Answers

(Multiple Choice Questions)

1. (i) (a); (ii) (c); (iii) (a); (iv) (a); (v) (c); (vi) (d); (vii) (b); (viii) (a); (ix) (a); (x) (b); (xi) (a); (xii) (c); (xiii) ( ); (xiv) (c); (xv) (d); (xvi) (c); (xvii) (a); (xviii) (d); (xix) (b); (xx) (a); (xxi) (b); (xxii) (c); (xxiii) (a); (xxiv) (c).

(Short Answer Type Questions)

2. (i) Current Account is an account maintained to record transactions other than transactions of capital such as drawings against profit, interest allowed on capital, interest charged on drawings, salary or commission payable to a partner, share of profits/losses. As a result, the balance of Current Account fluctuates with every transaction of the partner with the firm.

OR

Partnership Deed is necessary because it defines relationship between partners. It governs the rights, duties and liabilities of each partner.

(ii) The profit earned by a business during previous accounting periods on an average basis is termed as Average Profit.

OR

'Hidden Goodwill' is the excess of total capital of the firm as calculated on the basis of new partner's capital over the adjusted capitals of the existing partners and capital of incoming partner.

(iii) Prospectus is the document issued by a public company in which terms and conditions of the issue are stated along with the purpose for which the proceeds of the issue of securities shall be used.

"Prospectus" means any document described or issued as a prospectus and includes a red herring prospectus or shelf prospectus or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate. [*Section 2(70) of the Companies Act, 2013*]

(iv) Sacrificing ratio is calculated to determine share in goodwill brought by the new partner.

OR

Gaining Ratio is the ratio in which the remaining partners contribute for the share of goodwill of retiring or deceased partner. It is calculated as follows:

Gaining Ratio = New Profit Share – Old Profit Share

(v) Revaluation Account is a Nominal Account. Loss due to revaluation of assets and reassessment of liabilities is debited and gain is credited in the Revaluation Account.

OR

Accumulated Profit means net profit remaining undistributed. It is also termed as 'Retained Earnings'.

(vi) Gaining Ratio will be equal, *i.e.*, 1 : 1.

(vii) "According to Section 2(15) of the Companies Act, 2013, ''C*alled-up capital means such part of the capital which has been called for payment''*.

(viii) **Preference Shares** are the shares which carry the following two preferential rights:

(a) Preferential right to receive dividend, to be paid as fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income tax, before it is paid to Equity Shareholders, and

(b) Return of capital on the winding up of the company before that of equity shares.

(ix) Short-term Solvency Ratios or Liquidity Ratios are those ratios which are computed to evaluate the capability of the entity to meet its short-term liabilities. Commonly used liquidity ratios are:

(a) Current Ratio, and

(b) Quick Ratio or Liquid Ratio.

OR

Proprietary Ratio is the ratio that establishes the relationship between proprietors' funds and total assets.

Computation: The Proprietary Ratio is computed as follows:

$$\text{Proprietary Ratio} = \frac{\text{Proprietors' Funds or Shareholders' Funds or Equity}}{\text{Total Assets}}$$

Proprietors' Funds can be computed by following either Liabilities Approach or Assets Approach. It should be kept in mind that the result under both the approaches will be same.

(a) Liabilities Approach: Share Capital (Equity + Preference) + Reserves and Surplus.

(b) Assets Approach: Non-current Assets + Working Capital (*i.e.*, Current Assets – Current Liabilities) – Non-current Liabilities.

(x) One of the objectives of Financial Statement Analysis is to assess the earning capacity or profitability of the enterprise. In addition, the earning capacity of the enterprise, in coming years, may also be forecast.

OR

Common-size Income Statement is a tool for financial analysis. In the statement, Revenue from Operations (Net Sales) is taken as 100 and expenses are expressed as percentage of Revenue from Operations (Net Sales).

(xi) Dividend received is shown as operating activity by **financing companies**, it being its principal revenue producing activity.

(xii) **Fixed Assets Turnover Ratio: (Not in Syllabus)** Fixed Assets Turnover Ratio is the ratio to analyse the relationship between Net Fixed Assets and Revenue from Operations. It shows the number of times fixed assets are used or turned around for earning revenue from operations. It is calculated as follows:

$$\frac{\text{Revenue from Operations}}{\text{Net Fixed Assets}}$$

(Subjective/Descriptive Type Questions)

3. PROFIT & LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2022

Dr. | *Cr.*

Particulars		₹	Particulars	₹
To Interest on Capital:			By Profit & Loss A/c (Net Profit)	3,00,000
A	15,000		By Interest on Drawings:	
B	10,000		*A* (₹ 50,000 × 10/100 × 6/12)	2,500
C	5,000	30,000	*B* (₹ 40,000 × 10/100 × 6/12)	2,000
To Salary to *B*		60,000	*C* (₹ 25,000 × 10/100 × 6/12)	1,250
To Commission to *C*		90,000		
(₹ 9,90,000 × 10/110)				
To Profit transferred to:				
A's Capital A/c	62,875			
B's Capital A/c	41,917			
C's Capital A/c	20,958	1,25,750		
		3,05,750		3,05,750

OR

Characteristics of Profit & Loss Appropriation Account

1. It is an extension of the Profit & Loss Account.
2. It is prepared by the partnership firms.
3. It shows the appropriation of net profit for the accounting period.
4. The entries in this account are passed giving effect to the Partnership Deed.

4. JOURNAL OF HCL LTD.

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(*i*)	**For Forfeiture of Shares:**				
	Share Capital A/c	...Dr.		50,000	
	To Calls-in-Arrears A/c				15,000
	To Forfeited Shares A/c				35,000
	(Being the shares of *X* forfeited for non-payment of call money of ₹ 3)				
(*ii*)	**For Reissue of Shares:**				
	Bank A/c	...Dr.		40,000	
	Forfeited Shares A/c	...Dr.		10,000	
	To Share Capital A/c				50,000
	(Being the reissue of shares at 20% discount)				
(*iii*)	**For Transfer of Gain (Profit):**				
	Forfeited Shares A/c	...Dr.		25,000	
	To Capital Reserve A/c				25,000
	(Being the balance gain on reissue transferred)				

OR

(a) *Forfeiture of shares means cancelling the shares for non-payment of calls due*. But, shares can be forfeited only if the Articles of Association of the company allows forfeiture. If any shareholder does not pay the amount of a call, the company may exercise the power to forfeit the shares held by him on which amount of call or calls is not paid. The company before forfeiture, must first give clear 14 days' notice to the defaulting shareholder that unless due amount along with interest is paid if any, by the specified date, the shares shall be forfeited. If the shareholder still does not pay, the company may forfeit the shares by passing an appropriate resolution.

On forfeiture, the shares are cancelled and to that extent Share Capital is reduced. The amount received by the company is forfeited, *i.e.*, not refunded. Journal entry for forfeiting the shares is passed.

Disclosure of Forfeited Shares Account in the Balance Sheet: Till the time forfeited shares are reissued, balance of the Forfeited Shares Account is added to paid-up capital under Subscribed Share Capital in the Note to Accounts on 'Share Capital', being part of Shareholders' Funds shown under Equity and Liabilities part of the Balance Sheet.

(b) *Authorised Capital' or 'Nominal Capital' means such capital as is authorised by the Memorandum of a company to be the maximum amount of share capital of a company.*

—Section 2(8) of the Companies Act, 2013

'Authorised Capital' or 'Nominal Capital' or 'Registered Capital' is stated in the Memorandum of Association and is the maximum amount that a company can raise as share capital.

It is stated separately for each class of shares, *i.e.*, Preference Shares and Equity Shares and is the maximum amount of share capital under each class of shares which a company can issue for subscription. If a company has to issue more shares than authorised capital, it must first increase the authorised or nominal capital and thereafter issue shares for subscription.

Authorised Share Capital under each class (Equity or Preference) may be more or at the most equal to the Issued Share Capital, but **cannot** be less than the Issued Capital.

5. JOURNAL OF *XYZ* LTD.

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(*i*)	Equipment A/c	...Dr.		19,950	
	To Vendor				19,950
	(Being the purchase of equipment)				
(*ii*)	**Situation 1:**				
	Vendor	...Dr.		19,950	
	Discount on Issue of Debentures A/c	...Dr.		1,050	
	To 10% Debentures A/c				21,000
	(Being 210 Debentures (₹ 19,950 ÷ ₹ 95) issued as purchase consideration)				
(*iii*)	**Situation 2:**				
	Vendor	...Dr.		19,950	
	To 10% Debentures A/c				19,000
	To Securities Premium A/c				950
	(Being 190 Debentures (₹ 19,950 ÷ ₹ 105) issued as purchase consideration)				

6.

Dr. REVALUATION ACCOUNT Cr.

Particulars	₹	Particulars		₹
To Plant and Machinery A/c	10,000	By Loss transferred to:		
To Provision for Doubtful Debts A/c	500	*X*'s Capital A/c	5,250	
		Y's Capital A/c	3,500	
		Z's Capital A/c	1,750	10,500
	10,500			10,500

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)	Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
To Revaluation A/c (Loss)	5,250	3,500	1,750	By Balance *b/d*	40,000	50,000	30,000
To *Y*'s Capital A/c (Goodwill)	13,500	...	4,500	By Reserve	18,000	12,000	6,000
To Bank A/c	...	30,000	...	By *X*'s Capital A/c (Goodwill)	...	13,500	...
To *Y*'s Loan A/c	39,250	56,500	29,750	By *Z*'s Capital A/c (Goodwill)	...	4,500	...
				By Profit & Loss Suspense A/c	...	10,000	...
	58,000	90,000	36,000		58,000	90,000	36,000

Working Notes:

1. *Share of Goodwill of Y:*
   Goodwill of the firm = ₹ 54,000
   Y's share = ₹ 54,000 × 2/6 = ₹ 18,000
   It will be contributed by *X* and *Z* in their gaining ratio, *i.e.*, 3 : 1.
2. *Calculation of share of Y in estimated profit:*
   Estimated profit till date of retirement= ₹ 30,000 (₹ 60,000 × 1/2)
   Y's share = ₹ 30,000 × 2/6 = ₹ 10,000.

OR

Reconstitution of partnership firm means change in the partnership agreement whereby old partnership agreement comes to an end and new partnership agreement comes into existence but the firm continues. Reconstitution happens in the following circumstances

(a) When there is change in profit-sharing ratio among existing partners. Example: Amit and Amrit are partners sharing profits and losses in the ratio of 3 : 2. They decide to share profits equally *w.e.f.* 1st April, 2023.

(b) On admission of a partner. Example: Amit and Amrit are partners sharing profits and losses in the ratio of 3 : 2. They admit Amulya as a partner *w.e.f.* 1st April, 2023 and decide to share profits equally. It is a case of reconstitution whereby a new partner is admitted and as a result profit-sharing ratio has changed. Thus, Amit and Amrit have sacrificed their profit share in favour of Amulya (new partner).

(c) On retirement of a partner. Example: Amit, Bikram and Amrit are partners sharing profits and losses in the equal ratio. Amrit retired w.e.f. 1st April, 2023 and Amit and Bikram decide to share profits in the ratio of 3 : 2. It is a case of reconstitution whereby Amrit (a partner) retired and as a result profit-sharing ratio has changed. Amrit has sacrificed his profit share in favour of Amit and Bikram (Gaining Partners).

(d) On death of a partner. Example: Amit, Bikram and Amrit are partners sharing profits and losses in the equal ratio. Amrit died on 1st March, 2023. Amit and Bikram decide to share profits in the ratio of 3 : 2. It is a case of reconstitution whereby Amrit (deceased partner) died and as a result profit-sharing ratio has changed. Amrit's profit share is taken by Amit and Bikram (Gaining Partners).

7. JOURNAL OF *XYZ* LTD.

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(*i*)	Bank A/c	...Dr.		1,00,000	
	To Share Application A/c				1,00,000
	(Being the application money received on 50,000 shares)				
(*ii*)	Share Application A/c	...Dr.		1,00,000	
	To Share Capital A/c				1,00,000
	(Being the application money transferred on allotment of shares)				
(*iii*)	Share Allotment A/c	...Dr.		2,50,000	
	To Share Capital A/c				1,50,000
	To Securities Premium A/c				1,00,000
	(Being the allotment money due)				
(*iv*)	Bank A/c	...Dr.		2,45,000	
	Calls-in-Arrears A/c	...Dr.		5,000	
	To Share Allotment A/c				2,50,000
	(Being the allotment money received except on 1,000 shares)				
(*v*)	Share First Call A/c	...Dr.		1,50,000	
	To Share Capital A/c				1,50,000
	(Being the first call made due)				
(*vi*)	Bank A/c	...Dr.		1,47,000	
	Calls-in-Arrears A/c	...Dr.		3,000	
	To Share First Call A/c				1,50,000
	(Being the call money received)				
(*vii*)	Share Capital A/c	...Dr.		8,000	
	Securities Premium A/c	...Dr.		2,000	
	To Calls-in-Arrears A/c				8,000
	To Forfeited Shares A/c				2,000
	(Being 1,000 shares forfeited on non-payment of allotment and first call money)				

OR

Issue of shares at premium means shares have been issued at a price that is more than the nominal (face) value of the share. For example, a share with nominal (face) value of ₹ 10 is issued at ₹ 15, premium being ₹ 5.

Purposes for Utilisation: Section 52(2) of the Companies Act, 2013 restricts the use of the amounts received as premium on securities for the following purposes:

(i) Issuing fully paid bonus shares to the members;

(ii) Writing off preliminary expenses of the company;

(iii) Writing off the expenses of, or the commission paid or discount allowed on any issue of securities or debentures of the company;

(iv) Providing for the premium payable on the redemption of any redeemable Preference Shares or of any debentures of the company; and

(v) In purchasing its own shares and securities (buy-back).

8. (a)

Dr. REVALUATION ACCOUNT *Cr.*

Particulars		₹	Particulars	₹
To Machinery A/c		50,000	By Building A/c	80,000
To Provision for Doubtful Debts A/c		3,000		
To Stock A/c		4,000		
To Gain/Profit transferred:				
A's Capital A/c	13,800			
B's Capital A/c	9,200	23,000		
		80,000		80,000

(b)

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Balance *c/d*	5,13,800	3,09,200	4,11,500	By Balance *b/d*	3,00,000	2,00,000	...
				By General Reserve A/c	1,50,000	1,00,000	...
				By Revaluation A/c	13,800	9,200	...
				By Premium for Goodwill A/c	50,000	...	...
				By Bank A/c	...	...	4,11,500
	5,13,800	3,09,200	4,11,500		5,13,800	3,09,200	4,11,500

(c)

BALANCE SHEET *as on 1st Jan. 2023*

Liabilities		₹	Assets		₹
Capital A/cs:			Land and Building		5,00,000
A	5,13,800		Plant and Machinery		2,30,000
B	3,09,200		Stock		76,000
C	4,11,500	12,34,500	Debtors	1,25,000	
Creditors		1,60,000	*Less:* Provision for Doubtful Debts	8,000	1,17,000
Bills Payable		40,000	Cash at Bank		5,11,500
			₹ (50,000 + 4,11,500 + 50,000)		
		14,34,500			14,34,500

Working Notes:

1. *Calculation of Sacrificing Ratio:*

   A's sacrifice = Old Profit Share – New Profit Share

   $= \frac{3}{5} - \frac{2}{5} = \frac{1}{5}$

   B's sacrifice = $\frac{2}{5} - \frac{2}{5}$ = Nil

   It means only *A* is the sacrificing partner. Hence, share of goodwill brought by *C* will be credited to *A* only.

2. *Calculation of Capital of C:*

   A's Capital (After all adjustments) = ₹ 5,13,800

   B's Capital (After all adjustments) = ₹ 3,09,200

   Total = ₹ 8,23,000

   50% of combined capital of *A* and *B* = ₹ 4,11,500.

   This amount is brought by *C* as capital.

9. Given: Current Ratio = 3.5

Quick Ratio = 2.5

Working Capital = ₹ 1,20,000

Working Capital = Current Assets – Current Liabilities

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{3.5}{1}$$

Working Capital = 3.5 – 1 = 2.5

If working capital is 2.5, Current Assets = 3.5

If working capital is ₹ 1,20,000, Current Assets = $\frac{3.5}{2.5} \times$ ₹ 1,20,000 = ₹ **1,68,000** – (a)

Stock = Current Assets – Quick Assets

= 3.5 – 2.5 = 1.

If Current Assets are 3.5, Stock is 1

If Current Assets are ₹ 1,68,000, Stock = $\frac{1}{3.5} \times$ ₹ 1,68,000 = ₹ **48,000** – (b).

OR

(a) *Stock (Inventory) Turnover Ratio establishes relationship between Cost of Revenue from Operations, i.e., Cost of Goods Sold and Average Stock (Inventory) carried during that period.*

Stock (Inventory) Turnover Ratio is an *activity as well as efficiency ratio* and it measures the number of times an enterprise sells and replaces its Stock (Inventory), *i.e.*, the number of times Stock (Inventory) was converted into sales during the period.

Computation: The Stock (Inventory) Turnover Ratio is computed as follows:

Stock (Inventory) Turnover Ratio

$$= \frac{\text{Cost of Revenue from Operations (Cost of Goods Sold)}}{\text{Average Stock (Inventory)}} = \text{...Times.}$$

Cost of Revenue from Operations (Cost of Goods Sold)

= Revenue from Operations – Gross Profit

Or

= Revenue from Operations + Gross Loss

Or

= Opening Stock + Net Purchases + Direct Expenses (Assumed to be given) – Closing Stock

Or

In Case of Manufacturing Enterprise:

= Cost of Materials Consumed + Purchases of Stock-in-Trade + Changes in Stock (Inventories) of Finished Goods, Work-in-Progress and Stock-in-Trade + Direct Expenses (Assumed to be given)

In case, amount of Cost of Revenue from Operations (Cost of Goods Sold) is not given but instead amount of Revenue from Operations is given, amount of Revenue from Operations is used for calculating the ratio.

(b) Proprietary Ratio establishes the relationship between proprietors' funds and total assets.

Computation: The Proprietary Ratio is computed as follows:

$$\textit{Proprietary Ratio} = \frac{\text{Proprietors' Funds or Shareholders' Funds or Equity}}{\text{Total Assets}}$$

Proprietors' Funds can be computed by following either Liabilities Approach or Assets Approach. It should be kept in mind that the result under both the approaches will be same when calculated from the Balance Sheet.

(a) **Liabilities Approach:** Share Capital (Equity + Preference) + Reserves and Surplus + Money Received Against Share Warrants + Share Application Money Pending Allotment + Deferred Tax Liabilities (Net) – Deferred Tax Assets (Net).

(b) **Assets Approach:** Non-current Assets + Working Capital (*i.e.*, Current Assets – Current Liabilities) – Non-current Liabilities.

11. CASH FLOW STATEMENT *for the year ended 31st December, 2022*

Particulars	₹	₹
A. Cash Flow from Operating Activities		
Net Profit before Tax and Extraordinary Items (WN 1)		54,000
Adjustment for Non-cash and Non-operating Items:		
Add: Interest on 8% Debentures (WN 2)		4,000
Preliminary Expenses Written off		2,000
Opening Profit before Working Capital Changes		60,000
Add: Decrease in Current Assets/Increase in Current Liabilities		
(*i*) Debtors	9,000	
(*ii*) Bills Receivable	1,000	
(*iii*) Trade Payables	16,000	26,000
		86,000
Less: Increase in Current Assets: Inventories		10,000
Cash Generated from Operations		76,000
Less: Income Tax Paid		(60,000)
Cash Flow from Operating Activities		16,000
B. Cash Flow from Investing Activities		
Purchase of Fixed Assets		(40,000)
Cash Used in Investing Activities		(40,000)
C. Cash Flow from Financing Activities		
Proceeds from Equity Share Capital		20,000
Proceeds from 8% Debentures		10,000
Payment of Interest on Debentures		(4,000)
Cash Flow from Financing Activities		26,000
D. Net Increase in Cash and Cash Equivalents (A + B + C)		2,000
E. *Add:* Cash and Cash Equivalents in the beginning		10,000
F. Cash and Cash Equivalents at the end of the year		12,000

Working Notes:

1. *Calculation of Net Profit before Tax and Extraordinary Items:*

		₹
Closing balance of Profit & Loss A/c		66,000
Less: Opening Balance of Profit & Loss A/c		(82,000)
Net Loss incurred during the year		(16,000)
Add: Provision for Tax	64,000	
Transfer to General Reserve	6,000	70,000
Net Profit before Tax and Extraordinary Items		54,000

2. In the absence of information, it is assumed that fresh debentures have been issued on 31st December, 2022.

OR

(i) *Importance of Cash Flow Statement:*

1. ***Facilitates Short-term Planning:*** Cash Flow Statement gives information about sources and applications of Cash and Cash Equivalents for a specific period. It helps in planning investments and assessing the financial requirements of the enterprise.
2. ***Facilitates Assessing Liquidity and Solvency:*** Solvency is the ability of the enterprise to meet its liabilities on time. Cash Flow Statement helps to assess liquidity.
3. ***Efficient Cash Management:*** Cash Flow Statement gives information relating to surplus or deficit of cash. An enterprise, therefore, can decide about the Short-term Investments of the surplus and can arrange the Short-term Credit in case of deficit.
4. ***Comparative Study:*** A comparison of the actual cash flows with the budgeted cash flows of the year shows the extent to which Cash and Cash Equivalents were generated and applied as per the plan.
5. ***Reasons for Cash Position:*** Cash Flow Statement shows the reasons for lower and higher cash balances with the enterprise. Sometimes, an enterprise has lower cash balance in spite of higher profits or has higher cash balance in spite of lower profits. Reasons for such situations can be analysed with the help of Cash Flow Statement.
6. ***Evaluate Management Decisions:*** Cash Flow Statement, by providing information relating to company's investing and financing activities, gives the investors and creditors information about cash flow which helps them to evaluate management decisions.
7. ***Dividend Decision:*** Dividend payable is deposited in a separate Bank Account upon it being declared (*i.e.*, interim dividend) or approved (*i.e.*, final dividend). Cash Flow Statement helps in deciding how much dividend should be paid.

(ii) *Example of Operating Activities:* Receipts from sale of goods and/or rendering of services or payment for purchase of goods and/or services.

Example of Investing Activities: Payment for purchase of fixed assets or proceeds from sale of fixed assets.