Collage of Objective Type/Multiple Choice Questions (MCQs)

ANSWERS

1. FINANCIAL STATEMENTS OF NOT-FOR-PROFIT ORGANISATIONS

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) True

Reason: Newspapers when purchased are accounted as revenue expense. Therefore, when old newspapers are sold, it is a revenue income and is credited to Income and Expenditure Account.

(ii) True

Reason: Income and Expenditure Account is a Nominal Account the net result of which is either Surplus (Excess of Income over Expenditure) or Deficit (Excess of Expenditure over Income).

(iii) True

Reason: General/Corpus/Accumulated/Capital Fund is an Unrestricted Fund since it can be used for any of the purposes of the NPO. Surplus earned can be spent by a NPO for any of its objects. Thus, it is credited to General or Accumulated Fund. It comprises of Opening Balance, which is increased by the Surplus for the year and decreased by the deficit.

(iv) False

Reason: Match Fund is a specific fund and expenses incurred out of the fund are deducted from the fund and balance amount is shown in the liabilities side of Balance Sheet.

(v) False

Reason: Subscription received in advance is subscription for the next year or years but received before it is due. Thus, it is not an income for the current year but is income for the year to which it relates. Hence, it is shown as a liability in the current year.

(vi) True

Reason: The terms profit and loss are used to show the financial performance of a business entity whose objective is to earn profit whereas the objective of NPO is not to earn profit. In line with the activity, excess of Income over Expenditure is termed as Surplus.

(vii) False

Reason: Income and Expenditure Account is prepared on Accrual Basis of Accounting as it shows all revenue incomes and expenses for the year, whether the incomes and expenses are cash or non-cash and paid or not.

(viii) False

Reason: Life Membership Fee is a one-time payment received by a NPO from a member to avail the membership of an organisation and also to avail the benefit/services for life without further payment of subscription. Hence, it is Capital Receipt added to Capital/General/Accumulated/Corpus Fund.

(ix) False

Reason: Since Specific Fund does not exist for Billiards Match and expenses incurred are revenue, hence it will be shown in the debit side of the Income and Expenditure Account.

(x) True

Reason: Receipts and Payments Account is an Asset Account (Real Account) which shows classified summary of cash transactions.

(xi) True

Reason: Payments cannot exceed the cash in hand. It can be at the most equal to cash in hand. Therefore, cash balance can be either debit or nil balance.

(xii) True

Reason: NPO although set up by individuals, is not owned by them. Thus, it does not have capital (Owner's Equity) but has fund called Capital Fund, General Fund, Accumulated Fund or Corpus Fund.

(xiii) False

Reason: Excess of Expenditure over Income is Deficit.

(xiv) True

Reason: Honorarium is a token payment made to a person who voluntarily undertakes a service which normally commands a fee. It is an expense for a NPO not resulting in an enduring benefit. Hence, it is revenue expenditure.

(xv) True

Reason: The donor has specified the purpose for which the donation is to be used, *i.e.*, for constructing a gymnasium. Hence, it is a capital receipt to be shown as Gymnasium Fund in the liabilities side of Balance Sheet.

(xvi) False

Reason: ₹ 10,000 (Subscription Received During the year) + ₹ 1,000 (Subscription Outstanding at the end of the year) – ₹ 2,000 (Subscription Outstanding in the beginning of the year) = ₹ 9,000. ₹ 9,000 will be shown in the Income and Expenditure Account.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Honorarium

Reason: Honorarium is a token payment made to a person who voluntarily undertakes a service which normally commands a fee. It is an expense for a NPO not resulting in an enduring benefit. Hence, it is revenue expenditure.

(ii) Fund Based Accounting

(iii) Subscriptions

Reason: Subscription is the amount paid by the member monthly/quarterly/half yearly/yearly so that they can avail the services of the NPO. If they do not pay subscription, they may not be allowed to avail the services.

(iv) Legacy

Reason: Donation may be received by a NPO from a living person or an entity. Legacy is also a Donation, the only difference is that it is received from a deceased person by way of his will or wish.

(v) Balance Sheet, Fund Based

Reason: Amount received as legacy by a NPO use of which is specified is a capital receipt. Since it can be used for that purpose only, Fund Based Accounting is applied.

(vi) Credit, Income and Expenditure Account

Reason: Amount received as legacy by a NPO use of which is not specified is a revenue receipt which can be used by it for any of the objects of the NPO.

(vii) Capital Receipt

Reason: Life Membership Fee is a one-time payment received by a NPO from a person to avail the membership and avail benefit/services for life without further payment of subscription. Hence, it is Capital Receipt.

(viii) Accrual

Reason: Income and Expenditure Account is based on Accrual Basis of Accounting because it shows all revenue incomes and expenses for the year, whether cash or non-cash and whether paid or not.

(ix) Restricted

(x) Entrance/Membership Fees, Income and Expenditure Account

(xi) Assets

(xii) Receipts and Payments Account, Income and Expenditure Account

(xiii) Debit of Income and Expenditure Account

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (a)

Reason: Charitable Organisations are Not-for-Profit Organisation since their object is not to earn profit but to render service to the society. Public Hospital is a Charitable Organisation, since it renders medical services to the society at a nominal fee.

2. (b)

Reason: A NPO is set up for the welfare of the society in general and it is not owned by anyone. Thus, unlike in the case of business entity, surplus is not distributed among members but used further for the objects of the NPO.

3. (c)

Reason: Life Membership Fees is a Capital Receipt and is added to Capital or General or Accumulated or Corpus Fund. If it is wrongly accounted as revenue receipt, it means Surplus for the year is increased by ₹ 5,000. Since Surplus of Income and Expenditure Account is transferred (added) to Capital or General or Accumulated or Corpus Fund, Capital Fund is not affected.

4. (c)

Reason: Balance in the fund shows the amount yet to be used for the purpose they are received or set aside by the NPO. ₹ 6,00,000 will be transferred from Stadium Fund to General Fund to show that ₹ 10,00,000 (Balance, *i.e.*, ₹ 10,00,000 + ₹ 5,00,000 + ₹ 1,00,000 – ₹ 6,00,000) is yet to be applied for construction of Stadium while ₹ 6,00,000 is used which is shown as an asset in the Balance Sheet.

5. (d)

Reason: Specific Funds are used for the purposes they are received or set aside. Use of specific fund may or may not result in creation of an asset. When it does not result in creation of an asset, expenses incurred in excess of the fund is the expense of the NPO and is shown, *i.e.*, debited to Income and Expenditure Account.

6. (d)

Reason: At the time of subscription being made due 'Outstanding Subscription' or 'Subscription Receivable' is debited while Subscription Account is credited. Therefore, at the time of Writing off subscription, Outstanding Subscription Account is credited and it being a loss to the NPO, Subscription written off Account is debited. The Journal entry passed is:

Subscription Written-off A/c ...Dr.

To Outstanding Subscription A/c

7. (d)

Reason: Book Value of furniture is ₹ 40,000. Depreciation charged till 31st December, 2019 is ₹ 3,000 Depreciated value at the time of Sale ₹ 37,000. Loss is 20% on sale of asset. Therefore, Loss is ₹ 7,400.

8. (b)

Reason: Income and Expenditure Account is a Nominal Account prepared on Accrual Basis of Accounting to determine surplus or deficit from the activities for the year. Thus, it shows current accounting year income and expenses of revenue nature.

9. (c)

Reason: Subscription received for Annual Dinner is for a special purpose, *i.e.*, Annual Dinner. Thus, it is a Special Receipt.

10. (d)

Reason: Final Accounts of NPO consist of Receipts and Payments Account, Income and Expenditure Account and Balance Sheet. Profit and Loss Account is prepared by an enterprise, *i.e.*, a business entity.

11. (c)

Capital Fund + Liabilities = Assets

12. (a)

Reason: Rent for the year = Rent paid during the year + Outstanding Rent (31st March, 2020) + Prepaid Rent (1st April, 2019) – Outstanding Rent (1st April, 2019) – Prepaid Rent (31st March, 2020).

= ₹ 65,000 + ₹ 11,000 (₹ 7,000 + ₹ 4,000) – ₹ 13,000 (₹ 8,000 + ₹ 5,000) = ₹ 63,000.

2. ACCOUNTING FOR PARTNERSHIP FIRMS—FUNDAMENTALS

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) False

Reason: Capital Accounts and Current Accounts are maintained when Capital Accounts are fixed. Transactions that relate to capital are transferred to Capital Accounts while other transactions are transferred to their Current Accounts.

(ii) False

Reason: It is essential to have at least two partners in a partnership firm otherwise it will be a proprietorship firm.

(iii) False

Reason: In the absence of Partnership Deed or Partnership Agreement, provisions of the Partnership Act, 1932 apply. The Partnership Act, 1932 does not allow salary to partners unless the Partnership Deed or Partnership Agreement allows it.

(iv) True

Reason: The relationship of partners in business is defined in the Partnership Act, 1932, which means they are agents of each other, when the definition states a partner to be acting for all.

(v) True

Reason: It is an essential characteristic of Partnership that it is a relation between persons who have agreed to share profits of business carried on by all or any of them acting for all.

(vi) False

Reason: If the partnership deed is silent on allowing interest on Loan to the partners, the provisions of the Partnership Act, 1932 shall apply. It provides that interest on Loan shall be allowed @ 6% p.a. and not @ 6%.

(vii) False

Reason: The Partnership Act, 1932 provides that the parties to the partnership may determine the profit-sharing ratio. But, in case they do not decide the profit–sharing ratio, profit is to be shared equally.

(viii) True

Reason: Interest will be charged @ 5% p.a. on ₹ 1,20,000 for 5½ months. Thus, interest will be ₹ 1,20,000 × 5% × 5½/12 = ₹ 2,750.

(ix) True

Reason: Total amount withdrawn is ₹ 60,000. Rate of interest is 6% p.a. Therefore, interest will be charged for 9.5 months as follows:

Months Left After First Drawing is 12 Months

Months Left After Last Drawings is 7 Months (April, 2019 to September, 2019)

Therefore, total months 12 Months + 7 Months = 19 Months

Average Months = 19/2 = 9.5 Months

Interest = ₹ 60,000 × 6% × 9.5/12 = ₹ 2,850

(x) False

Reason: Total amount withdrawn is ₹ 60,000 (₹ 10,000 × 6). Rate of interest is 6% p.a. Therefore, interest will be charged for 3.5 months as follows:

Months Left After First Drawing is 6 Months (October, 2019 to March, 2020)

Months Left After Last Drawings is 1 Months (March, 2020)

Therefore, total months 6 Months + 1 Month = 7 Months

Average Months = 7/2 = 3.5 Months

Interest = ₹ 60,000 × 6% × 3.5/12 = ₹ 1,050

(xi) False

Reason: Salary to a partner is debited to Profit & Loss Appropriation A/c as it is an appropriation of profit and not a charge on profit. It is credited to Partner's Capital Account, if Capitals are fluctuating otherwise it is credited to Partner's Current Account.

(xii) True

Reason: Interest is allowed on capital that is used in the business during the year. For example, Opening Capital of a partner is ₹ 1,00,000 and further capital is not introduced, interest on capital will be allowed for 12 months on ₹ 1,00,000. Taking the example further, if he introduces further capital of ₹ 50,000 on October 1, he will get interest on ₹ 1,00,000 for 12 months and on ₹ 50,000 for 6 months. Still taking the example further, if he withdraws capital of ₹ 25,000 on 1st October, he will get interest on ₹ 1,00,000 for 6 months and on ₹ 75,000 for 6 months.

(xiii) True

(xiv) False

Reason: Rent paid to a partner is debited to Profit and Loss Account, it being a charge against the profit.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Partnership Deed

(ii) charge

(iii) 6.5 Months

Reason: It is calculated as follows:

Months left After First Drawing + Months Left After Last Drawing/2

12 Months + 1 Month/2 = 6.5 Months.

(iv) 50, Companies Act, 2013

(v) Partner's Current Account

(vi) Profit, Loss

(vii) not

Reason: The Partnership Act, 1932 does not have a provision for charging interest on loan to a partner by the firm. Thus, if interest is to be charged on loan to the partner by the firm, it should be agreed by the partners or provided in the Partnership Deed.

(viii) 6

Reason: The period of 6 months is calculated as follows:

Time Left After First Drawing is 11.5 Months

Time Left After Last Drawing is 0.5 Months

Average Period on which interest will be charged is $\frac{11.5 + 0.5}{2}$ = 6 Months.

(ix) Product

Reason: Average Method of calculating interest is applied when both conditions are met, *i.e.*, amount is fixed and also time interval is regular.

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (b)

Reason: It is unlimited liability because personal or private assets of the partner can be used for payment of firm's liabilities.

2. (d)

Reason: The contribution as capital by all the partners is not an essential feature of partnership firm, since the Partnership Act, 1932 does not prescribe that all the partners have to contribute capital to be a partner. Capital contribution is governed by the agreement among the partners.

3. (b)

Reason: Capital Account under Fixed Capital Accounts Method has always credit balance while Current Account may have credit or debit balance. The account will have credit balance if drawings are less than the share of profit, interest on capital and remuneration and debit balance if drawings during the year are more than the amount of appropriations credited to the account.

4. (b)

Reason: Salary/remuneration allowed to a partner means appropriation of profit and profit is a credit balance. Hence, when salary/remuneration is allowed to a partner, Profit and Loss Appropriation Account is debited.

5. (b)

Reason: The Partners have an agreement with the other partner to give him minimum profit. The deficiency thus, will be borne by the guaranteeing partners in the ratio in which they have guaranteed the minimum profit. If the ratio of guarantee is not given, they will share the deficiency in their profit-sharing ratio.

6. (c)

Reason: If the Partnership Deed or agreement allows payment of interest on capital of the partners, interest can be paid out of current year's profit because appropriation of profit is for the current year.

7. (c)

Reason: *R* is guaranteed minimum profit of ₹ 18,000 per annum. His share of profit comes to ₹ 14,000 (₹ 42,000/3). In the absence of profit-sharing ratio being given, they are equal partners. He is guaranteed minimum profit of ₹ 18,000 p.a., his Capital Account will be credited by ₹ 18,000, which is higher than his share of actual profit.

8. (a)

Reason: Interest on capital is allowed to the partners on their capital balance. Interest allowed is credited to Partner's Capital account. In the absence of information, it is assumed that Capital Accounts are maintained on Fluctuating Capital Accounts method hence, interest on Capital is credited to Partner's Capital Account.

9. (b)

Reason: The rate of interest is 10% p.a., and the capitals of *P* and *Q* is ₹ 30,000 and ₹ 20,000 respectively. Interest will be ₹ 3,000 (10% p.a. of ₹ 30,000) and ₹ 2,000 (10% p.a. of ₹ 20,000) respectively.

10. (d)

Reason: In the absence of Partnership Deed, interest is not allowed on capitals of the partners, as is provided in the Partnership Act, 1932.

11. (d)

Reason: If the Partnership Deed is silent on interest on loan to Partner, it is not charged because the Partnership Act, 1932 does not provide for charging interest on Loan to Partner.

12. (b)

Reason: It is calculated as follows:

Profit before Manager's Commission is ₹ 4,20,000 (₹ 5,80,000 – ₹ 1,60,000)

Manager's Commission is ₹ 4,20,000 x 5/105 = ₹ 20,000

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) True

Reason: It is an asset which has a realisable value but it does not have physical existence. Thus, it is an intangible asset.

(ii) True

Reason: If a customer base is large in size then the demand for goods is higher resulting in higher profits. Ultimately goodwill of the firm increases.

(iii) True

Reason: Management, if efficient, leads to higher sales and higher profits, which in turn leads to higher value of Goodwill. Similarly, repeated Customers lead to increased sale and thus higher profits resulting in increase in value of Goodwill.

(iv) False

Reason: Weighted Average Method of calculating goodwill is used when profit shows a trend either increasing or decreasing because profits of latest years indicate the profit the firm is likely to earn in coming years.

(v) False

Reason: According to AS-26 only purchased goodwill is recognised in the books of account. Self-generated goodwill is not recognised as its value is subjective in nature and money or money's worth has not exchanged hands.

(vi) False

Reason: Capitalised Value of the business = (Average Profit ×100)/NRR

= (₹ 1,20,000 ×100)/15 = ₹ 8,00,000

Capital employed = ₹ 8,00,000

Goodwill = ₹ 8,00,000 – ₹ 8,00,000 = Nil

(vii) True

Reason:

Net Assets = ₹ 85,000 – ₹ 5,000 (Fictitious assets)

= ₹ 80,000

Outside Liabilities = ₹ 30,000

Capital Employed = Net Assets – Outside Liabilities

= ₹ 80,000 – ₹ 30,000 = ₹ 50,000

Normal Profit = Capital Employed × NRR/100

= ₹ 50,000 × 10/100 = ₹ 5,000

Super Profit = Average Profit – Normal Profit

= ₹ 8,000 – ₹ 5,000 = ₹ 3,000

Goodwill (As per Capitalisation of Super Profit) = Super Profit × 100/NRR

= ₹ 3,000 × 100/10

Goodwill = ₹ 30,000

(viii) True

Reason: Capital Employed for valuation of Goodwill is the capital of the partners employed in the business because the purpose is to determine the profit being earned on own capital and compensation that should be paid for the sacrifice made by the sacrificing partners.

(ix) True

Reason: Capital Employed for valuation of Goodwill is the capital of the partners employed in the business because the purpose is to determine the profit being earned on own capital and compensation that should be paid for the sacrifice made by the sacrificing partners.

(x) True

Reason: Purchased Goodwill normally is not sold/purchased as an individual asset but is purchased when a business is purchased. Therefore, it may be paid along with the payment of purchase consideration and also may be recognised as an asset in the Balance Sheet.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Number of Years' Purchase

(ii) Sacrificing, Gaining

(iii) ₹ 1,00,000

Working Note:

Capital Employed = Assets – Outside Liabilities

= ₹ 11,00,000 – ₹ 1,00,000

= ₹ 10,00,000

Value of Goodwill by Average Profit = 10% of ₹ 10,00,000

= ₹ 1,00,000.

(iv) Dissolution of the firm

(v) ₹ 72,000

(vi) Average Profit

(vii) Excess of Average Profit over Normal Profit

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (d)

Reason: Amount paid in excess of net assets is not on account of any asset but for acquiring a running business and in effect to earn profit from the day the business is taken over. Hence, it is debited to Goodwill Account. It being a Purchased Goodwill, can be shown in the Balance Sheet as an asset.

2. (b)

Reason: Capital Employed = ₹ 5,00,000

Average Profit = ₹ 60,000

Normal Profit = Capital Employed × NRR/100

= ₹ 5,00,000 × 10/100 = ₹ 50,000

Super Profit = Average Profit – Normal Profit

= ₹ 60,000 – ₹ 50,000 = ₹ 10,000

3. (c)

Reason:

Average Profit = ₹ 60,000

Normal Profit = Capital Employed × NRR/100

= ₹ 5,00,000 × 10/100 = ₹ 50,000

Super Profit = Average Profit – Normal Profit

= ₹ 10,000

Goodwill = Super Profit × Number of years' purchase

= ₹ 10,000 × 3 = ₹ 30,000

4. (c)

Reason: Average Profit = (₹ 60,000 + ₹ 65,000 + ₹ 70,000 + ₹ 90,000 – ₹ 10,000)/5

= ₹ 55,000

Goodwill = Average Profit × Numbers of Years' Purchase

= ₹ 55,000 × 2

Goodwill = ₹ 1,10,000.

5. (b)

Reason: Actual Profit = ₹ 80,000 – ₹ 10,000 = ₹ 70,000

Super Profit = Actual Profit – Normal Profit

= ₹ 70,000 – ₹ 60,000 = ₹ 10,000

Goodwill = Super Profit × Number of years' purchase

= ₹ 10,000 × 2 = ₹ 20,000.

6. (c)

Reason: Goodwill is valued for the business and therefore, normal business profits are taken for the purposes of valuation. Normal business profits can be determined when abnormal gains (profits) are deducted as they increase the profit and abnormal losses are added as they decrease the profit.

7. (b)

Reason: Capital Employed to value Goodwill is calculated as follows:

Capitals of Partners (₹ 9,00,000) + General Reserve (₹ 50,000) + Workmen Compensation Reserve (₹ 25,000) – Goodwill (₹ 1,00,000) – Non-trade Investments (₹ 35,000) = ₹ 8,40,000.

8. (c)

Reason: Capital Employed to value Goodwill is calculated as follows:

Total Assets (₹ 15,00,000 – Goodwill (₹ 1,00,000) – Advertisement Suspense (₹ 50,000) – Term Loan (₹ 2,50,000) – Bank Overdraft (₹ 75,000) – Sundry Creditors (₹ 2,00,000) – Workmen Compensation Claim (₹ 10,000) = ₹ 8,15,000.

4. CHANGE IN PROFIT-SHARING RATIO AMONG THE EXISTING PARTNERS

Objective Type Questions

1. *State whether the following statements are* ***True*** *or* ***False****:*

(i) True

Reason: Reserves and accumulated profits and losses are for the period when old profit-sharing ratio was agreed upon. At the time of change in profit-sharing ratio, reserves and accumulated profits and losses are transferred to the capital accounts of the partners in their old profit-sharing ratio. If a liability exists against the reserve (Workmen Compensation Claim) or there is fall in market value (Investments) they are distributed among partners after setting off the claim or fall in value.

(ii) **False**

Reason: There is a difference between the two and can be understood with the help of an example. Suppose, Inventory (Stock) is of ₹ 10,00,000 and the inventory is reduced by 30%, it means that loss is of ₹ 3,00,000. And if inventory is reduced to 30%, it means loss is of ₹ 7,00,000.

(iii) True

Reason: Profit and Loss Account (Dr.) is shown on the Assets side of Balance Sheet and is an accumulated loss and is distributed among old partners in old profit–sharing ratio.

Sudhir's Share = 50,000 × 3/5 = ₹ 30,000

Bhuwan's Share = ₹ 50,000 × 2/5 = ₹ 20,000.

(iv) False

Reason: Gaining partners compensate the sacrificing partners by paying them premium for goodwill.

(v) True

Reason: Gaining partners compensate the sacrificing partners for sacrificing their profit share in their favour. Therefore, it is necessary to determine the gaining and sacrificing ratios.

(vi) False

Reason: Goodwill has a debit balance and so does the loss in case of debit balance in the Profit and Loss Account. Goodwill when written off or loss when distributed, Capital Accounts of the partners will be debited. Profit on revaluation of assets or reassessment of liabilities will have credit balance, which will be credited to the Capital Accounts.

Correct Statement: Capital Accounts of the partners will be debited for Writing off goodwill.

(vii) True

Reason: At the time of Change in Profit-sharing Ratio, the combined shares of all partners remains unchanged because their individual profit share may change but the total share of all the partners remains same.

(viii) Yes

(ix) False

Reason: *A* has gained 1/8th share, calculated as follows:

	A	*B*
Old Profit Share	3	5
New Profit Share	1	1
Change in Profit sharing Ratio =	3/8 – 1/2 = 3 – 4/8	5/8 – 1/2 = 5 – 4/8
	= –1/8 (Gain)	1/8 (Sacrifice)

(x) True

Reason: Workmen Compensation Reserve to the extent of ₹ 60,000 will be distributed among partners in their old profit-sharing ratio as it is from the effort of the partners before the reconstitution of partnership firm. Balance ₹ 40,000 will be transferred to Workmen Compensation Claim Account.

(xi) True

Reason: It is calculated as follows:

	A	*B*
Old Profit Share	1	1
New Profit Share	4	3
Change in Profit sharing Ratio	= 1/2 – 4/7 = 7 – 8/14	1/2 – 3/7 = 7 – 6/14
	= –1/14 (Gain)	1/14 (Sacrifice)

B's sacrifice = 1/14

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Debited

Reason: If profit-sharing ratio changes, Investments Fluctuation Reserve is debited by the amount of fall in value of investments because it is a reserve set aside to meet this loss.

(ii) Capital Accounts

(iii) *B*

(iv) Dr. Asset Account and Cr. Revaluation Account

(v) Dr. Abhay's Capital Account and Cr. Amar's Capital Account by ₹ 20,000

(vi) Increase, Decrease, Total

(vii) Dr. Investment Fluctuation Reserve Account by ₹ 10,000 and Revaluation A/c by ₹ 5,000; Cr. Investment A/c by ₹ 15,000.

(viii) Dr. Ravi's Capital Account, Rakesh's Capital Account and Raman's Capital Account by ₹ 5,000 each and Cr. Advertisement Suspense Account by ₹ 15,000.

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (a)

Reason:

	X	*Y*
Old profit-sharing ratio of *X* and *Y*	3	2
New profit-sharing ratio	1	1
Change in profit-sharing ratio	= 3/5 – 1/2 = 6 – 5/10	2/5 – 1/2 = 4 – 5/10
	= 1/10 (Sacrifice)	–1/10 (Gain)

Value of Goodwill of the firm = ₹ 60,000

Y's share = ₹ 60,000 × 1/10 = ₹ 6,000

X's share = ₹ 60,000 × 1/10 = ₹ 6,000.

2. (a)

Reason:

	A	*B*
New Profit Share	3/5	2/5
Old Profit Share	2/3	1/3
Gaining/Sacrificing Ratio	(1/15)	1/15

B is the Gaining Partner while *A* is the Sacrificing Partner. Therefore, *B* will compensate *A* an amount equal to 1/15th of ₹ 60,000, *i.e.*, ₹ 4,000.

3. (c)

Reason: Market value of investments is higher than its book value hence, the reserve is a free reserve which will be distributed among partners in their old profit-sharing ratio. Also, the question requires to pass the adjustment entry for Investment Fluctuation Reserve only.

4. (d)

Reason: Asset has a debit balance and therefore. Asset Account will be debited. Since the asset was not recorded in the books and is now to be recorded, it is a gain for the firm. All gains and losses on reconstitution of partnership are transferred to Revaluation Account. Hence, Revaluation Account will be credited.

5. (d)

Reason: Both asset and liability are not recorded in the books and the unrecorded asset is given in settlement of the unrecorded liability. All gains (unrecorded asset) and losses (unrecorded liability) are transferred to Revaluation Account. The Journal entry if recorded will be:

Revaluation A/c ...Dr.

To Revaluation A/c

(by the same amount. Hence, entry will not be passed)

6. (a)

Reason: Yamini has neither gained nor sacrificed. Barun has sacrificed 3/10 and Zafar has gained 3/10.

Net Effect of the change in Values is:	₹
Land and Building	1,50,000
Plant and Machinery	(30,000)
Trade Creditors	15,000
Outstanding Rent	(45,000)
Net Effect (Increase)	90,000

Therefore, Zafar will compensate Barun 3/10th of ₹ 90,000, *i.e.*, ₹ 27,000.

7. (b)

Reason: Furniture is to be reduced to 40%, *i.e.*, ₹ 20,000. Hence, it is to be reduced by ₹ 30,000. Stock is to be reduced by 10%, *i.e.*, ₹ 10,000.

8. (a)

Reason: At the time of reconstitution, goodwill existing in the balance sheet is written off among the partners in their old profit-sharing ratio and new value of goodwill is given effect. Hence, existing goodwill (₹ 50,000) is written off while Zora will compensate Maira for 1/6th of new value of goodwill (₹ 36,000) for gain in profit share.

5. ADMISSION OF A PARTNER

Objective Type Questions

1. *State whether the following statements are* ***True*** *or* ***False****:*

(i) False

Reason: The Companies Act, 2013 restricts the number of partners to 50. Therefore, Pawan and Vayu can not be admitted as partners.

(ii) True

Reason: If claim is less than the reserve, the surplus in Workmen Compensation Reserve is transferred to the Capital Accounts of the old partners in their old profit-sharing ratio it being a free reserve.

(iii) True

Reason: A partner can be admitted into partnership if the Partnership Deed exists and it has a clause for admission of a partner. In other case, The Partnership Act, 1932 prescribes that a partner can be admitted into Partnership with the consent of all the partners.

(iv) False

Reason: Unrecorded assets and liabilities are credited and debited respectively in Revaluation Account and resulting net gain (profit) or loss is credited/debited to Partners' Capital Accounts.

(v) False

Reason: Sacrificing Ratio is the ratio which is given by the old partners to the new partner. Thus, new profit-sharing ratio is lesser than the old profit-sharing ratio. Thus, Sacrificing Ratio will be Old Profit-sharing Ratio less New Profit-Sharing Ratio. It is sometimes calculated as New Profit-sharing Ration less Old Profit-sharing Ratio. However, if calculated in this manner, it will give negative value, which also means Sacrificing Ratio.

(vi) True

Reason: Contingent liability is not recorded in the books and is recorded in the books of account if it becomes a determined liability. Since it relates to the period before the admission of a partner, it is transferred to the debit of Revaluation Account, the net effect of which is transferred to the capital accounts of old partners in their old profit-sharing ratio.

(vii) False

Reason: Admitted partner is not liable for the past losses because he becomes partner to share profits and losses after he or she is admitted into partnership.

(viii) True

Reason: Decrease in liabilities is a gain (profit) for the firm. Following the rule 'Credit all Incomes and Gains', it is credited to Revaluation Account and net gain (profit) or loss is transferred to old partners in their old profit-sharing ratio.

(ix) False

Reason: It is a principle that Gaining Partner or Partners compensate the Sacrificing Partner or Partners in Sacrificing Ratio and not Gaining Ratio.

(x) True

Reason: Revaluation Account is closed by transferring the balance in the account to the Capital Accounts of the partners. Excess of total of credit side over the total of debit side is gain (profit) to the firm.

Therefore, Revaluation Account is debited by the amount of gain (profit). Since, the gain (profit is due to the old partners, old partners' Capital Accounts are credited in their old profit sharing ratio.

(xi) True

Reason: Asset (Plant and Machinery) has a debit balance and, therefore, any increase in its value is debited to it. Since, increase in value of Plant and Machinery is a gain (profit), it is credited to Revaluation Account.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Premium for Goodwill

Reason: Newly admitted partner takes his share of profits from one or more of the existing partners. He brings capital towards the net assets of the firm and compensates the sacrificing partner or partners for foregoing their profit share in his premium which is termed as premium for goodwill.

(ii) Compensated, premium for goodwill

Reason: Gaining Partner or Partners compensate the Sacrificing Partner or Partners for gaining the profit share. They are compensated by payment of premium for goodwill.

(iii) Current Account

Reason: Since Sacrificing Partners have foregone a part of their profit share in favour of the admitted partner they should be compensated for it. At the same time, admitted partner, is unable to bring his or her share of premium of goodwill but the sacrificing partner or partners should be compensated. Therefore, their Capital Accounts are credited with their share of premium for goodwill and admitted partner's Current Account is debited, which is received from him at a later date.

(iv) old partners, old profit-sharing ratio

Reason: Investment Fluctuation Reserve is set aside out of profits to meet the loss for market value falling below the Book Value. Thus, the amount of reserve over and above the fall in value is free reserve which belongs to the old partners and therefore is distributed among old partners in their old profit-sharing ratio.

(v) their old profit-sharing

Reason: Reserve is set aside out of profits to meet the possible loss or to strengthen the financial position of the business. Amount is set aside to Workmen Compensation Reserve to meet any claim by the workmen. In case amount of reserve is more than the amount of claim, it means more amount than required was set aside. Hence, it is a free reserve and therefore, is distributed among old partners in their old profit-sharing ratio.

(vi) Capital Accounts, their old profit-sharing ratio

Reason: Existing goodwill in the Balance Sheet is written off by transferring it to the debit of Old Partners' Capital Accounts because the new partner brings premium for goodwill which is valued afresh and includes the existing goodwill.

(vii) Sacrificing Ratio

Reason: Old partners sacrifice their share of profit in favour of new partner. Therefore, new partner compensates the sacrificing partners in their sacrificing ratio.

(viii) old profit-sharing ratio

(ix) ₹ 50,000

Reason: Goodwill existing in the books will be written off by debiting the Capital Accounts of the old partners. Ravi will bring his share of premium for goodwill on the basis of new valuation, *i.e.*, ₹ 2,00,000.

(x) Old Partners, Old Profit-Sharing Ratio

(xi) debited

(xii) Revaluation Account

Reason: It is a gain (profit) for the firm since it is decrease in liability. Hence, it is credited to Revaluation Account.

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (c)

Reason: Since Sacrificing Partners have foregone a part of their profit share in favour of the admitted partner they should be compensated for it. At the same time, admitted partner, is unable to bring his or her share of premium of goodwill but the sacrificing partner or partners should be compensated. Therefore, their Capital Accounts are credited with their share of premium for goodwill and admitted partner's Current Account is debited, which is received from him at a later date.

2. (a)

Reason: Unrecorded liability is a loss for the firm which is for the period earlier to the admission of the partner. Therefore, new partner should not be bearing it and hence, is debited to Revaluation Account. Net balance of Revaluation Account is transferred to the Capital Accounts of old partners in their old profit-sharing ratio.

3. (a)

Reason: In case, information as to profit share sacrificed by the existing partners in favour of the new partner is not given, it is presumed that all the partners have sacrificed their profit share in favour of the new partner in their profit-sharing ratio. *D* is admitted for 1/8th share in profits and profit share forgone by existing partners in favour of new partner is not given, it will be presumed that they have sacrificed their profit share in their profit-sharing ratio. Therefore, the remaining share of 7/8th will be shared by the old partners', in the ratio 6 : 3 : 3, and the new ratio will be 14 : 7 : 7 : 4.

4. (b)

Reason: When the capital accounts of partners are maintained following Fixed Capital Accounts method, two accounts are maintained for each partner, *i.e.*, Capital Account and Current Account. Capital Account is credited or debited with the permanent increase or decrease in capitals of the partners. All other transactions of the partners are transferred in the Current Accounts. Thus, the undistributed profits, General Reserve, etc. will be transferred to Partners' Current Accounts.

5. (c)

Reason: *C* takes 3/5th and 2/5th share from *A* and *B* respectively. Thus, sacrifice by *A* and *B* is 3/5th of 1/3rd and 2/5th of 1/3rd respectively. Sacrificed share will be deducted from the Old profit share to arrive at the new profit-sharing ratio. New profit-sharing ratio is calculated as follows:

	A	*B*	*C*
Old Profit Share	3/5	2/5	...
Less: Sacrificed Share	3/15 (3/5th of 1/3rd)	2/15 (2/5th of 1/3rd)	...
New Profit Share	6/15 (3/5 – 3/15)	4/15 (2/5 – 2 /15)	1/3 or 5/15
New Profit-sharing Ratio	6 :	4 :	5

6. (a)

Reason: Existing capital of the firm is ₹ 4,50,000, being 3/4th in the new firm. Therefore, total capital of the new firm will be ₹ 6,00,000 (₹ 4,50,000 × 4/3). *X*'s share in the new firm is 1/4th, thus capital of *X* will be ₹ 1,50,000.

7. (d)

Reason: Unless agreed otherwise, Sacrificing Ratio of old partners will be the same as their old profit-sharing ratio.

8. (d)

Reason: If goodwill is paid privately, it is not recorded in the books of account of the firm.

9. (b)

Reason: The amount of claim in excess of reserve is a loss, hence debited to Revaluation Account.

10. (c)

Reason: It is for the period earlier to the admission of the partner. Hence, it is debited to old partners in their old profit-sharing ratio.

11. (c)

Reason: A transaction to record Unrecorded asset, given to settle a liability (fully or partially) is recorded in the Revaluation Account since that asset and liability does not exist in the books of accounts. In the present case, Unrecorded asset is given in part settlement of unrecorded liability and balance is paid in cash. If an entry is passed for the above unrecorded asset and liability, the entry will be:

Revaluation A/c	...Dr.	₹ 15,000	
Cash/Bank A/c	...Dr.	₹ 5,000	
To Revaluation A/c			₹ 20,000

The net effect is

Cash/Bank A/c	...Dr.	₹ 5,000	
To Revaluation A/c			₹ 5,000

Hence, the answer.

6. RETIREMENT OF A PARTNER

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) True

Reason: Old profit sharing Ratio of *P*, *Q* and *R* is 5 : 4 : 3 *Q* retires and *P* and *R* decide to share profit equally.

P's Gain = 1/2 – 5/12 = (6 – 5) /12 =1/12

R's Gain = 1/2 – 3/12 = (6 – 3) /12 = 3/12

Gaining Ratio = 1 : 3.

(ii) False

Reason: If the new profit-sharing ratio or the gain by the remaining or continuing partners is not given, it is presumed that they have gained in their profit-sharing ratio. Thus, Gaining Ratio is the profit-sharing ratio of the remaining or continuing partners.

This can be verified from the following calculations:

Old Profit-sharing ratio among Anurag, Sanjeev and Sumit = 2 : 3 : 4

Anurag retires from the firm.

New profit-sharing ratio between Sanjeev and Sumit = 3 : 4

Gaining Ratio = New Ratio – Old Ratio

Sanjeev's Gain = 3/7 – 3/9 = (27 – 21)/63 = 6/63

Sumit's Gain = 4/7 – 4/9 = (36 – 28) /63 = 8/63

Gaining Ratio = 6 : 8 or 3 : 4.

(iii) True

Reason: Gain (profit) or loss that arises before the retirement of a partner is for the period when retiring partner was also a partner. Thus, the retiring partner shares the gain (profit) or loss for that period in the profit–sharing ratio. Thus, all the partners (including retiring partner) share the gain (profit) or loss in their old profit-sharing ratio.

(iv) True

Reason: Goodwill is an intangible asset. At the time of retirement of a partner, value of goodwill is determined afresh and the new value includes the value of existing goodwill also. Existing Goodwill is transferred to the debit of Partners' Capital Accounts (including Retiring Partner) and Retiring Partner's Capital Account is credited for his share in goodwill based on new value of goodwill.

(v) False

Reason: Increase in value of an asset (stock) is credited to Revaluation Account while decrease is debited. In the present case, value of stock is reduced. Hence, Revaluation Account should be debited and Stock Account should be credited.

(vi) False

Reason: Entry will not be passed for giving Unrecorded asset in part settlement of liability because the asset and also the liability was not recorded in the books and if now an entry is passed it will be debiting and crediting Revaluation Account with the same amount. However, ₹ 10,000 have also been paid towards Unrecorded Liability, it will be recorded in the books by debiting Revaluation Account and crediting Cash/Bank Account.

(vii) True

Reason: Entry will not be passed for giving Unrecorded asset in part settlement of liability because the asset and also the liability was not recorded in the books and if now an entry is passed it will be debiting and crediting Revaluation Account with the same amount. Since, ₹ 25,000 has been received from the creditor, it will be recorded in the books by crediting Revaluation Account and debiting Cash/Bank Account.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Retiring Partner's Loan Account

Reason: The amount due to retiring partner is credited to his Loan Account as the amount is not paid to him. It will exist in the Balance Sheet as a liability.

(ii) Gaining Ratio

Reason: The remaining or continuing partners will get the profits in future that belonged the retiring partner. Therefore, they compensate the retiring partner in their gaining ratio.

(iii) debited

Reason: Loss due to decrease in value of assets or increase in liabilities is debited to Revaluation Account because all gains (profits) and losses are transferred to Revaluation Account and net result (gain or loss) is transferred to the capital accounts of the partners. Besides losses are always debited.

(iv)

Provision for Doubt Debts A/c	...Dr.	₹ 4,500	
Stock A/c	...Dr.	₹ 5,000	
To Revaluation A/c			₹ 9,500

(Decrease in Provision for Doubtful Debts and

Increase in Stock recorded)

Reason: Provision for Doubtful Debts is maintained to meet bad debt, if any. Since all the debtors are good, provision for doubtful debts is not required, hence is to be written back. Increase in value of stock is a gain.

(v)

Cash/Bank A/c	...Dr.	₹ 5,000	
To Revaluation A/c			₹ 5,000

Reason: Entry will not be passed for giving Unrecorded asset of ₹ 25,000 in settlement of liability of ₹ 20,000 because both asset and liability were not recorded in the books and if now an entry is passed it will be debiting and crediting Revaluation Account with the same amount.

(vi)

Revaluation A/c	...Dr.	₹ 30,000	
To Cash/Bank A/c			₹ 30,000

Reason: Since, ₹ 30,000 has been paid and a liability is settled, the transaction will be recorded in the books by debiting Revaluation Account and crediting Cash/Bank Account by ₹ 30,000.

(vii) all partners, old profit-sharing ratio.

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (a)

Reason: It is calculated as follows:

Old profit sharing ratio among *P*, *Q* and *R* is 8 : 5 : 3

P retired from the firm and his profit share is taken by *Q* (3/16) and *R* (5/16).

P's profit share = 8/16

$$Q\text{'s new profit share} = 5/16 + \left(\frac{8}{16} \times \frac{3}{16}\right) = 13/32$$

$$R\text{'s new profit share} = 3/16 + \left(\frac{8}{16} \times \frac{5}{16}\right) = 11/32$$

New Profit-sharing Ratio of *Q* and *R* = 13 : 11.

2. (b)

Reason: Amount payable to *B* will be ₹ 70,820, calculated as follows:

	₹
Balance in Capital Account	50,000
Share of General Reserve	6,000
Share of Revaluation Gain (Profit)	2,820
Share of Goodwill	12,000
Total	70,820

3. (d)

Reason: Goodwill is the amount paid by the gaining partner or partners to the sacrificing partner or partners. The retiring partner sacrifices his share in favour of all or some of the partners who compensate him by paying goodwill. The share of Goodwill of the retiring partner is debited to Gaining Partners in their gaining ratio and credited to Retiring Partner's Capital Account.

4. (a)

Reason: Decrease in liability at the time of retirement of a partner is a gain (profit). Since, liability account has a credit balance, therefore, liability account is debited. It being a gain (profit) is credited to Revaluation Account, it being a nominal account. Net result of Revaluation Account (Gain (profit) or Loss) is transferred to the Partners' Capital/Current Accounts, including retiring Partner's Capital Account, in their profit-sharing ratio.

7. DEATH OF A PARTNER

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) True

Reason: Gain (profit) or loss that arises before the death of a partner is for the period when deceased partner was also a partner. Thus, the deceased partner shares the gain (profit) or loss for that period in the profit–sharing ratio. Thus, all the partners (including deceased partner) share the gain (profit) or loss in their old profit-sharing ratio.

(ii) False

Reason: Goodwill at the time of death of a partner, valued afresh and the new value includes the value of existing goodwill also. Existing Goodwill is transferred to the debit of Partners' Capital Accounts (including Deceased Partner) and Deceased Partner's Capital Account is credited for his share in goodwill based on new value of goodwill.

(iii) True

Reason: Because of death, payment of amount due cannot be made to him since he is not a living person. His legal heirs become entitled to his estate. Therefore, the payment is made to legal heirs of the deceased partners.

(iv) False

Reason: The deceased partner foregoes his profit share in favour of the remaining or continuing partners. Therefore, remaining partners or continuing partners compensate the deceased partner in their gaining ratio.

(v) False

Reason: Entry will not be passed for giving Unrecorded asset in settlement of liability because the asset and also the liability was not recorded in the books and if now an entry is passed it will be debiting and crediting Revaluation Account with the same amount. However, ₹ 10,000 has been received in settlement of Unrecorded Liability, it will be recorded in the books by crediting Revaluation Account and debiting Cash/Bank Account.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) credited

Reason: Gain (profit) due to increase in value of assets or decrease in the amount of liabilities is credited to Revaluation Account because all gains (profits) and losses are transferred to Revaluation Account and net result (gain or loss) is transferred to the Capital Accounts of the partners. Besides gains (profits) are always credited.

(ii) Old profit-sharing ratio, deceased partner

Reason: General Reserve was transferred from profits of the firm earned in the past when the deceased partner was also partner. Stating it differently, it is an undistributed profit kept aside to meet loss, if any, or an unforeseen liability or to strengthen the financial position. Thus, it is transferred to the Capital Accounts of the partners including deceased partner.

(iii)

Revaluation A/c	...Dr.	5,000	
To Stock A/c			5,000
(Decrease in value of stock recorded)			

Reason: Decrease in value of stock is a loss for the firm for the period when the deceased partner was also a partner. Thus, he is liable to share the loss. The gain (profit) or loss on revaluation of assets and reassessment of liabilities is transferred to the Partners' Capital Accounts, including deceased partner.

(iv) (b)

Reason: Amount payable to Bhaskar will be ₹ 1,41,640, calculated as follows:

	₹
Balance in Capital Account	1,00,000
Share of General Reserve	12,000
Share of Revaluation Gain (Profit)	5,640
Share of Goodwill	24,000
Total	1,41,640

(v) (b)

Reason: Amount payable to Bhaskar will be ₹ 1,41,640, calculated as follows:

	₹
Balance in Capital Account	1,00,000
Share of General Reserve	12,000
Share of Revaluation Gain (Profit)	5,640
Share of Goodwill	24,000
Total	1,41,640

25% of the due amount (₹ 1,41,640), *i.e.*, ₹ 35,410 is paid immediately and balance 75%, *i.e.*, ₹ 1,06,230 is transferred to Executor's Loan Account.

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (b)

2. (a)

It is calculated as follows:

Total Profit of last three completed years = ₹ 1,05,000 + ₹ 30,000 + ₹ 84,000 = ₹ 2,19,000

Raja's Share of profits credited to his account is 4/8, *i.e.*, ½ of ₹ 2,19,000 = ₹ 1,09,500

Value of Goodwill of the firm is ₹ 1,09,500.

3. (a)

Reason: Gaining Ratio = New Profit Share – Old Profit Share. However, in the present question *D*'s share is taken by *A*, *B*, and *C* equally. Hence, Gaining Ratio is 1 : 1 : 1.

4. (b)

Reason: The firm incurred loss of ₹ 72,000 for the year ended 31st March, 2020 and Narain died on 31st March, 2020. Thus, Narain's share of loss will be ₹ 28,800, *i.e.*, 2/5 of ₹ 72,000.

5. (a)

		₹
Reason:	Unrecorded assets taken over by *X*	25,000
	Less: Unrecorded liabilities assumed by *X*	2,500
		22,500
	Less: *X*'s share of unrecorded assets and liabilities (1/3 rd of ₹ 22,500)	7,500
	Net amount to be deducted from the amount due to *X*	15,000

Therefore, *X*'s amount due = ₹ 75,000 – ₹ 15,000 = ₹ 60,000.

8. DISSOLUTION OF A PARTNERSHIP FIRM

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) True

Reason: If any firm is engaged in unlawful business then it is compulsorily dissolved since unlawful activities cannot be carried in the country.

(ii) True

Reason: The Partnership Act, 1932 prescribes for dissolution of the firm, if a partner becomes a person of unsound mind.

(iii) True

Reason: It is calculated as follows:

Debtors Realised ₹ 50,000 *less* 2% of ₹ 50,000. Amount Realised is ₹ 49,000.

(iv) False

Reason: Dissolution of Partnership means old partnership has come to an end and new partnership has come into effect.

On the other hand, Dissolution of Partnership Firm means the business of the firm has come to an end and thus, firm is dissolved. As a result, its assets are realised and liabilities are paid.

(v) False

Reason: It is not transferred to his/her Capital Account but is received in cash. It is so because if it is transferred to Capital Account, it will be repayment of capital before payment of outside liabilities.

(vi) False

Reason: Liabilities towards outside parties means liability of the firm to persons other than liability towards Partners. Since, Partner's relative is not a partner, it will be transferred to Realisation Account.

(vii) False

Reason: When the firm is dissolved, assets and its corresponding reserve is transferred to Realisation Account.

(viii) True

Reason: Tarun has paid the amount on behalf of the firm and therefore, should be reimbursed the amount. It is reimbursed by crediting his Capital Account.

(ix) False

Reason: Cash is already in liquid form, so it is not transferred to Realisation Account.

2. *Fill-in the Blanks* *with appropriate words:*

(i) joint, several

Reason: Liability of a partner is unlimited and if the firm is unable to pay its liabilities by realising its assets, balance amount will be payable by any or all the partners. Thus, the liability of partners is unlimited, joint and several.

(ii) dissolution of the firm

Reason: Loan by partner is repaid after payment of outside liabilities but before repayment of capitals. Hence, it is not transferred to Realisation Account but is kept in a separate account to be paid after outside liabilities.

(iii)

Realisation A/c	...Dr.	₹ 25,000	
To Hari's Capital A/c			₹ 25,000
(Liability paid by Hari credited)			

Reason: Liabilities of the firm are transferred to Realisation Account on dissolution. Therefore, Realisation Account will be debited. Since liability of the firm is paid by Hari, a partner, his Capital Account will be credited.

(iv) Profit-sharing

Reason: Accumulated profits/losses are undistributed profits/losses and therefore, are transferred to their capital accounts in their profit-sharing ratio.

(v) debited, credited

Reason: Amount is received from sale of unrecorded asset hence, Cash/Bank Account is debited. The amount is received from sale of unrecorded asset is credited to Realisation Account being a gain (profit).

(vi) ₹ 50,000

Reason: Realisation Account is debited by the amount of expenses that are borne by the firm. In this case, firm is bearing ₹ 50,000 and dissolution expenses were to be borne by Bharat.

(vii) ₹ 38,000

Reason: All liabilities are transferred to the credit of Realisation Account. Liability towards creditors and Bills Payable is ₹ 38,000 which will be transferred to the credit of Realisation Account.

(viii) Partners' Capital Accounts in their profit-sharing ratio

Reason: Since there is no claim against the reserve, it will be transferred to Partners' Capital Accounts in their profit-sharing ratio. Had there been a claim against the reserve then it would have been transferred to Realisation Account.

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (b)

Reason: The section prescribes that firm's liabilities can be paid out of partner's net assets, *i.e.*, private assets less private debts.

2. (b)

Reason: If a partner pays the liability of a firm on dissolution, it will be recorded as:

Realisation A/c	...Dr.	₹ 10,000	
To Anil's Capital A/c			₹ 10,000

Liabilities of the firm are transferred to Realisation Account on dissolution. Therefore, Realisation Account is debited. Since liability of the firm is paid by Anil, a partner, his Capital Account is credited.

3. (a)

Reason: Amount payable to the partner as his remuneration and expense is credited to his Capital Account. The transaction of payment of expense by the partner is not a transaction that of the firm. Hence, entry is not passed for it.

4. (c)

Reason: The assets have been taken by Sudhir in settlement of his loan meaning thereby, the firm does not have to pay the balance amount. Thus, it is a gain (profit) for the firm. It will be, therefore, transferred to Realisation Account.

5. (d)

Reason: Loan by partner to the firm is paid after payment of outside liabilities but before repayment of capitals. Therefore, Rohan's loan will be paid and Bank Account will be credited.

COMPANY ACCOUNTS

9. COMPANY ACCOUNTS—ACCOUNTING FOR SHARE CAPITAL

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) True

Reason: Dividend on Equity Shares is decided each year by the company and it may or may not be paid. Against this Preference Shares get dividend at the fixed rate, if the company earns profit. Similarly, market values of Equity Shares fluctuate with the performance of the company. But Preference Shares are affected by the performance of the company but has less effect being more safe.

(ii) False

Reason: Subscribed Share Capital is a part of Issued Share Capital which the company issues for subscription. Shares are subscribed against the shares issued. Hence, it cannot be more than Issued Share Capital.

(iii) True

Reason: If forfeited shares are reissued at par or premium the total amount forfeited on forfeited shares is a gain of capital nature hence, transferred to Capital Reserve Account.

(iv) True

Reason: Maximum discount that can be allowed on reissue of forfeited shares is the amount forfeited. In this case, ₹ 6 per share has been forfeited therefore, maximum discount can be ₹ 6 per share which is the case.

(v) False

Reason: Balance in the forfeited Shares Account is shown in the Balance Sheet under the head Share Capital.

(vi) True

Reason: Section 53 of the Companies Act, 2013 does not allow issue of shares at a discount. However, Section 54 allows issue of shares to employees and directors at a discount.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Equity Share Capital and Preference Share Capital

Reason: The Companies Act, 2013 defines Share capital to be comprising both Equity Share Capital and Preference Share Capital. Hence, share capital is the sum total of both the share capitals.

(ii) Dividend

(iii) Calls-in-Arrears, Calls-in-Arrears

(iv) Minimum Subscription

(v) discount

Reason: Section 54 of the Companies Act, 2013 allows issue of shares at a discount to employees and directors.

(vi) Securities Premium Reserve Account

Reason: Premium received on issue of shares is a capital receipt. The Companies Act, 2013 prescribes that the amount received as premium is to be credited to Securities Premium.

(vii) higher than the face value

(viii) Capital profits

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (d)

Reason: Reserve Capital is that part of Subscribed Share Capital, which the company decides to call at the time of its winding up. Thus, it means that the shares are subscribed but not fully paid-up. Schedule III of the Companies Act, 2013 requires companies to show Authorized Share Capital, Issued Share Capital and Subscribed Capital but not the Reserve Capital.

2. (d)

Reason: Securities Premium Reserve means amount received over and above the nominal (face) value of the shares. Capital Reserve means profit of capital nature. Revaluation Reserve represents amount being upward revision of book value of an asset or assets. All three are part of the Shareholders' Funds but are not Share Capital. When shares are issued, whether for cash or for Consideration Other than Cash, Share Capital of the company increases by that amount. Thus, when shares are issued for consideration other than cash, Share Capital Account is credited.

3. (d)

Reason: Share Capital Account is debited with the amount of share capital called-up till the date of forfeiture. In this case, ₹ 9 per share has been called-up till the date of forfeiture.

Hence, ₹ 18,000 (2,000 × ₹ 9) will be debited.

4. (a)

Reason: Share Capital Account is debited with the amount of share capital called-up till the date of forfeiture. In this case, ₹ 10 per share has been called-up till the date of forfeiture. Hence, ₹ 50,000 (5,000 x ₹ 10) will be debited. Securities Premium Reserve Account will be debited by ₹ 10,000 (5,000 × ₹ 2, since securities premium is not received).

5. (d)

Reason: Maximum discount that can be allowed on reissue of forfeited shares is the amount forfeited. In this case, ₹ 6 per share has been forfeited, therefore, maximum discount can be ₹ 6 per share. It means that the company can reissue these shares at minimum ₹ 4 per share.

6. (c)

Reason: It can be used at the time of winding up of the company. It cannot be used to write off capital loss.

7. (c)

Reason: Maximum permissible discount on re-issue is the amount credited to 'Forfeited Shares Account', *i.e.*, 8,000 × ₹ 70 = ₹ 5,60,000.

10. COMPANY ACCOUNTS—ISSUE OF DEBENTURES

Objective Type Questions

(i) True

Reason: Collateral security is the security given to bank in addition to prime security. In case, companies do not have physical assets to give as collateral security, they may give debentures as collateral security.

(ii) False

Reason: Securities Premium received can be used for the purposes specified in section 52(2) of the Companies Act, 2013, *i.e.*,

(a) Writing off preliminary expenses;
(b) Writing off Share Issue Expenses.
(c) Writing off loss on issue of debentures;
(d) Writing off Loss on Issue of preference shares;
(e) Buy-back of own shares and other securities.

Thus, it cannot be used for writing off revenue losses.

(iii) False

Reason: Interest on debentures is paid whether the company earns profit or incurs loss since it is charge against profit.

(iv) True

True: It is a liability payable at the time of redemption and is known to exist on the date debentures are issued. It should be provided following the Prudence Concept.

(v) False

Reason: Debentures may be secured not only by charge against fixed assets but also be secured by charge against floating assets such as inventory (stock), debtors, etc.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Liabilities, Reserves and Surplus

Reason: Disclosure of an item in the Balance Sheet or Statement of Profit and Loss is specified in Schedule III of the Companies Act, 2013. It specifies that Securities Premium Reserve to be shown under Reserves and Surplus under Shareholders' Funds in the Balance Sheet.

(ii) charge

Reason: Interest on debentures is payable whether the company earns profit or incurs loss. Thus, it is a charge against profit.

(iii) shares or new debentures, *i.e.*, Debentures of another category

Reason: If the terms of issue of debentures provides for conversion of debentures into shares or new debentures, they can be converted. It is so because terms of issue of debentures are specified at the time of their issue based on which the debentureholders have subscribed.

(iv) Non-convertible

Reason: Debentures can be converted into shares or new debentures, if the terms of issue of debentures provides for their conversion. Non-convertible debentures cannot be converted because terms of issue of debentures did not specify their conversion at the time of their issue based on which the debenture holders have subscribed.

(v) premium, premium

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (b)

Reason: Debentures issued as collateral security is an event in which amount does not exchange hands, an entry is passed so that user is informed about the security given. Debentures issued as collateral security will have credit balance. Therefore, Debentures Account will be credited. Since an asset does not come into existence and following the rule of double entry system of accounting, an account needs to be debited, which is Debentures Suspense Account.

2. (a)

Reason: It is customary to state rate of interest to category of Debentures. Thus, 10% means that the interest on debentures is paid @ 10% per annum.

3. (c)

Reason: Debentures are debt of a company and is payable as and when it becomes due. Therefore, it is a liability.

4. (c)

Reason: When the total issue price is receivable in lump sum, Debentures Application and Allotment Account is credited (at the time of receipt) and debited at the time of issue. Following the prudence concept, premium payable at the time of redemption of debentures is provided at the time of issue of debentures. Premium received on issue of debentures is credited to Securities Premium Reserve Account.

5. (b)

Reason: When the total issue price is receivable in lump sum, Debentures Application and Allotment Account is credited (at the time of receipt) and debited (at the time of issue).

Since, debentures are issued at discount, Discount on Issue of Debentures account will be debited.

6. (a)

Reason: Being a capital gain, excess value of net assets over purchase consideration is credited to the Capital Reserve.

7. (d)

Reason: Loss on Issue of Debentures = Discount on Issue of Debenture ₹ 50,000 + Premium on Redemption ₹ 1,00,000

= ₹ 1,50,000.

ANALYSIS OF FINANCIAL STATEMENTS

1. FINANCIAL STATEMENTS OF A COMPANY

1. (b)

2. Other Current Liabilities

3. Other Current Liabilities

2. FINANCIAL STATEMENT ANALYSIS

1. (b)

2. (a)

3. TOOLS OF FINANCIAL STATEMENT ANALYSIS— COMPARATIVE STATEMENTS AND COMMON-SIZE STATEMENTS

Objective Type Questions

1. *State whether the following statements are* ***True*** *or* ***False****:*

(i) False

Reason: In Comparative Financial statements, percentage change is based on previous year's values and not current year's values.

(ii) False

Reason: Financial Position is shown by the Balance Sheet. Comparative Statement is prepared to compare items of two or more years of the firm taking previous year value as the base. Hence, the answer is "Comparative Balance Sheet".

(iii) False

Reason: In Intra-firm Comparative Statement, value of one period is compared to another period of the same firm.

(iv) True

Reason: Common-Size Statement analyses the current year data and determines percent of a common base, *i.e.*, Revenue from Operations in the case of Common-size Statement of Profit and Loss and total of Balance Sheet in the case of Common-size Balance Sheet. This analysis helps in establishing trend. The trend in turn helps in forecasting.

2. ***Fill-in the Blanks*** *with appropriate words:*
   (i) Common-size Statement of Profit and Loss
   (ii) the total of Balance Sheet
   (iii) 50,000

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (c)

Reason: Current year's Revenue from Operations is ₹ 10,00,000 and proportionate increase is 25% as compared to the previous year's Revenue from Operations. Previous year's Revenue from Operations is ₹ 8,00,000, calculated as follows ₹ 10,00,000 × 100/125.

2. (c)

Reason: Profitability is shown by Statement of Profit and Loss. Common-size Statement of Profit and Loss is prepared to show percentage of items of Statement of Profit and Loss to a common base (Revenue from Operations) of the same year. Hence, the answer is "Common-size Statement of Profit and Loss".

3. (d)

Reason: Financial position is shown by the Balance Sheet. Common-size Statement is prepared to show percentage of items of Balance Sheet to a common base (Total of Assets/ Liabilities Side) of the same year. Hence, the answer is "Common-size Statement of Profit and Loss".

4. (a)

Reason: It shows financial position.

4. ACCOUNTING RATIOS

Objective Type Questions

1. *State whether the following statements are* ***True*** *or* ***False****:*

(i) True

Reason: Discharge of Bills Payable of Rs. 5,000 will increase Current Ratio because both Current Assets (Cash) and Current Liabilities (Bills Payable) reduce by the same amount and the Current ratio is 2 : 1.

(ii) False

Reason: Current Ratio is calculated to assess whether the firm will be able to meet its short-term liabilities, hence it is short-term solvency ratio.

(iii) True

Reason: Working Capital Turnover Ratio shows the number of times Working Capital has been turned over in generating revenue. Higher revenue means higher profit. Thus, high Working Capital Turnover Ratio means efficient use of working capital.

(iv) False

Reason: Inventory Turnover Ratio measures the number of times investment in inventory is converted into Revenue from Operations.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Current Assets, Current Ratio (ii) Solvency Ratios

(iii) Current Ratio

Reason: Loose Tools and Stores and Spares are not held for conversion into cash. Current Ratio is calculated to determine the ability of the enterprise to meet its short-term financial commitments. Since, they are not to be converted into cash, it is excluded from Current Assets to calculate Current Ratio.

(iv) Profitability

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (a)

Reason: Current Ratio = Current Assets/Current Liabilities; 2/1 = ₹ 82,000/Current Liabilities; Current Liabilities = ₹ 82,000 × 1/2 = ₹ 41,000.

2. (a)

Reason: Trade Receivables Turnover Ratio is calculated to assess the efficiency with which investment in debtors is used. Higher ratio indicates efficient use of investment.

3. (c)

Reason: Stock Turnover Ratio = Cost of Revenue from Operations/Average Inventory
Cost of Revenue from Operations = Opening Inventory + Purchases – Closing Stock
= ₹ 20,000 + ₹ 1,60,000 – ₹ 60,000 = ₹ 1,20,000

Average Inventory = Opening Inventory + Closing Inventory/2
= (₹ 20,000 + ₹ 60,000)/2 = ₹ 40,000

Inventory Turnover Ratio = ₹ 1,20,000/₹ 40,000 = 3 Times.

5. CASH FLOW STATEMENT

Objective Type Questions

1. *State whether the following statements are* ***True*** *or* ***False****:*

(i) True

Reason: Non-cash Transactions do not result in Inflow or outflow of Cash and Cash Equivalents. Cash Flow Statement is prepared to determine flow (inflow and outflow) of cash. Hence, such expenses are added back to the net profit. Depreciation is a non-cash expense.

(ii) False

Reason: Cash Flow Statement is prepared to determine cash (inflow and outflow) flow during the period. Hence, it is based on cash basis and not accrual basis of accounting.

(iii) False

Reason: Proposed Dividend of current year is not added to determine Net Profit before Tax and Extraordinary Activities because it is not accounted in the books of account and hence is not shown in the financial statement.

Proposed Dividend is accounted in the books when it is declared (approved) by the shareholders which happens in the next financial year.

In the current financial year, Proposed Dividend of the previous year is approved. Hence, Proposed Dividend of the Previous Year is added to Net Profit before Tax and Extraordinary Activities of the Current Year.

(iv) True

Reason: Because it is associated with the objective of increasing the earning capacity of the enterprise.

2. ***Fill-in the Blanks*** *with appropriate words:*

(i) Operating

Reason: Cash Flow Statement, when prepared by Indirect Method the starting point is Net Profit for the year. Transfer of amount to General Reserve from Net Profit means Net Profit for the year is lower by that amount. Hence, it is added back to Net Profit.

(ii) Financial Statements

Reason: Cash Flow Statement, when prepared by Indirect Method the starting point is Net Profit for the year, which is known from the Balance Sheet and/or Statement of Profit and Loss.

Hence, it is prepared from financial statements.

(iii) Interest on Debentures

Reason: Interest on Debentures is a non-operating expense since it is shown under Cash Flow from Financing Activities.

(iv) Investing

Reason: Loan and Advances, on which interest is received, is shown as Investing Activity. Since, Interest on Loan and Advances is associated with it, it is shown as Investing Activity.

(v) Contingent Liability

Reason: AS-4, Contingencies and Events Occurring After the Balance Sheet Date prescribes that Proposed Dividend unless declared (approved) by the shareholders is to be shown as Contingent Liability because payment of dividend is subject to declaration by shareholders, who may reduce it or do not approve the dividend.

Multiple Choice Questions (MCQs)

Select the correct alternative:

1. (a)

Reason: Purchase of Non-Current Assets whether tangible or intangible is an Investing Activity as it results in acquisition of long-term assets.

2. (a)

Reason: Rent received by a Real Estate company is the principal revenue producing activity of the company.

3. (c)

Reason: Because marketable securities are highly liquid and therefore, are included in cash and cash Equivalents.

4. (c)

Reason: Outflow of Cash for acquisition of shares = (₹ 4,00,000)

Inflow of Cash for dividend received = ₹ 40,000

Net Cash Used in Investing Activities = (₹ 4,00,000) + ₹ 40,000 = ₹ 3,60,000.

5. (b)

Reason: The definition of Cash and Cash Equivalents as per AS-3, Cash Flow Statement includes such investments in Cash and Cash Equivalents.