognized stock exchange.
The company, whose shares are not listed on any recognized stock exchange, is called "Unlisted Company"
In Case of private companies, shares are not listed in any stock exchange.

8. **Unlimited Company**-Section 2(92) of the companies Act ,2013 defines unlimited company not having any limit on the liability of its members.

9. **Company Limited by Shares**-As per Section 2(22) of the companies Act,2013 "Company limited by shares " means a company having the liability of its member limited by the memorandum to the amount, if any ,unpaid on the shares respectively held by them.

10. **Company Limited By the Guarantee**-As Per Section 2(21) of the "Company limited by guarantee "means a company having the liability of its members limited by the memorandum to such a amount as the members may respectively under take to contribute to the assets of the company in the event of its being wound up.

11. **<u>Holding Company</u>**-According to Section 2(46) of the companies Act, 2013 "Holding company" in relation to one or more other companies, means a company of which such companies are subsidiary companies.

12. **<u>Subsidiary Company</u>**-Section 2(87) of the Companies Act,2013 Defines "Subsidiary Company" as a company n which the holding company.

    I. Controls the composition of the Board Of Directors; or

    II. Exercise or controls more than one –half of the total share capital either at its own or together with one or more of its subsidiary companies.

13. **<u>Preparation of Financial Statements</u>**

    Schedule III of the Companies Act,2013

PART I- Form of Balance Sheet

Name of the Company…………………………..

Balance Sheet as at………………………………

Particulars	Notes No.	Figures as at end of the current reporting period	Figures as at end of the previous reporting period
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			
4 Current liabilities			
a Short-term borrowings			
b Trade Payables			
c Other current liabilities			
d Short-term provisions			
Total			
ASSETS			
1 Non-current assets			
a Fixed assets			
i Tangible assets			
ii Intangible assets			
iii Capital Work-in-progress			
iv Intangible assets under development			
b Non-current investments			
c Deferred tax assets (Net)			
d Long-term loans and advances			
e Other non-current assets			
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			

Part II- form of Statement of Profit & Loss

Name of the Company………………………

Profit & Loss Statement for the year ended…………………………………

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:			xxx		xxx
	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					
	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
VIII.	Extraordinary Items			xxx		xxx
IX.	Profit before tax (VII- VIII)			xxx		xxx
X.	Tax expense:					
	(1) Current tax		xxx		xxx	
	(2) Deferred tax		xxx	xxx	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:					
	(1) Basic			xxx		xxx
	(2) Diluted			xxx		xxx

Self Examination Question

1. Which Of the following Statement is not a feature of Company?
   - **a.** Separate Legal entity
   - **b.** Common Seal
   - **c.** Perpetual Succession
   - **d.** Members have unlimited liability
2. In a Government Company, the holding of the Central Government in paid-up capital should not be lees than
   - **a.** 25%
   - **b.** 50%
   - **c.** 51%
   - **d.** 75%
3. Which of the Following statement is true in case of a foreign Company?
   - **a.** A Company incorporated in India and has place of business in India.
   - **b.** A Company incorporated outside India and has a place of business in India.
   - **c.** A Company incorporated in India and has a place of business in India.
   - **d.** A Company incorporated outside India and also has a place of business outside.

ANSWER

1. (d)
2. (c)
3. (b)

Unit-2

Company Account

1. **Share Capital-** Total Capital of the company is divided into a number of small indivisible units of a fixed amount and each such unit is called a share. The Fixed value of a share, printed on the share certificate, is called nominal/par/face value of a share .However , a company can issue share at a price different from the face value of a share. The Liability of holder of shares (called shareholders) is limited to the issue price of shares acquired by them.

   The total capital of the company is divided into shares, the capital of the company is called Share Capital At the time of issue of shares every Company is required to follow SEBI Regulations.

i. **Authorised Share Capital or Nominal Capital**: A company estimates its maximum capital requirements. This amount of capital is mentioned in Capital Clause of the Memorandum of Association registered with the Registrar of Companies. It puts a limit on the amount of capital, which a company is authorised to raise during its lifetime and is called Authorised Capital" It is shown in the balance sheet at face value.

ii. **Issued Share Capital**-A Company need not issue total authorized capital whatever Portion of the share capital is issued by the company, it is called "Issued Capital ' issued capital means and includes the nominal value of shares issued by the company for:

   a. Promoters of a company; and
   b. Others.

   It also shown in the balance sheet at nominal value
   The remaining portion of the authorized capital which is not issued either in cash or consideration may be termed as Un issued Capital. It is not shown in the balance sheet.

iii. **Subscribed Share Capital-**It is that part of the issued share capital, which is subscribed by the public i.e, applied by the public and allotted by the company. It also includes the face value of shares issued by company for consideration other than cash

iv. **Called-up Share Capital-**Companies generally receive the issue price of shares in installment. The Portion of the issue price of shares which a company has a demanded or calle from shareholders is known as Called up Capital and the balance, which the company has decided to demand in future may be referred to as uncalled Capital.

v. **Paid-up Share capital –**It is the portion of called up capital which is paid by the shareholders. Whenever a particular amount is called by the company and the shareholder(s) fails to pay the amount fully or partially, it is known as unpaid calls or installments (or Calls) in Arrears.

vi. **Reserve Share Capital-**As per Section 65 of the Companies Act,2013,a Company may decide by passing a resolution that a certain portion of its subscribed uncalled capital shall not be called up except in the event of winding up of the company. Portion of the uncalled capital which a company has decided to call only in case of liquidation of the company is called Reserve Capital

2. **Types Of Shares.**

i. Preference Shares-According to section 43 of the companies Act,2013 person holding preference shares, called preference shareholders, are assured of a preferential dividend at a fixed rate during the life of the company. They also carry a preferential right over other shareholders to be paid first in case of winding up of the company.

- **I.** Payment of dividend, and
- **II.** Repayment of capital

Types of Preference

- **a.** Cumulative Preference Shares;
- **b.** Non-Cumulative Preference Shares;
- **c.** Participating Preference Shares
- **d.** Non- Participating Preference Shares
- **e.** Redeemable Preference Shares
- **f.** Non- Redeemable Preference Shares
- **g.** Convertible Preference Shares
- **h.** Non- Convertible Preference Shares

ii. Equity Shares-Equity Shares are those shares, which are not Preference Shares .It means that they do not enjoy any preferential rights in the matter of payment of dividend or repayment of capital. The rate of dividend on equity shares is recommended by the Board of Directors and may vary from year to year.Rate of dividend depends upon the dividend policy and the availability of profits after satisfying the rights of preference shareholders. These shares carry voting rights. Companies Act, 2013 permits issue of equity share capital with differential rights as to dividend, voting or otherwise in accordance with prescribed rules.

The share can be issued by a company either

- **a)** For Cash or
- **b)** For consideration other than cash

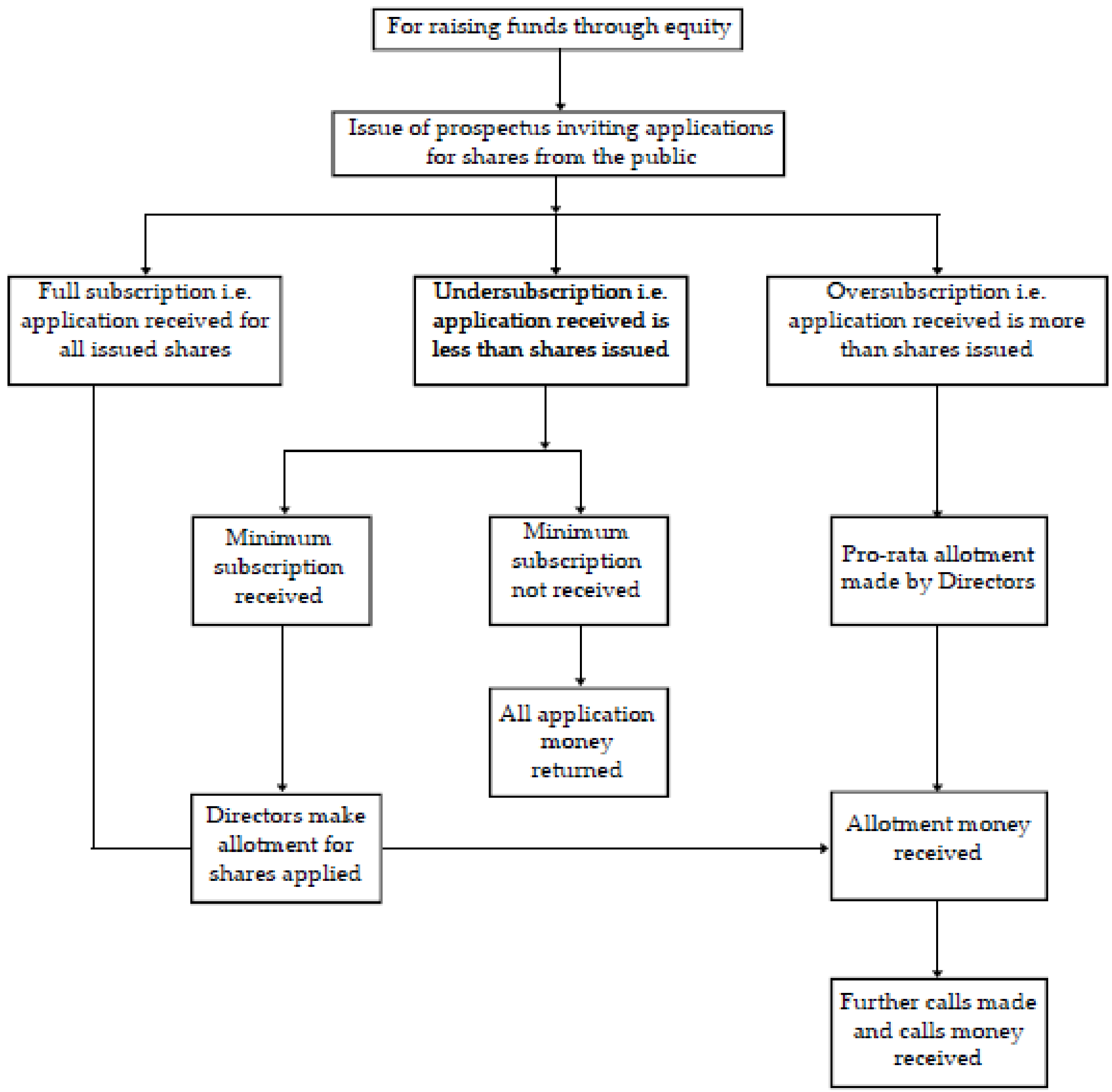
3. **Issue of Share for Cash-**To Issue share, private companies depend upon Private Placement of shares. Public Companies issue a Prospectus and invite general public to subscribe for shares.
   First Installment paid along with application is called Application Money. As per Section 39 of the Companies Act, 2013.Application money must be at least 5% of the nominal value of shares.
4. **Minimum Subscription-**A Public limited company cannot make any allotment of shares unless the amount of minimum subscription stated in the prospectus has been subscribed and sum payable as application money for such shares has been paid to and received by the company.
   As per Guidelines of the Securities Exchange Board of India (SEBI),a company must receive a minimum of 90% subscription against the entries issue(Including development on underwrites in case of underwritten issue) before making any allotment of shares or debentures to the public.

5. Subscription of Shares

i. **Full Subscription-**Issue is fully Subscription if the number of shares offered for Subscription and the number of shares actually Subscribed by the public are same. To start discussion on accounting treatment for issue of shares, let us assume that the issue is fully subscribed.

ii. **Under subscription** -It means the number of shares offered for Subscription is more than the number of shares subscribed by the public. In this case, journal entries as discussed above are passed but with one change i.e., calculation of application , allotment and for that matter, the call money is based on number of shares actually applied and allotted. It must be remembered that shares can be allotted, in this case, only when the minimum Subscription is received.

iii. **Oversubscription**-In actual practice, issue of shares is either under or oversubscribed . if an issue is over- subscribed, some application may be rejected and application money refunded of others, only a part of the shares applied for may be allotted and the excess amount received can be utilized towards allotment or call money which has fallen due or will soon fall due for payment.



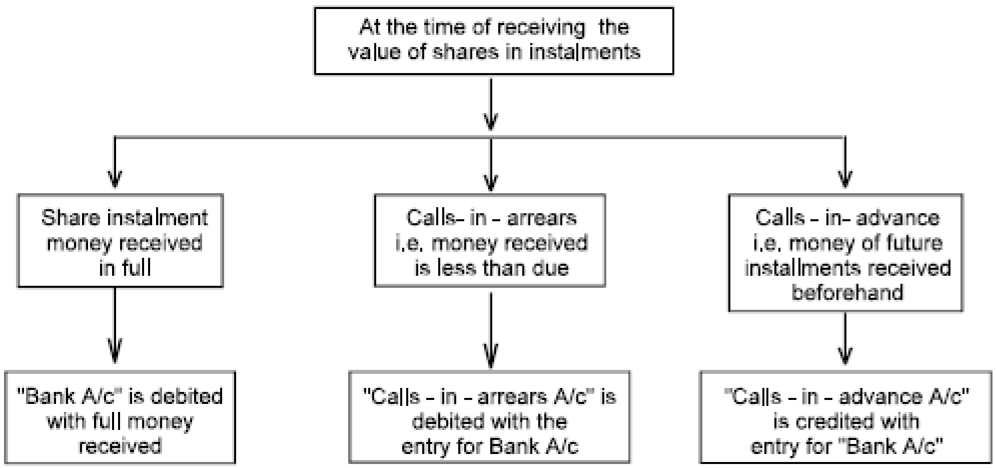
6. **Shares Issued At Discount-**Share are said to be issued at a discount, if issue is at an amount less than the nominal or par value of shares. The excess of the nominal value over the price represents discount on the issued shares.

7. **Share Issued At Premium-** When a company issues its securities at a price more than face value, It is said to be an issue at a premium. Premium is the excess of issue price over face value of the securities. It is quite common for the financially strong , and well-managed companies to issue their shares at a premium.

8. **Over Subscription and Pro-Rata Allotment-**Over Subscription is the application money received for more than the number of shares offered to the public by a company .It usually occurs in the case of good issues and depends on many other factors like investors confidence in the company, general economic conditions, pricing of the issue etc. When the shares are oversubscribed.

The Company may reject some applicants in full,i.e.,no shares are allotted to some applicants and application money is refunded. Usually, multiple applications by the same person are not considered. Allotment may be given to the rest of the applicants in full,i.e., for the number of shares they have applied for. A third alternative is that a company may allot shares to the applicants on pro-rata basis."Pro-Rata" allotment means allotment in proportion of shares applied for.

9. Calls-In-Arrears And Calls-In-Advance



i. **Calls-In-Arrears-** Sometimes shareholders fail to pay the amount due on allotment or calls. The total unpaid amount on one or more installments is known as Calls-in-Arrear or Unpaid Calls. Such amount represent the uncollected amount of capital from the shareholders, hence, it is shown by way of deduction from called-up capital to arrive at paid –up value of the share capital.

The Article of Association of a company usually empowers the directors to charge interest at a stipulated rate on call-in-arrears. According to Table F interest at the rate of 10 per annum is to be charged on unpaid calls for the period investing between the due date of the call and the time of actual payment.

ii. Calls-In-Advance-Some Shareholders may sometimes pay a part, or whole, of the amount not yet called up such amount is known as calls-in-advance. According to table F, interest at a rate not exceeding 12 per cent p.a. is to be paid on such advance call money. This Amount is credited in Calls In Advance Account.

10. **Forfeiture of Shares-** The Team Forfeit actually means taking away of property on breach of a condition. It is very common that one or more shareholders fail to pay their allotment and /or calls on the due dates. Failure to pay call money results in forfeiture of shares. Forfeiture of shares is the action taken by a company to cancel the shares.
11. **Re-Issue Of Forfeited Shares-** A forfeited share is merely a share available to the company for sale and remains vested in the company for that purpose only. Reissue of forfeited shares is not allotment of shares but only a sale**.**
12. **Issue Of Shares For Consideration Other than Cash-** Public limited companies, generally, issue their shares for cash and use such cash to buy the various types of assets needed in the business. A company may issue shares in a direct exchange for land, building

or other assets. Shares May also be issued in payment for services rendered by promoters, lawyers in the formation of the company. These Share Should be shown separately under the heading 'Share Capital'.

Self Examination Question

1. The Excess Price receive over the par value of shares, should be credited to…………………………
   a. Call-In-Advance Account
   b. Share Capital Account
   c. Reserve Capital Account
   d. Securities Premium Account
2. Which of the following statements is false?
   a. The forfeited Share Should not be issued at a premium.
   b. At the time of forfeiture of Shares, Securities Premium should not be debited with the amount of premium already received
   c. Public Ltd. Company generally issues shares for cash
   d. Securities premium account cannot be utilized to redeem preference Shares.
3. When Share are Issued to promoters for the services offered by them, the amount that will be debited with the nominal value of shares is…………………………
   a. Preliminary Expenses Account
   b. Goodwill Account
   c. Asset Account
   d. Share Capital Account
4. The Securities Premium amount may be utilized by a company for…………
   a. Writing off any loss on sale of fixed Asset
   b. Writing off any loss of revenue nature
   c. Payment Of dividends.
   d. Write off the expenses/discount on the issue of debentures
5. Which type of the following shares has the right to receive dividends unpaid in prior years, whenever earnings become adequate?
   a. Cumulative Preference Shares
   b. Participating Preference Shares
   c. Convertible Preference Shares
   d. Callable Preference Shares
6. Which of the following Statements is false?
   a. Interest on Call-in-Advance is paid from the date of receipt of advance to the date of relevant call
   b. Call-in-advance are not entitled for any dividend
   c. According to Table F, interest on call-in-advance is at the rate of 12% of p.a.
   d. Payment of interest on calls-in-advance is at the discretion of the company
7. Dividends are usually paid as a percentage of……………
   a. Authorised Share Capital
   b. Net Profit
   c. Paid-up capital
   d. Called-up Capital
8. If Forfeited shares (which were originally issued at par) are reissued at a premium, the

amount of such premium will be credited to…………
  - **a.** Share Forfeiture Account
  - **b.** Securities Premium Account
  - **c.** Capital Reserve Account
  - **d.** Profit on issue of shares Account

9. The Maximum capital beyond which a company is not allowed to raise funds, by issue of shares its'………………
  - **a.** Issued Share Capital
  - **b.** Reserve Share capital
  - **c.** Authorised Share Capital
  - **d.** Subscribed Share Capital

10. As per the SEBI guidelines, on issue of shres, the application money should not be less than
  - **a.** 2.5% of the nominal value of Shares
  - **b.** 2.5% of the issue price of shares
  - **c.** 25.0% of the nominal value of Shares
  - **d.** 25.0% of the issue price of shares

11. Capital reserves are credited out of
  - **a.** Balance in profit and loss account
  - **b.** Capital profits
  - **c.** Reserve profits
  - **d.** Provisions

12. The interest on calls-in-advance is paid for the period from the…………..
  - **a.** Date of receipt of application money to the date of appropriation
  - **b.** Date of receipt of allotment money to the date of appropriation
  - **c.** Date of receipt of calls-in-advance to the date of appropriation of the call
  - **d.** Date of appropriation to the date of dividend payment

13. As per Schedule III of the Companies Act, 2013, under which of the following heads is 'Premium on issue of Preference Shares' shown in the balance sheet of a company?
  - **a.** Non-current assets
  - **b.** Debentures
  - **c.** Reserves and surplus
  - **d.** Current liabilities and provisions

14. The excess price received over the par value of shares, should be credited to
  - **a.** Calls-in-advance account
  - **b.** Share capital account
  - **c.** Reserve capital account
  - **d.** Securities premium account

.

15. The following statements apply to equity/preference shareholders. Which one of them applies only to Preference Shareholders?
  - **a.** Shareholders risk the loss of investment
  - **b.** Shareholders bear the risk of no dividends in the event of losses
  - **c.** Shareholders usually have the right to vote
  - **d.** Dividends are usually a fixed amount in every financial year

16. As per The Companies Act, only preference shares (not issued for infrastrucral projects), which are redeemable within…..can be issued.
   a. 24 years
   b. 22 years
   c. 30 years
   d. 20 year
17. Which of the following is not true?
   a. Loss on reissue of shares cannot be more than the gain on forfeiture of those shares.
   b. Where all the forfeited shares are not reissued the share forfeited account will show a credit balance equal to gain on forfeiture of shares not yet re-issued.
   c. When the shares are forfeited, securities premium is debited along with share capital where premium has not been received.
   d. Where forfeited shares are re-issued at premium, the amount of such premium is credited to capital reserve account.
18. Which of the following should be deducted from the called-up share capital to find out paid-up capital?
   a. Calls-in-advance
   b. Calls-in-arrears
   c. Share forfeiture
   d. None of these
19. If a shareholder does not pay his dues on allotment, for the amount due, there will be a…………..
   a. Credit balance in the share allotment account
   b. Debit balance in the share forfeiture account
   c. Credit balance in the share forfeiture account
   d. Debit balance in the share allotment account
20. According to Section 52 of the Companies Act,2013,amount in the Securities Premium A/c cannot be used for the purpose of
   a. Issue of fully paid bonus shares.
   b. Writing off losses of the company
   c. For purchase of own securities
   d. Writing off commission or discount on issue of shares
21. Which of the following can be utilized for redemption of preference Shares?
   a. The Proceeds of fresh issue of equity shares
   b. The Proceeds of issue of debentures
   c. The Proceeds of fresh issue of fixed deposit
   d. All of the above
22. Which of the following statements is True?
   a. Capital redemption reserve cannot be used for writing off miscellaneous expenses and losses
   b. Capital profit realized in cash cannot be used for payment of dividend
   c. Reserve created by revaluations of fixed assets are not permitted to be capitalized
   d. Dividend is payable on the calls paid in advance by shareholders.
23. Which of the following account can be used for transfer to capital redemption reserve

account

a. General Reserve Account
b. Forfeited shares Account
c. Profit prior to incorporation
d. Securities Premium Account

24. Securities Premium cannot be used to……………………..

a. Issue Bonus Shares
b. Redeem Preference shares
c. Write-off preliminary expenses
d. Write-off discount on issue of shares

25. Which of the following cannot be used for the purpose of creation of capital redemption reserve account?

a. Profit & loss Account(Credit Balance)
b. General Reserve Account
c. Unclaimed Dividend Account
d. All of the above

ANSWER

1. (d)
2. (a)
3. (b)
4. (d)
5. (a)
6. (d)
7. (c)
8. (b)
9. (c)
10. (d)
11. (b)
12. (c)
13. (c)
14. (d)
15. (d)
16. (d)
17. (d)
18. (b)
19. (d)
20. (b)
21. (a)
22. (a)
23. (a)
24. (b)
25. (c)

Unit-3
Issue of Debentures

1. **Meaning-**A Debenture is a bond issued by a company under its seal, acknowledging a debt and containing provision as regards repayment to the principal and interest .If a charge has been created on any or on the entire assets of the company , the nature of the charge and the assets charged are described therein.
   It also customary to create a trusteeship in favor of one or more persons in the case of mortgage debentures. The trustees of debenture holders have all powers of a mortgage of a property and can act in whatever way they think necessary to safeguard the interest of debenture holders.

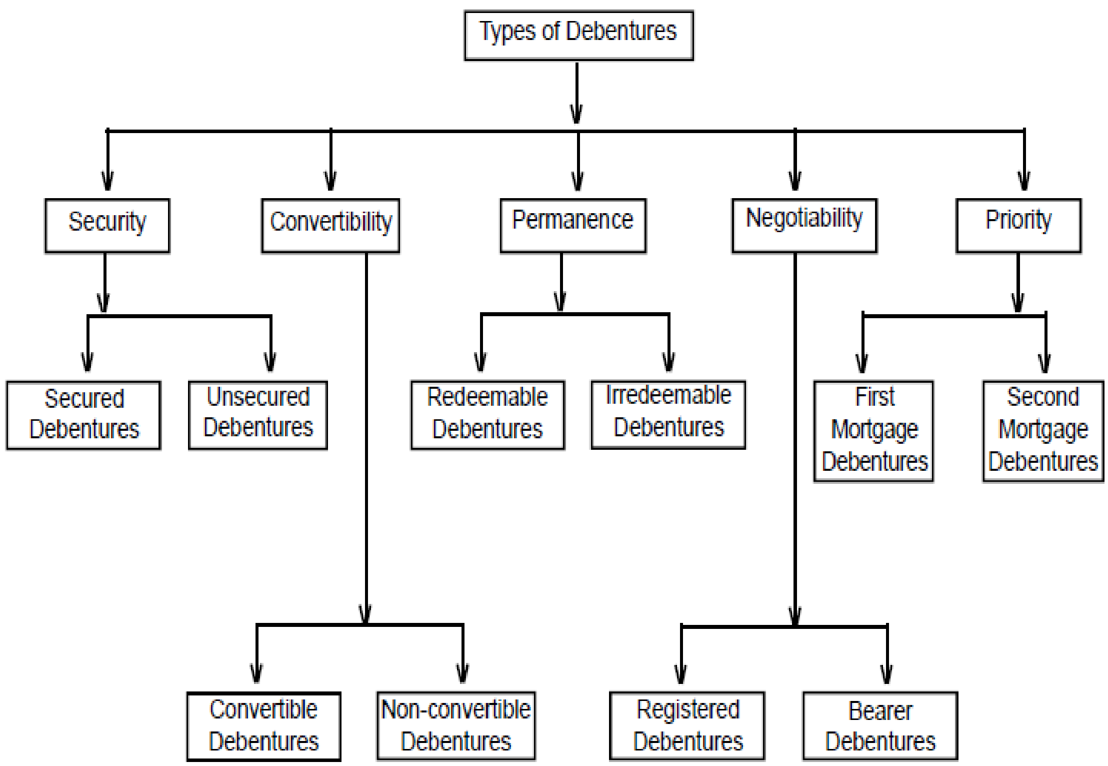
2. **Features of Debentures**
   1. It is a Document which evidences a loan made to a company.
   2. It is a fixed interest-bearing security where interest falls due on specific dates.
   3. Interest is payable at a predetermined fixed rates, regardless of the level of profit.
   4. The Original sum is repaid at a specified future date or it is converted into shares or other debentures
   5. It may or may not create a charge on the assets of a company as securities.
   6. It can generally be bought or sold through the stock exchange at a price above or below its face value.

3. Distinction Between Debentures And Shares

S.No.	Debentures	Shares
1.	Debenture holder are the creditors of the company.	Shareholders are the owners of the Company.
2.	Debenture holders have no voting rights and consequently do not pose any threat to the existing control of the company	Share holders have voting rights and consequently control the total affairs of the Company.
3.	Debenture interest is paid at a pre-determined fixed rate. It is payable, whether there is any profit or not. Debentures rank ahead of all types of shares for payment of the interest due on them.	Dividend on equity shares is paid at a variable rate which is vastly affected by the profits of the company (However, dividend on preference shares is paid at a fixed rate.)
4.	Interest on Debentures are the charges against profits and they are deductible as an expenses in determining taxable profit of the company.	Dividends are appropriation of profits and these are not deductible in determining taxable profit of the company.
5.	There are different kinds of debentures, such as Secured/ Unsecured ; Redeemable /Irredeemable; Registered/Bearers; Convertible/Non- convertible, etc.	There are only two kinds of shares- Equity Shares& Preference Shares.

6.	In the Company's Balance Sheet , Debentures are shown under "Long Term Borrowing".	In the Company's Balance Sheet shares are shown under "Shareholder's Fund" Detailed in Share Capital of Notes to Accounts.
7.	Debentures can be converted into shares as per the terms of issue of the debentures.	Shares cannot be converted into debentures in any circumstances.
8.	Debentures cannot be forfeited for non-payment of call moneys.	Shares can be forfeited for non-payment of allotment and call moneys.
9.	At maturity, debenture holders get back their money as per the terms and conditions of redemption.	Equity Shareholders cannot get back their money before the liquidation of the company (however, preference shareholders can get back their money before liquidation.)
10.	At the time of Liquidation, debenture holders are paid- off before the shareholders.	At the time of Liquidation, shareholders are paid at last after paying debenture holders, Trade payable,etc.

27. Types Of Debentures



28. Security

A. **Secured Debentures-**These Debentures are secured by a charge upon some or all assets of the company.

There are two types of charges:

i. Fixed Charges
ii. Floating Charge.

A fixed charge is a mortgage on specific asset. These assts cannot be sold without the consent of the debentures holders. The sale proceeds of these assets are utilized first for repaying debentures holders. A Floating charge generally covers all the assets of the company including future one.

B. **Unsecured or "Naked" Debenture-** These Debenture are not secured by any charge upon any assets. A Company merely promises to pay interest on due dates and to the repay the amount due on maturity date. These types of debentures are very risky from the view point of investors.

29. Convertibility

a) **Convertible Debentures-** These are debentures which will be converted into equity shares(Either at par or premium or discount) after a certain period of time from the date of its issue. These debentures may be fully or partly convertible. In Future, these debenture holders get a chance to become the shareholder of the company.

b) **Non-Convertible Debentures-**These are debentures which can not be converted into shares in future. As per the terms of issue, these debentures are repaid.

30. Permanence

a) **Redeemable Debentures-**These debentures are repayable as per the terms of issue, for example, after8 years from the date of issue.

b) **Irredeemable Debentures-**These Debentures are not repayable during the life time of the company. These are also called perpetual debentures. These are repaid only at the time of liquidation

31. Negotiability

a) **Registered Debentures-** These Debentures are payable to a registered holder whose name, address and particulars of holding is recorded in the Register of Debenture holders. They are not easily transferable.

b) **Bearer Debentures-** These debentures are transferable by delivery. These are negotiable instruments payable to the bearer. No kind of record is kept by the company in respect of the holders of such debentures. Therefore, the interest on it is paid to the holder irrespective of any identity. No transfer deed is required for transfer of such debentures.

32. Priority

a) **First Mortgage Debentures-**These debentures are payable first out of the property charged.

b) **Second Mortgage Debentures-**These debentures are payable after satisfying the first mortgage debentures.

33. Accounting Entries for issue of Redeemable Debentures-Issue of Redeemable Debentures can be categorized into the following.

1. Debenture issued at a par and redeemable at par or at a discount;
2. Debenture issued at a discount and redeemable at par or at discount;
3. Debenture issued at premium and redeemable at par or at discount;
4. Debenture issued at par and redeemable at premium;
5. Debenture issued at a discount and redeemable at premium;
6. Debenture issued at premium and redeemable at premium;

34. Issue of debentures As Collateral Security

Collateral security means secondary or supporting security for a ,loan which can be realized by the lender in the event of the original loan not being repaid on the due date. Under this arrangement the borrower agrees that the particular assets will be realized and the proceeds there from will be applied to repay the loan in the event that the amount due, cannot be paid.

Sometimes companies issue their own debentures as collateral security for a loan or a fluctuating overdraft. When the loan is repaid on the due date , these debentures are at once released with the main security. In case, the Company cannot repay its loan and the interest thereon on the due date, the lender becomes the debenture holder who can exercise all the rights of a debentures holder.

35. Interest on Debentures

Interest payable on coupon debenture is treated as a charge against the profits of the company. Interest on debenture is paid periodically and is calculated at coupon rate on the nominal value of debentures.

Self Examination Question

1. Which of the following statement is true?
    a. A Debenture holder is an owner of the company
    b. A Debenture holder can get his money back only on the liquidation of the company
    c. A Debenture issued at a discount can be redeemed at a premium
    d. A Debenture holder receives interest only in the event of profits

2. Premium on redemption of debentures account appearing in the balance sheet is…………
    a. A Real Account

b. A Nominal Account
c. A Personal Account- Income
d. A Nominal Account-Expenditure

3. Which Of the following statement is false?
   a. At Maturity, debenture holders get back their money as per the terms and conditions of redemption
   b. Debentures can be forfeited for nonpayment of call money
   c. In Company's balance sheet, debentures are shown under secured loans
   d. Interest on debentures is charged against profits

4. Which of the following statement is false?
   a. A Company can issue convertible debentures
   b. Debentures cannot be secured
   c. A Company can issue redeemable debentures
   d. Debentures have no right to participate in profits over and above their fixed interest

5. Debenture Interest
   a. Is Payable only in case of profits
   b. Accumulates in case of losses or inadequate profits
   c. Is Payable after the payment of preference dividend but before the payment of equity dividend
   d. Is Payable before the payment of any dividend on shares

6. Which of the following is not a characteristic of Bearer Debentures?
   a. They are treated as negotiable instruments
   b. Their transfer requires a deed of transfer
   c. They are transferable by mere delivery
   d. The interest on it is paid to the holder irrespective of identity.

7. Which of the following is/are true with respect to debenture?
   a. They can be issued for cash
   b. They can be issued for consideration other than cash
   c. They cannot be issued as collateral security
   d. Both(a) and (b) above

8. When debentures are issued as collateral security, the final entry for recording the collateral debentures in the books is………………
   a. Credit Debentures A/c and debit Cash A/c.
   b. Debit Debenture suspense A/c and credit Cash A/c.
   c. Debit Debenture suspense A/c and Debentures Cash A/c.
   d. Debit cash A/c and credit the loan A/c for which security is given.

9. Which of the following is false ?
   a. A company can issue redeemable debentures

b. A company can issue debentures with voting rights
c. A company can buy its own shares
d. A company can buy its own debentures

10. Which of the following is false with respect to debentures?
- **a.** They can be issued for cash
- **b.** They can be issued for consideration other than cash
- **c.** They can be issued as collateral security
- **d.** They can be issued in lieu of dividends

11. Debentures can be…………..
- i. Mortgage Debentures or Simple Debentures.
- ii. Registered Debentures or Bearer Debentures.
- iii. Redeemable Debentures or Irredeemable Debentures.
- iv. Convertible Debentures or Non-convertible Debentures.
- **a.** Both(I) and (II) above
- **b.** Both (I) and (III) above
- **c.** Both (II) and (III) above
- **d.** All of (I),(II),(III) and (IV) above.

12. Which of the following statement is false?
- **a.** Debentures is a from of public borrowing
- **b.** It is customary to prefix debentures with agreed rate of interest in case of fixed interest
- **c.** Debenture interest is a charge against profits
- **d.** The issue price and redemption value of debentures cannot differ.

13. Interest on debentures is calculated on
- **a.** Its face value
- **b.** Its issue price
- **c.** Its market price
- **d.** Its redemption price

14. P Ltd issued 5,000,12% debentures of Rs.100 each at a premium of 10%, which are redeemable after 10 years at a premium of 20%. The amount of loss on redemption of debentures to be written off every Year =?
- **a.** Rs.80,000
- **b.** Rs.40,000
- **c.** Rs.10,000
- **d.** Rs.8,000

15. Which of the following is false?
- **a.** Equity is owner stake and the debentures is a debenture is a debt
- **b.** Rate of interest on debentures is fixed
- **c.** Debenture holders get preferential treatment over the equity holders at the time of

liquidation

d. Interest on debentures is an appropriation of profits.

16. Discount on issue of debentures is a………………………..

a. Revenue loss to be charged in the year of issue

b. Capital loss to be written off from capital reserve

c. Capital loss to be written off over the tenure of the debentures

d. Capital loss to be shown as goodwill

17. When debentures are issued as collateral security any loan then holder of such debentures is entitled to

a. Interest only on the amount of loan

b. Interest only on the face value of debentures

c. Interest both on the amount of the loan and on the debentures

d. None of the above

18. When Debentures are redeemable at different dates, the total amount on issue of debentures should be written off

a. Every year by applying the sum of the year's digit method

b. Every year by applying the straight line method

c. To profit & loss account in full in the year of final or last redemption

d. To profit & loss account in full in the year of first redemption

ANSWER

1. (c)
2. (c)
3. (b)
4. (b)
5. (d)
6. (b)
7. (d)
8. (c)
9. (b)
10. (d)
11. (d)
12. (d)
13. (a)
14. (c)
15. (d)
16. (c)
17. (a)
18. (a)

Chapter-12

Unit-1

Accounting for Specific Business and Transactions

1. **Branch Accounting**- In this Method, A business opens different branches at different geographical locations to facilitate and expand its business activities. Each branch is treated as an individual entity.

   (A) Methods of Accounting for Branch Accounting

   Following Method of Accounting cab be used:

   1. **Debtors Method-**Under this method, head office maintain a branch account. Goods and cash sent to branches are debited to this account and goods and cash received from branch are credited to this account.
   2. **Branch Trading And Profit & Loss Account Method-** Under this method, head office prepares
      - Profit & Loss Account
      - Branch Account, treating each branch as a separate entity.
   3. **Stock Debtors Method-**Under this method, head office opens the following accounts:
      - Branch Stock Account
      - Branch Debtors Account
      - Branch Asset Account
      - Branch Expenses Account
      - Branch Adjustment Account
      - Branch Profit & Loss Account

2. **Hire-Purchase-** It is an agreement between two parties in which one party purchases an asset and promises to pay the price of the asset along with interest in a series of installments. The distinct

feature of this arrangement is that the ownership of the asset remains with the seller, unless and until the last instalment is received by him .The Seller has a right to repossess the asset if the buyer defaults in the payment of instalments

(A) Accounting Method for Hire-Purchase Transaction

1. **Cash Price Method-**Under this method, transactions and event are recorded as they happen
2. **Interest Suspense Method-**Under this method, full amount of interest due from the hire-purchase is credited to interest suspense account in the books of hire vendor. When interest becomes due, interest suspense account is debited and interest account is credited.
3. **Trading Method-**In this method, a hire-purchase trading account is prepared in the books of hire vendor to record the transaction relating to hire-purchase.
4. **Stock and Debtor Method-**In this method, hire purchase stock, hire –purchase debtors and hire-purchase adjustment accounts are maintained in the books of vendor.

Unit-2

Corporate Accounting

1. Some Important Terms Related to Shares

- **Right Issue-**It refers to the right of the existing Shareholders to subscribe in proportion of their existing holding to the shares issued by a company.
- **Private Placement of Shares-**It refers to issue and allotment of shares to a selected group of persons privately and not to general public. In order to issue share through this route, a company should pass a special resolution.
- **Sweat Equity Shares-** These are equity shares issued by a company to its employees and Directors at a discount or for consideration other than cash for. Providing know-how or making available rights in the nature of intellectual property.
- **Employees Stock Option Scheme –**It is scheme under which the company grants an option to an employee to apply for shares of the company at a predetermined price.
- **Employees Stock Purchase Scheme-**It is a scheme under which a company offers shares to its employees as part of a public issue or otherwise.
- **Buy-Back Shares-**It means purchasing of own shares by the company of immediate cancellation. Important provisions relating to buy-back are (Section 68)
    - A company may purchase its own shares out of
        a. Free Reserve
        b. Securities Premium Reserve Account
        c. The proceeds of an earlier issue of shares. However, no buy-back can be done out of proceeds of an earlier issue of same kind of Shares.
    - For Buy-Back, the following conditions must be fulfilled

a. Buy-Back should be authorised by the Articles of Association of company.
b. A Company may buy-back upto 10% of the aggregate of paid-up equity capital and free reserves

2. **Issue And Redemption of Preference shares-**Section 55 of the Companies Act provides for the issue and redemption of Preference Shares. This Section prescribes that such shares can be redeemed either out of the profits of the company or out of the proceeds of a fresh issue of shares made for the purpose of redemption. Also, unless the shares are fully paid –up they cannot be redeemed. Where such shares are redeemed out of profits, a sum equal to the nominal amount of the shares so redeemed must be transferred out of the profits to a reserve fund called 'Capital Redemption Reserve Account'. If any premium is to be payable on redemption, such premium has to be provided out of the profits of the company or out of securities premium account.
3. **Amalgamation of Companies-**Amalgamation is an event in which two or more companies are brought under common control in a single legal entity. Amalgamation may take one of the following forms:
   - **Merger-**In this case, both the combining companies are dissolved and assets and liabilities are transferred to a newly created company.
   - **Acquisition-**In this case only one of the combining companies survive and the other losses its separate identify.

   Types of Amalgamation

   According to AS-14 amalgamation can be of two types
   - Amalgamation in the nature of merger, and
   - Amalgamation in the nature of purchase

Method of Accounting for Amalgamation

There two main methods for accounting for amalgamation

- Pooling of Interest Method
- Purchase Method

4. **Holding & Subsidiary Company-**Holding Company is one which acquires all or a majority of the equity shares of any other company called subsidiary company in order to have control over it.

   Subsidiary Company in relation to any other company, means a company in which the holding company:

   - Controls the Composition of the Board of Directors.
   - Exercises or Controls more than one-half of the total Share Capital.

5. **Consolidated Financial Statements-**Section 129(3) provides that where a company has one or more subsidiaries, It shall, in addition to financial statements, prepare a consolidated financial statement of the company and of all the subsidiaries in accordance with the provision of Schedule III of Companies Act, 2013

6. Cash Flow Statement

It is a statement showing the changes in financial position of a business concern during different intervals of time in terms of cash and cash equivalents.

- **Cash Flows** It implies movement of cash in and out of non-cash items. Receipt of cash from a non-cash item is termed as cash inflow while cash payment in respect of such items is termed as cash outflow.
- **Cash and Cash Equivalents** As per AS-3, cash' comprises cash in hand and demand deposits with banks and 'cash equivalents means short-term highly liquid investments that are readily convertible into known amounts of cash and which are subjected to an insignificant risk of changes in value. E.g. Short-term marketable securities, which can be readily converted into cash, are treated as cash equivalents.
- **Classification of Business Activities**

Accounting Standard-3 Revised) requires that the changes resulting in inflows and outflows of cash and cash equivalents be classified into following three activities.

- **Cash Flow from operating Activities -**Operating activities are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.

Operating Activities

Cash Inflow	**Cash Outflow**
Cash sales	Cash purchases
Cash received from debtors	Payment to creditors

Cash received from	Cash operating expenses
Commission and fees	Payment of wages
Royalty	Income tax

For a Finance Company

Cash received for interest and dividends	Cash paid for interest
Sale of securities	Purchase of securities

For an Insurance Company

Premiums and claims received	Premiums and claims paid

For a Real Estate (Infrastructure**) Company**

Rent received	Rent paid

- **Cash Flow from Investing Activities-** As per AS-3, investing activities are the acquisition and disposal of the long-term assets and other investments not included in cash equivalents.

Cash flow from investing activities are exhibited as follow

Investing Activities

Cash Inflow	**Cash Outflow**
Sale of fixed assets	Purchase of fixed assets

Sale of investments	Purchase of investments
Interest received	Income tax (If identified with investing activities)
Dividends received	
Rent received	

- **Cash Flow from Financing Activities -**These are the activities which result in change in the issue and composition of the owner's capital (including preference share capital) and borrowings (including debentures) of the enterprise from other sources.

Cash flow arising from financing activities are exhibited as follows

Financing activities

Cash inflow	**Cash outflow**
Issue of shares in cash	Payments of loans
Issue of debenture in cash	Redemptions of preference shares, debentures
Proceeds from long-term	Buy-back of equity shares
Borrowings	Payment of dividend
Increase in balance of bank	Payment of interest
Overdraft or cash credit account	Premium paid on redemption of preference shares, debentures
	Decrease in balance of bank overdraft or cash credit account
	Income tax (if identified with financing activities)

➢ Format of Cash Flow Statement

Indirect Method [As per Accounting Standard-3 (Revised)] for the year end….

	Particulars		Amt (₹)
I.	**Cash Flow from Operating Activities**		
	Net Profit before Taxation and Extraordinary Items		
	Adjustments for		…
	(+) **items to be Added**		
	Depreciation	…	
	Goodwill, Patents and Trademarks Amortized	…	
	Interest on Borrowings and Debentures	…	
	Loss on Sale of Fixed Assets	…	
	Increase in Provision for Doubtful Debts	…	
	(-) **items to be Deducted**		
	Interest Income	(…)	
	Dividend Income	(…)	…
	Rental Income	(…)	
	Gain (Profit) on Sale of Fixed Assets	(…)	
	Operating Profit before Working Capital Changes		
	(+) Decrease in Current Assets and Increase in Current Liabilities		
	(-) Increase in Current Assets and Decrease in Current Liabilities		(…)
	Cash Generated from Operations		
	(-) Income Tax Paid (Net of tax refund received)		
	Cash Flow before Extraordinary items		
	(+/-) Extraordinary Items		…
	Net Cash from (or used in) Operating Activities		…
II.	**Cash Flow from Investing Activities**		(…)
	Proceeds from Sale of Tangible Fixed Assets	…	
	Proceeds from Sale of Investments (Other than marketable securities)	…	…
			(…)
	Proceeds from Sale of Intangible Fixed Assets	…	

	Interest and Dividend Received (For non-financial companies only)	…	…
	Rent Received	…	…
	Purchase of Tangible Fixed Assets	(…)	…
	Purchase of Investments (Other than marketable securities)	(…)	
	Purchase of Intangible Fixed Assets like Goodwill	(…)	
	(+/-) Extraordinary items	…	
	Net Cash from (or used in) Investing Activities		
III.	**Cash Flow from Financing Activities**		
	Proceeds from Issue of Shares and Debentures	…	
	Proceeds from Other Long-term Borrowings	…	
	Increase/Decrease in Bank Overdraft and Cash Credit	…	
	Final Dividend Paid	(…)	
	Interim Dividend Paid	(…)	
	Interest on Debentures and Loans	(…)	
	Repayment of Loans	(…)	
	Redemption of Debentures/Preference Shares	(…)	
	(+/-) Extraordinary Items	…	
	Net Cash from (or used in) Financing Activities		
IV.	**Net Increase/Decrease in Cash and Cash Equivalents** (I + II + III)		
V.	(+) **Cash and Cash Equivalents in the Beginning of the Year**		…
	Cash in Hand	…	
	Cash at Bank	…	
	Short-term Deposits	…	
	Marketable Securities	…	
VI.	**Cash and Cash Equivalents at the End of the Year**		
	Cash in Hand	…	
	Cash at Bank	…	
	Short-term Deposits	…	
	Marketable Securities	…	

- Amounts in brackets indicate negative amounts, i.e. , amounts that are to be deducted
- Increase/decrease in unpaid interest on debentures/loans affects the cash flow from financing activities and not from the operating activities.
- Increase/decrease in unclaimed dividend affects the cash flow from financing activities and not from the operating activities.
- Increase/decrease in accrued interest on investments affects the cash flow from investing and not from the operating activities.

Self Examination Questions

1. In case of a financial enterprise, interest received on debentures held as investment is-
   - **a.** Financing activity
   - **b.** Investing activity
   - **c.** Operating activity
   - **d.** None of the above.
2. Cash payments to and on behalf of employees is an example of cash flow from-
   - **a.** Operating activity
   - **b.** Investing activity
   - **c.** Financing activity
   - **d.** None of the above.
3. Net profit before working capital changes of super Ltd. Is Rs435000. Changes in working capital during the year are as follows :

Particulars	Rs
Decrease in stock	258000
Decrease in bills payable	8400
Increase in bills receivable	38800
Increase in prepaid expenses	2500
Increase in outstanding expenses	7800

Cash generated from operation for super Ltd. Will be-

- **a.** Rs 218900
- **b.** Rs 745500
- **c.** Rs 651100
- **d.** Rs 234500

4. In cash flow statement, interest received by company is classified as-
   a. Operating activities
   b. Cash and cash equivalents
   c. Investing activities
   d. Financing activities.
5. In cash flow statement, dividend paid in case of financing company is classified as-
   a. Operating activities
   b. Investing activities
   c. Financing activities
   d. Cash and cash equivalents.
6. The purchase of machinery by issuing long-term notes payable should be reported as a-
   a. Non-cash investing and financing activity
   b. Cash outflow in the operating activity
   c. Cash outflow in the investing activity
   d. Cash outflow in the financing activity
7. Balance of investment account is Rs20000 on 31st March, 2014 and Rs 30000 on 31st March, 2015. As per additional information, dividend received Rs3000 includes Rs1000 from pre-acquisition profit which is credited to investment account. The amount of investment purchased/sold during the year 2014-2015-
   a. Rs13000 Purchased
   b. Rs11000 Purchased
   c. Rs9000 Purchased
   d. Rs9000 Sold.
8. Which statement contains opening as well as closing balances of cash and cash equivalents and prepared on accrual basis-
   a. Cash flow statement
   b. Fund flow statement
   c. Both (A) and (B) above
   d. Statement of income and expenditure

Answer

1- (c)
2- (a)
3- (c)
4- (c)
5- (a)
6- (a)
7- (a)
8- (c)

Unit-3

Management Accounting

1.Tools and Technique of Management Accounting-A Management Accountant generally uses the following tools and techniques:

- Financial Planning
- Financial Statement Analysis
- Decision Making
- Control Techniques

2. Common Size and Comparative Statements

- **Common size statement** is a statement in which amount of individual items of balance sheet and statement of profit and loss for two or more years are converted into percentage, taking a common base.

  The common base in case of balance sheet is the total of the balance sheet and in case of statement of profit & loss it is net sales.

- **Comparative Statement** are a tool of financial analysis that shows change in each item of the financial statements in both absolute terms and in percentage, taking the item in preceding accounting period as base.

3. **Ratio Analysis-**It is an art of determining relationship between different components of financial statement so as to be able to get meaningful information relating to the profitability and solvency of business.

A. Objectives of Ratio Analysis

- Estimation of business earnings
- Solvency determination
- Formulation of policies
- Judging managerial efficiency
- Making comparison

Quick View

	Ratio	Formula	Explanation
		Liquidity Ratio	
1.	**Current ratio**	$\frac{current\ assets}{current\ liabilties}$ = ……….	**Current assets =** current investments + inventories (excluding stores and spares and loose tools) + trade receivables (net of provision for doubtful debts) + cash and cash equivalents + short-term loans and advances + other current assets **Current liabilities =** short-term borrowings + trade payables + other current liabilities + short-term provisions
2.	**Liquid ratio/ acid test ratio/ quick ratio**	$\frac{quick\ assets\ or\ liquid\ assets}{current\ liabilities}$ = ………	**Quick assets =** current assets – inventories – prepaid expenses
		Solvency ratios	
1.	**Debt equity ratio**	$\frac{debt}{equity\ (shareholders'\ funds)}$ = ………	**Debt =** long-term borrowings (i.e., debentures, mortgages, public deposits) + long-term provisions **Shareholders' funds =** share capital + reserves and surplus Or Non-current assets (tangible assets + intangible assets + non-current investments + long-term loans and advance) + working capital – non-current liabilities (long-term borrowings + long-term provisions) working capital = current assets – current liabilities
2.	**Total assets to debt ratio**	$\frac{total\ assets}{long-term\ debts}$ = ……….	**Total assets =** non-current assets (tangible assets + intangible assets + non-current investments + long-term

			loans and advance) + current assets [current investments + inventories (including stores and spares and loose tools) + trade receivables + cash and cash equivalents + short-term loans and advances] + other current assets **Debt =** long-term borrowings + long-term provisions
3.	**Proprietary ratio**	$\frac{shareholders' funds\ or\ proprietors' funds}{total\ assets}$ = …….%	**Shareholders' funds =** share capital + reserves and surplus **Total assets** as per total assets to debt ratio.
4.	**Interest coverage ratio**	$\frac{net\ profit\ before\ interest\ and\ tax}{interest\ on\ long-term\ debt}$ = ….. times	**Profit before interest and tax =** profit after + tax + interest
		Activity ratios/turnover ratios	
1.	**Inventory** (stock) **turnover ratio**	$\frac{cost\ of\ revenue\ from\ operations}{average\ inventory}$ = ….times	**Average inventory or stock =** $\frac{\text{opening inventory or stock} + closing\ inventory\ or\ stock}{2}$ Trade receivables means debtors plus bills receivables. Provisions for doubtful debts is not deducted.
2.	**Trade receivables or debtors turnover ratio**	$\frac{credit\ revenue\ from\ operations}{average\ trade\ receivables}$ = ……times	**Average trade receivables =** $\frac{(\text{opening debtors + opening bills receivables}) + (\text{closing debtors + closing bills receivables})}{\mathbf{2}}$ Trade payables means creditors plus bills payable.
3.	**Trade payables or creditors' turnover ratio**	$\frac{net\ credit\ purchases}{average\ trade\ payables}$= ……time	**Average trade payables** = $\frac{(opening\ creditors + opening\ bills\ payables) + (closing\ creditors + closing\ bills\ payables}{2}$

4.	**Working capital turnover ratio**	$\frac{revenue\ from\ operations}{workings\ capital}$ = ……..times	**Working capital =** current assets – current liabilities Current assets = as per current ratio Current liabilities = as per current ratio
		Profitability ratios	
1.	**Gross profit ratio**	$\frac{gross\ profit}{revenue\ from\ operations}$ × 100 = …… %	**Gross profit =** revenue from operations – cost of revenue from operations cost of revenue from operations = opening inventory (excluding stores and spares and loose tools) + net purchases + direct expenses – closing inventory(excluding stores and spares and loose tools) Or Revenue from operations – gross profit Or Cost of materials consumed + purchases of stock-in-trade + change in inventories of finished goods, WIP and stock-in-trade + direct expenses If direct expenses are not given, assume it to be nil.
2.	**Opening ratio**	$\frac{cost\ of\ revenue\ from\ operations + operatings\ expenses}{revenue\ from\ operations} \times 100 =$ ……..%	**Cost of revenue from operations =** opening inventory (excluding stores and spares and loose tools) + net purchases + direct expenses – closing inventory (excluding stores and spares and loose tools) Or Revenue from operations – gross profit Or Cost of materials consumed + purchases of stock-in-trade + change in inventories of finished goods, WIP and

			stock-in-trade + direct expenses If direct expenses are not given, assume it to be nil. **Revenue from operations =** sales – sales return **Operating expenses =** employees benefits expenses + other expenses (other than non-operating expenses).
3.	**Operating profit ratio**	$\frac{operating\ profit}{revenue\ from\ operations}$ × 100 = ………%	**Operating profit =** net profit (before tax) + non-operating expenses – non-operating income Or Gross profit + operating income – operating expenses Non-operating expenses = interest on long-term borrowings + loss on sale of fixed assets or non-current assets Non-operating income = interest received on investments + profit on sale of fixed assets or non-current assets
4.	**Net profit ratio**	$\frac{net\ profit\ before\ interest\ and\ tax}{revenue\ from\ operations}$ × 100 ……..%	**Net profit before interest and tax =** gross profit + other income – indirect expenses
5.	**Return on investments or return on capital employed**	$\frac{net\ profit\ before\ interst\ tax\ and\ preference\ dividend}{capital\ employed}$ × 100 = ………%	**Capital employed** liabilities approach: share capital + reserves and surplus + long-term borrowings + long-term provisions Assets approach: non-current assets (tangible assets + intangible assets) + non-current investment + long-term loans and advances + working capital =

			current assets – current liabilities (assume that all non-current investments are trade investments). (interest on non-trade investments should be deducted from profit before interest, tax and dividend).
6.	**Earning Per share**	$\frac{profit\ after\ tax - prefence\ dividend}{Number\ of\ Equit\ Share}$	

5. Zero- Base Budgeting-It may be defined as a planning and budgeting process which requires each manager to justify his entire budget requirement in detail and convenience the management about his requirement. The managers cannot take help from historical data.

6. Fund Flow Statement-It is a statement in which the changes in the financial position of a business unit are studied. It is a statement showing source and uses of funds for a period of time. Fund means working capital.

So, basically a fund flow statement studies the changes in current assets and current liabilities in the course of an accounting year.

<u>Exercise</u>

1. The role of management accounting does not normally include the function of
   a. Cash Management
   b. Product Costing
   c. Planning and Control
   d. Decision Making
2. In relation to a company, creditors are least concerned with
   a. Its Solvency
   b. Its Short-term liquidity
   c. Its future share price
   d. Its profitability
3. In comparative analysis of financial statement, the technique used is

a. Returning analysis
b. Preference analysis
c. Common size analysis
d. Graphical analysis

4. The net income available for shareholders is Rs.1,12,500 and total assets (excluding fictitious assets) are Rs 25,00,000. Then return on equity will be
   a. 4.5%
   b. 5%
   c. 10%
   d. 12%
5. The price her share is Rs. 250 and the cash flow per share is Rs.12.5.The price of cash flow ratio will be
   a. 5 Times
   b. 20 Times
   c. 10 Times
   d. None of these
6. The price her share is Rs.250 and the cash flow per share is Rs.12.5. The price to cash flow ratio will be
   a. 5 Times
   b. 20 Times
   c. 10 Times
   d. None of these
7. The Profit Margin of a firm is 5.2% assets turnover is 3.2 times and equity multiplier is 2.2 times. Then return on assets will be
   a. 36.6%
   b. 7.56%
   c. 3.575%
   d. 1.35%
8. The Formula: $\frac{Net\ income\ available\ for\ shareholders}{Total\ Assets}$ is used to calculate
   a. Return on total equity
   b. Return on total debt
   c. Return on total assets

d. None of these

9. The price per ratio divided by cash flow per share ratio is used to calculate
   a. Cash flow to price ratio
   b. Price to cash flow ratio
   c. Dividend to stock ratio
   d. None of these

10. The net income available for shareholders is Rs.21,25,000 and total assets are Rs. 1,75,00,000.Return on total assets will be
   a. 20.8%
   b. 15.3%
   c. 14.6%
   d. 12.14%

11. The Debt equity ratio of a firm is 2:1.the amount of debt is Rs.4,00,000. What will be the value of the total assets of the company?
   a. Rs.4,00,000
   b. Rs.8,00,000
   c. Rs.6,00,000
   d. Rs.2,00,000

12. The ideal debt equity ratio is
   a. 1:1
   b. 1:2
   c. 2:1
   d. 3:1

13. For a company, the current ratio and the quick ratio for 2014 were 3:1 and 2:1 respectively. For the some company, these ratios were 3:1 and 1:1 in 2015.This is Indicative of
   a. Higher liquidity

b. Higher Stock

c. Lower liquidity

d. Lower stock

14. Authorised share capital of a company is Rs.5 Lakh. 40% of it is paid-up. Loss incurred during the year is Rs.50,000.Accumulated loss carried forward from the last year is Rs.2 lakhs. The company has a net worth of

a. Rs.1 Lakh

b. –Rs.5,000

c. Rs.2.5 Lakh

d. Nil

15. Proprietary ratio is calculated by

a. Total Assets/Total Outside Liability

b. Total outside liability/total tangible assets

c. Fixed Assets/ Long-term source of fund

d. Proprietors 'fund/ total tangible assets

16. Current ratio of a business is 1:1. Its net working capital will be

a. Positive

b. Negative

c. Nil

d. Cannot be computed

17. Current ratio of a business is 4:1.Its net working capital is Rs.3,00,000.Find the value of current assets.

a. Rs.4,00,000

b. Rs.3,00,000

c. Rs.2,00,000

d. None of these

18. Current ratio of company is 2.5.Its current liability is Rs.3,00,000. The net working capital for the business will be

- **a.** Rs.1,80,000
- **b.** Rs.3,00,00
- **c.** -Rs.1,80,000
- **d.** -Rs.3,00,00

19. Financial leverage means

- **a.** Use of more debt capital to increase profit
- **b.** High degree of solvency
- **c.** Low bank finance
- **d.** None of the above

20. The capital gearing ratio is high for a company. It indicates a position of

- **a.** Low debts
- **b.** High Preference Capital
- **c.** High Equity
- **d.** Low debt-equity ratio

21. Capital employed can be calculated with the help of following formula

- **a.** Share capital+ Reserve and Surplus+ Long-term loans +non-operating assets +Fictitious assets
- **b.** Share capital+ Reserve and Surplus+ Long-term loans-non-operating assets-Fictitious assets
- **c.** Share capital+ Reserve and Surplus-Long-term loans+ non-operating assets-Fictitious assets
- **d.** Share capital-Reserve and Surplus +Long-term loans +non-operating assets-Fictitious assets

22. Return on shareholder's fund =

a. $\frac{Net\, profit\, after\, interest\, and\, Tax}{Sharehoders'fund}$×100

b. $\frac{Net\, profit\, before\, interest\ \ Tax}{Sharehoders'fund}$×100

c. $\frac{Net\, profit\, before\, interest\, before\ \ Tax}{Sharehoders'fund}$×100

d. $\frac{Net\, profit\, after\ \ interest\ \ Tax\, and\, preference\, dividend}{dxSharehoders'fund}$×100

23. Which ratio expresses the relationship between gross profit and net sales?

- **a.** Activity Ratio
- **b.** Operating ratio
- **c.** Gross Profit Ratio
- **d.** Net profit Ratio

24. Fixed assets turnover ratio =

- **a.** Net Assets- Fixed Assets
- **b.** Net Assets+ Fixed Assets
- **c.** Net Assets× Fixed Assets
- **d.** Net Assets/ Fixed Assets

25. Current liabilities of a firm are Rs1,50,000. Its current ratio is 3:1 and liquid ratio is 1:1.The value of stock will be-----

- **a.** Rs3,00,000
- **b.** rs4,50,000
- **c.** Rs2,50,000
- **d.** Rs1,50,000

26. Stock turnover : 6 times
Total sales : Rs. 3,00,000
Gross profit ratio : 20%
Closing stock : Rs4,000 more than opening stock
The opening stock is ------

- **a.** Rs36,000
- **b.** Rs38,000

c. Rs40,000
d. Rs42,000

27. Which one of the following statements is correct------
a. Lower debt equity ratio means lower financial risk
b. Increase in net profit ratio means increase in sales
c. A higher receivable turnover is not desirable.
d. Interest coverage ratio depends upon tax rate.

28. Which of the following statement(s) is/are true :
I. Common size balance sheet is vertical financial analysis.
II. Financial analysis performed on behalf of shareholders is called internal analysis
III. Trend percentage may be used for both balance sheet and profit and loss account.

Select the correct answer from the options given below------
a. (i) and (iii)
b. (ii) and (iii)
c. (i) and (iii)
d. (ii) only.

29. Cost of goods sold : Rs4,00,000
Administration and office expense : Rs35,000
Selling and distribution expenses : Rs45,000
Net credit sales : Rs4,75,000
Cash sales : Rs 125000
Operating profit ratio will be-
(a) 30%
(b) 35%
(c) 20%
(d) 25%

30. Current ratio is 2.5 and liquid ratio is 1.5 Working capital is Rs 75000.
Value of the products.
(a) Rs 60000

(b) Rs 100000
(c) Rs 50000
(d) None of the above

31. Determine a firm's total assets turnover, if its net profits margin is 8%, total assets are Rs800000 and the return on investment is 14%
(a) 2.05
(b) 4.00
(c) 1.75
(d) 2.00

32. Match the following :

	List I	List II
p)	Prepaid expenses	1. Solvency ratio
q)	Sales ratio Investment ratio	2. Net profit margin *
r)	Return on investment	3. Turnover ratio
s)	100 minus proprietary ratio	4. Current Asset

Select the correct answer from the options given below-

	P	Q	R	S
(A)	4	3	1	2
(B)	4	3	2	1
(C)	2	1	4	3
(D)	2	4	1	3

33. Which of the following pairs is correctly matched-?

(a) Administrative expenses + Selling and distribution expenses = Operating expenses

(b) (Gross profit / Net sales) * 100 = Net profit ratio

(c) Both (A) and (B) above

(d) None of the above.

34. Return on investment depends on two ratios-

(a) Net profit ratio and capital turnover ratio

(b) Gross profit ratio and net profit ratio

(c) Capital employed ratio and assets turnover ratio

(d) Earnings per share and net profit ratio

35. Financial statement of X Ltd. Shows the following data-

Opening stock	Rs 150000
Total Purchase (Including cash purchase of Rs175000)	Rs 1050000
Closing stock	Rs 120000

Stock turnover ratio is –

(a) 6.70 times
(b) 8 times
(c) 7.2 times
(d) 9 times

36. Equity share capital Rs 30 lakh (30000 shares of Rs 100 each); 9% preference shares: Rs 10 lakh; profit before tax: Rs 24.46 lakh and tax rate 30%. Earnings per share will be-

(a) Rs 54.07
(b) Rs 81.53
(c) Rs 78.53
(d) Rs 57.07

37. The net profit of a company is Rs 200000, preference dividend Rs 25000 and taxes paid Rs 15000. Number of equity shares is 100000. The earnings per share (EPS) is-

a. Rs 1.5
b. Rs 1.6
c. Rs 2
d. Rs 1.75

38. The current ratio of Brave Ltd. Is 2 : 1 while quick ratio is 1.8 : 1. If the current liabilities are Rs 40000, the value of stock will be-

- **a.** Rs 12000
- **b.** Rs 6500
- **c.** Rs 8000
- **d.** Rs 10000

39. In an organization, working capital is Rs100000 and current ratio 3 : 1. The value of current assets is-

- **a.** Rs150000
- **b.** Rs100000
- **c.** Rs50000
- **d.** Rs15000

40. Working capital ratio is also known as-

- **a.** Quick ratio
- **b.** Debt-equity ratio
- **c.** Current ratio
- **d.** Liquid ratio.

41. Credit sales of jump Ltd. For the year is Rs 1200000 and debtors at the end of year Rs240000. Assuming 360 days in a year, average collection period will be-

- **a.** 60 Days
- **b.** 72 Days
- **c.** 180 Days
- **d.** 80 Days

42. For the financial year ended 31st March 2015, the figures extracted from the balance sheet of Excel Ltd. Are as under :

Opening stock	Rs29000
Closing stock	Rs31000
Purchase	Rs242000

The stock turnover ratio will be-

a. 12 times
b. 15 times
c. 9 times

d. 8 times

43. Which of the following is a method used in analyzing financial statements-

a. Variance analysis
b. Trend analysis
c. Break-even analysis
d. Budget analysis.

44. In an organization, current ratio is 2.5,l liquid ratio 1.5, prepaid expenses nil and stock Rs4000. The amount of current liabilities is-

a. Rs20000
b. Rs40000
c. Rs80000
d. Rs4000

45. Find the current liability from the following :

Current ratio	2:5
Liquid ratio	1:5
Prepaid Expenses	Nil
Stock	Rs4000.

a. Rs20000
b. Rs40000
c. Rs80000
d. Rs4000

46. From the following information find the value of closing stock-

Stock velocity : 6 months

Gross profit ratio : 25%

Gross profit for the year ended 31st March 2014 : Rs100000

Closing stock for the period Rs20000 more than it was in the beginning of the year.

a. Rs150000
b. RS140000
c. RS160000
d. Rs70000.

47. 8% Preference share capital : Rs300000
Equity share capital (Rs 10 per share): Rs280000
Profit after 30% tax : Rs280000
Market price of equity share : Rs 40
The earnings per share and the Prices earnings ratio will be-

a. Rs3.50 and 11.43
b. Rs5 and 8
c. Rs4.70 and 8.51
d. Rs3.20 and 12.50

48. If average collection period is 15 days and average account receivables is Rs45000, the total amount of credit sales will be (assume 360 days in a year)

a. Rs1080000
b. Rs1620000
c. Rs675000
d. Rs187500

49. Return on investment is also known as-

a. Du-Pont chart
b. Activity ratio
c. P/V ratio
d. Market test ratio.

50. In ratio analysis, 'proforma analysis' implies-

a. Making a list of all the present ratios of the firm
b. Comparison of liquidity ratios with other kind of ratios of the firm
c. Comparison of liquidity ratios of the firm relating to the performance of the firm
d. Comparison of the firm's past and current ratios with future ratios to ascertain the relative strengths and weaknesses in the past and future

Answer

1. (a)
2. (c)
3. (c)
4. (a)
5. (a)
6. (b)
7. (a)
8. (c)
9. (b)
10. (d)
11. (c)
12. (b)
13. (b)
14. (b)
15. (d)
16. (c)
17. (a)
18. (c)
19. (a)
20. (d)
21. (b)
22. (a)
23. (c)
24. (d)

Fund Flow Statement

1. A company reported current year profit as Rs70,000 after the following adjustments :
   Loss on sale of equipment : Rs9,000
   Premium on debenture Redemption : Rs1,500
   Tax provision : Rs22,000
   Dividend income : Rs4,000
   Profit on revaluation of Fixed asset : Rs2,500
   The amount of fund from operations will be------
   - **a.** Rs96,000
   - **b.** Rs93,000
   - **c.** Rs78,000
   - **d.** Rs61,000
2. If provision for taxation is treated as a current liability, then payment of tax is-
   - **a.** An application of funds
   - **b.** A source of funds
   - **c.** No flow of funds
   - **d.** None of the above
3. Which of the following does not result into inflow of funds in case of fund flow statement-
   - **a.** Issue of equity share Capital
   - **b.** Premium received on issue of share debentures
   - **c.** Sale of investments
   - **d.** Cash received from debtors
4. Which of the following statement is not true-
   - **a.** Fund flow statement is also known as statement of sources and application of funds
   - **b.** Fund is equal to current assets minus current liabilities
   - **c.** There is an inverse relationship between current assets and working capital
   - **d.** Fund flow statement is prepared on accrual basis

Answer- 1. (a) 2. (a) 3. (d) 4. (d)