INTERMEDIATE EXAMINATION

GROUP I

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2011

Paper-5 : FINANCIAL ACCOUNTING

Time Allowed : 3 Hours **Full Marks :** 100

The figures in the margin on the right side indicate full marks.

Answer **Question No. 1**, *which is compulsory and* **any five** *questions from the rest.*

Q. 1. (a) From the four alternative answers given against each indicate the correct answer : [1×10=10]

(i) From the four alternative answers given against each indicate the correct answer :

(A) Periodic inventory system
(B) Perpetual inventory system
(C) Both of (A) and (B)
(D) None of (A) and (B)

(ii) The cost of a Fixed Assets of a business has to be written off over its

(A) Natural Life
(B) Accounting Life
(C) Physical Life
(D) Estimated Economic Life

(iii) Shortworkings can be recouped out of

(A) Minimum rent
(B) Excess of actual Royalty over minimum rent
(C) Excess of minimum rent over actual Royalty
(D) Profit and Loss Account

(iv) In Hire Purchase system cash price plus interest is known as

(A) Capital value of asset

(B) Book value of asset

(C) Hire purchase price of asset

(D) Hire purchase charges

(v) In partnership when a new Partner brings his share of Goodwill in cash, then the amount of such Goodwill will be credited to Partners' capitals as per the following ratio :

(A) Old Profit sharing ratio

(B) Sacrifice ratio

(C) Gain ratio

(D) None of the above

(vi) The Receipts and Payments Account generally begins with

(A) Credit Balance

(B) Debit Balance

(C) Both Debit and Credit Balance

(D) None of the above

(vii) Which of the following is a category of Share Capital of a company?

(A) Authorised Capital

(B) Issued Capital

(C) Called up Capital

(D) All of the above

(viii) In case of a Banking Company, entries in the Personal Ledger are made from

(A) Day Book

(B) Vouchers

(C) Rough Register

(D) None of the above

(ix) When Sales = ` 1,80,000, Purchase = ` 1,60,000, Opening Stock = ` 34,000 and rate of the Gross Profit is 20% on cost, the Closing Stock would be

(A) ` 50,000

(B) ` 44,000

(C) ` 46,000

(D) None of the above

(x) Goods are transferred from Department X to Department Y at a price so as to include a profit of 33.33% on cost. If the value of closing stock of Department Y is ` 18,000, then the amount of stock reserve on closing stock will be

(A) ` 6,000

(B) ` 4,500

(C) ` 9,000

(D) None of the above

(b) State whether the following statements are TRUE (T) or FALSE (F) : [1×5=5]

(i) Original cost minus scrap value is the depreciable value of asset.

(ii) Royalty is a Revenue Expenditure to Lessor.

(iii) According to AS-2 Inventories are held for sale in normal course of business.

(iv) Income and Expenditure Account is prepared by adopting accrual principle of accounting.

(v) Advance payment of Tax is shown in the Liabilities side of Balance Sheet.

(c) Fill in the blanks in the following sentences using the appropriate word from the alternatives indicated : [1×5=5]

(i) Depreciation is an item of _________ . (gross profit/expenditure)

(ii) Compensation paid to employees who are retrenched is _________ expenditure (Capital/ Revenue)

(iii) Receipts and Payment Account is a _________ Account is nature. (Real/Nominal)

(iv) Unclaimed Dividend appears under the head of _________ in the Balance Sheet of a Company (Deferred Expenditure/Liabilities)

(v) According to Insurance Act, the provision required to be made against unexpired risk in fire insurance business is _________ per cent. (30/50)

(d) Match the following : [1×5=5]

(i)	AS—6	(I)	Borrowing costs
(ii)	AS—13	(II)	Consolidated Financial Statements
(iii)	AS—16	(III)	Depreciation Accounting
(iv)	AS—19	(IV)	Accounting for Investment
(v)	AS—21	(V)	Leases
		(VI)	No matching statements found

Answer 1. (a)

(i) — (A) Periodic inventory system

(ii) — (D) Estimated Economic Life

(iii) — (B) Excess of actual Royalty over minimum rent

(iv) — (C) Hire purchase price of asset

(v) — (B) Sacrifice ratio

(vi) — (B) Debit Balance

(vii) — (D) All of the above

(viii) — (B) Voucher

(ix) — (B) ` 44,000

(x) — (B) ` 4,500

Answer 1. (b)

(i) — (T)

(ii) — (F)

(iii) — (T)

(iv) — (T)

(v) — (F)

Answer 1. (c)

(i) — Expenditure

(ii) — Revenue

(iii) — Real

(iv) — Liabilities

(v) — 50

Answer 1. (d)

(i) AS-6 — (III)

(ii) AS-13 — (IV)

(iii) AS-16 — (I)

(iv) AS-19 — (V)

(v) AS-21 — (II)

Q. 2. (a) For the year ending 31st December, 2011, the Sales, Purchases, Opening Stock and Closing Stock of a Trader was ` 5,00,000, ` 3,80,000, ` 65,000 and ` 52,000 respectively. Some goods were destroyed by fire (without realization of any value) during the year. If the Trader earned Gross Profit @ 25% on Sales for the year, calculate the value of goods destroyed by fire. [3]

(b) On 1st April, 2009, Nath Ltd. purchased a second-hand Machine for ` 1,20,000 and spent ` 30,000 on its renewal. On 1st October, 2010, ` 3,000 was spent on repairs. On 30th September, 2011 the Machine was sold for ` 75,000. Depreciation is to be provided @ 20 per cent per annum according to written down value method.

Prepare Machinery Account reflecting all these transactions assuming Books are closed on 31st March each year. [5]

(c) A and B are currently partners in a firm sharing Profit/Loss in the ratio of 4 : 3. A new partner C is admitted and after his admission new profit sharing ratio between A, B and C becomes 5 : 3 : 2. What will be the sacrifice ratio of A and B after admission of C? [2]

(d) What do you understand by gradual realisation of assets and piecemeal distribution? State the priority that should be followed in piece meal distribution. [5]

Answer 2. (a)

Calculation of value of goods destroyed by fire :

Dr. **Memorundum Trading A/c** *Cr.*

Particulars	`	Particulars	`
To Opening stock	65,000	By Sales	5,00,000
To Purchases	3,80,000	By Goods destroyed by fire (bal. fig.)	18,000
To Gross Profit (25% of Sales)	1,25,000	By Closing stock	52,000
	5,70,000		5,70,000

Goods destroyed by Fire = ` 18,000

Answer 2. (b)

Ledger of Nath Limited

Dr. **Machinery A/c** *Cr.*

	Particulars	`		Particulars	`
1.4.09	To Bank A/c	1,20,000	31.3.10	By Depreciation	30,000
	Bank A/c (Exp.)	30,000		By Balance c/d	1,20,000
		1,50,000			1,50,000
1.4.10	To Balance b/d	1,20,000	31.3.11	By Depreciation	24,000
				By Balance c/d	96,000
		1,20,000			1,20,000
1.4.11	To Balance b/d	96,000	30.9.11	By Depreciation (@ 20% on ` 96,000 for ½ year)	9,600
				Bank A/c (Sale)	75,000
				P & L A/c (Loss)	11,400
		96,000			96,000

Answer 2. (c)

Sacrifice of A = 4/7 – 5/10 = 40 – (35/70) = 5/70

Sacrifice of B = 3/7 – 3/10 = 30 – (21/70) = 9/70

Hence the sacrifice ratio = 5/70 : 9/70 or 5 : 9

Answer 2. (d)

When a partnership is in process of being dissolved, assets are sold gradually one after another to fetch maximum price. Assets are realized individually and it may need a time period to realize from all the assets. The partners in such a case may not wish to wait till all the assets are realized. It is universally accepted practice that an interim distribution is made to the partners for their claim (after paying off all creditors) as and when cash is available.

Priority of distribution will be as under :

(i) to meet the realization expenses

(ii) to pay off preferential creditors

(iii) to pay off other creditors

(iv) to pay off partner's loans

(v) to pay off partner's capital

Q. 3. (a) From the following information relating to Evergreen Sports Club, prepare Balance Sheet of the Club as on 1-1-2010 and on 31-12-2010 : [10]

(i) Assets as on 1-1-2010

	`
Club Ground	80,000
Sports Equipment	50,000
Furniture	10,000

(ii) Accrued Subscription as on 1-1-2010 was ` 2,000.

(iii) Creditor for stationery as on 1-1-2010 was ` 1,800.

(iv) Receipts and Payments Account for the year ended 31-12-2010

Dr.				*Cr.*
	Receipts `			*Payments* `
To Balance brought down	8,000		By Salaries	14,000
Subscription received (2009)	1,800		Printing and Stationery	3,500
-do- (2010)	22,000		Fire Insurance	2,200
-do- (2011)	600		Advertisement	3,000
Sales of old Newspaper	500		Furniture	4,000
Rent Received	5,800		Investments	21,000
Entrance Fees	18,000		Balance c/d	9,000
	56,700			56,700

Income and Expenditure Account for the year ended 31-12-2010.

Dr.	*Expenditure* `		*Income* ` *Cr.*
To Salaries	16,000	By Subscription	24,000
Printing & Stationery	2,000	Entrance Fees	9,000
Advertisement	3,000	Rent	6,000
Audit Fees	800	Sale of old Newspapers	500
Fire Insurance	2,000		
Depreciation:			
Equipment	7,000		
Furniture	1,000		
Excess of Income over Expenditure	7,700		
	39,500		39,500

(b) A and B are Partners sharing profits in the ratio of 5 : 3. Following is the Balance Sheet of the Firm on 31-3-2011 : [5]

Balance Sheet as at 31-3-2011

	`		`
Capital :		Drawings	
A	80,000	A	5,000
B	20,000	B	3,000
		Other Assets	92,000
	1,00,000		1,00,000

Profit for the year 2010-11 was ` 16,000 and was divided between the Partners as per agreed ratio, but interest on capital @ 5% p.a. and on drawings @ 6% was inadvertently omitted. Interest on drawing may calculated on an average basis for 6 months.

You are required to pass Journal Entry(ies) to make the adjustments in the Capital accounts of A and B.

Answer 3. (a)

Balance Sheet as at 1.1.2010

Liabilities	`	**Assets**	`
Capital Fund (bal. fig.)	1,48,200	Club Ground	80,000
Creditors (for stationery)	1,800	Sports Equipment	50,000
		Furniture	10,000
		Accrued Subscription	2,000
		Cash	8,000
	1,50,000		1,50,000

Balance Sheet as at 31.12.2010

Liabilities	`	`	Assets	`
Capital Fund	1,48,200		Club Ground	80,000
Entrance Fees	9,000		Sports Equipment	43,000
Surplus	7,700	1,64,900	(` 50,000 – ` 7,000)	
Advance Subscription		600	Furniture	
			(` 10,000 + 4,000 *Less*: Depn. 1,000)	13,000
Liabilities for expenses			Investments	21,000
Printing	300		Accrued Subscription	
Salaries	2,000		- 2009 ` 200	
Audit fees	800	3,100	- 2010 ` 2,000	2,200
			Accrued Rent	200
			Prepaid Insurance	200
			Cash	9,000
		1,68,600		1,68,600

Answer 3. (b)

	Partner A `	Partner B `
Capital as at 31-3-11	80,000	20,000
Less : Profit credited	10,000	6,000
	70,000	14,000

(Figures in `)

Adjustments for :	Partner A		Partner B	
	Dr.	*Cr.*	*Dr.*	*Cr.*
Interest on capital @ 5%		3,500		700
Interest on drawings @ 6%	150		90	
Profit written back	10,000		6,000	
Divisible Profit		7,525		4,515
(16,000 + 240 – 4,200) = 12,040				
Total	10,150	11,025	6,090	5,215
Net	(+) 875		(–) 875	

Journal Entry :

		Dr.	*Cr.*
Partner B A/c	Dr.	875	
To Partner A A/c			875

Q. 4. (a) Mr. X, a cloth trader of Kolkata opened a Branch at Kanpur on 1-4-2010. The goods were sent by Head Office to the Branch and invoiced at selling price to the Branch, which is 25% of the cost price of Head Office. [10]

The following are the particulars relating to the transactions of the Kanpur Branch:

	`	`
Goods sent to Branch (at cost to H.O.)		4,50,000
Sales — Cash		2,10,000
— Credit		3,20,000
Cash collected from Debtors		2,85,000
Return from Debtors		10,000
Discount Allowed		8,500
Cash sent to Branch for Freight	30,000	
for Salaries	8,000	
for other expenses	12,000	50,000
Spoiled clothes written off at invoice price		10,000
Normal loss estimated at		15,000

Prepare Branch Stock Account, Branch Debtors Account and Branch Adjustment Account showing the net profit of the Branch.

(b) The following information for the year ended 31st March, 2011 is available for Seva Bank Ltd.: [5]

	`	`
Standard Assets		5,50,00,000
Sub-standard Assets		31,50,000
Doubtful Assets but secured—		
Up to one year	29,00,000	
One to three years	17,00,000	
More than three years	7,00,000	53,00,000
Loss Assets		21,00,000

You are required to ascertain the amount of provision required to be made by the Bank.

Answer 4. (d)

Dr. **Branch Stock Account** *Cr.*

Particulars	`	Particulars	`
To Goods sent to Branch	5,62,500	By Cash sales	2,10,000
(` 4,50,000 + 25% of ` 4,50,000)		Branch Debtors (Cr. Sales)	3,20,000
Branch debtors Account	10,000	Branch adjustment a/c	
		(Normal Loss)	15,000
		Branch adjustment a/c	
		(Spoiled)	2,000
		Profit & Loss A/c (Spoiled)	8,000
		Stock shortage	17,500
	5,72,500		5,72,500

Dr. **Branch Debtors Account** *Cr.*

Particulars	`	Particulars	`
To Goods sent to Branch	3,20,000	By Cash	2,85,000
		Discount	8,500
		Branch Stock (return)	10,000
		Balance c/d	16,500
	3,20,000		3,20,000

Dr. **Branch Adjustment Account** *Cr.*

Particulars	`	Particulars	`
To Branch Stock A/c (spoilage)	2,000	By 25% mark up on goods sent	1,12,500
Stock shortage ($\frac{25}{125}$ of ` 17,500)	3,500		
Normal Loss	15,000		
Gross Profit c/d	92,000		
	1,12,500		1,12,500

Dr. **Branch Profit Account** *Cr.*

Particulars	`	Particulars	`
To Freight	30,000	By Gross Profit b/d	92,000
Salaries	8,000		
Other expenses	12,000		
Spoilage	8,000		
Stock Shortage	14,000		
Net Profit	20,000		
	92,000		92,000

Answer 4. (b)

Seva Bank Ltd

Statement showing the amount of provision for the year ending 31st March 2011

	Assets	Amount (`)	Rate of Provision (%)	Amount of Provision (`)
1.	Standard Assets	5,50,00,000	0.40	2,20,000
2.	Sub-standard	31,50,000	10	3,15,000
3.	Doubtful Assets :			
	Upto on year	29,00,000	20	5,80,000
	One to three years	17,00,000	30	5,10,000
	More than three years	7,00,000	100	7,00,000
	Loss Assets	21,00,000	100	21,00,000
	Total amount of required for provision			44,25,000

(Rates of provision as per Master Circular issued by RBI 'DBOD No. BP. BC. 11/21.04, 048/2005-06 dated November 4, 2005')

Q. 5. (a) The following balances are appearing in the Books of All Xerox Ltd. on 1-4-2011: [10]

	`
Redeemable Preference Share Capital (Shares of ` 10 each)	2,00,000
Calls-in-Arrear	2,000
General Reserve	1,00,000
Share Premium	5,000

The preference shares are fully called up and due for redemption at a premium of 10%. Calls-in-Arrear are in respect of final call at the rate of ` 4 per share and these shares are held by Mr. Rahul whose whereabouts are not known.

The Board of Directors decided that 50% of the General Reserve is to be utilized for the purpose of redemption of redeemable preference share capital and to meet the further requirement of funds, further 14,500 numbers of equity shares of ` 10 each were issued at a premium of 20%.

The redemption of preference shares were duly carried out and subsequently the company utilized the balance of Capital Redemption Reserve Account to issue equity shares at ` 10 each as bonus to shareholders.

You are required to show necessary journal entries in the Books of All Xerox Ltd.

(b) Discuss some important provisions of the Banking Regulation Act, 1949 regarding disposal of Non-Banking Assets u/s 9 of the Act. [5]

Answer 5. (a)

Book of All Xerox Ltd.

Journal Entries *Dr.* *Cr.*

Date	Particulars	Amount (`)	Amount (`)
	Redeemable Prefrence Share Capital A/c Dr. Premium on Redemption A/c Dr. To Redeemable Preference Sharholders A/c (Being 19,500 fully paid Red. Pref. Shares along with premium Payable on redemption as per Board resolution no. dt.)	1,95,000 19,500	 2,14,500
	General Reserve A/c Dr. To Capital Redemption Reserve A/c (Being General Reserve transferred)	50,000	 50,000
	Bank A/c Dr. To Equity Shares capital A/c To Equity Share Premium A/c (Being issue of 14,500 Equity shares at a premium)	1,74,000	 1,45,000 29,000
	Share Premium A/c Dr. To Premium on Redemption A/c (Being premium payable adjusted)	19,500	 19,500
	Prefrence Shareholders A/c Dr. To Bank A/c (Being amount paid off to Pref. shareholders)	2,14,500	 2,14,500
	Capital Redemption Reserve A/c Dr. To Bonus payable to Shareholders A/c (Being Bonus declared and transferred to Capital Redemption Reserve account)	50,000	 50,000
	Bonus payable to Shareholders A/c Dr. To Equity Share capital A/c (Being amount transferred to Equity Share capital)	50,000	 50,000

Working Note **:**

	`
Nominal Value of shares Redeemed	1,95,000
Less : General Reserve Utilised	50,000
	1,45,000

Answer 5. (b)

Notwithstanding anything contained in Section 6 which specifies the various forms of business in which a Banking company may engage in addition to the business of Banking, no Banking company shall hold any immovable property howsoever acquired, except such as is required for its own use, for any period exceeding seven years from the acquisition thereof or from commencement of the Act, whichever is later, or any extension of such period as in Section provided; and such property shall be disposed of within such period or extended period, as the the case may be.

Provided that the Banking company may, within the period of seven years as aforesaid; deal or trade in any such property for the purpose of facilitating the disposal thereof. Provided further that Reserve Bank may in any particular case extend the aforesaid period of seven years by such period not exceeding five years, where it is satisfied that such extension would be in the interest of the depositors of the Banking company.

Q. 6. (a) On April 1, 2008 Chandra Transport Company purchased a mini truck from S. K. Motors on hire purchase system. The terms were that they would pay ` 1,00,000 down on same date and the balance was payable in three annual instalments. First instalment amounted to ` 74,000 was payable on 31-3-2009, second ` 93,000 on 31-3-2010 and third ` 84,000 on 31-3-2011. Interest is charged @ 12% per annum. Rate of depreciation is 20% on written down value.

You are required to calculate the total cash price and prepare, (i) S. K. Motors Account; and (ii) Mini-Truck Account in the Books of Chandra Transport Company. [6]

(b) Distinguish between Hire Purchase System and Instalment Payment System. [4]

(c) Give the journal entries to rectify or adjust the following in the books of the Head Office: [5]

(i) Goods purchased by branch ` 7,500 but payment made by Head Office. The Head Office has wrongly debited this amount to its own purchases account.

(ii) Branch paid ` 6,500 as salary to a visiting Head Office official. The Branch has debited the amount to salaries account.

(iii) Depreciation ` 11,250 in respect of Branch Shop whose account is kept in Head Office Books.

(iv) Expenses ` 5,600 to be charged to the Branch for work done on its behalf by the Head Office.

(v) Goods sent by the Head Office to Branch ` 25,000 not yet received by the Branch.

Answer 6. (a)

Calculation of Cash Price

Date	Particulars	Instalment (`)	Interest (`)	Cash Price (`)
31-3-11	3rd Instalment	84,000	9,000	75,000
	(–) Interest $\left(\frac{12}{112}\times 84{,}000\right)$	9,000		
	Balance of Cash Price	75,000		
31-3-10	+ 2nd Instalment	93,000	18,000	75,000
		1,68,000		
	(–) Interest $\left(\frac{12}{112}\times 1{,}68{,}000\right)$	18,000		
	Balance of Cash Price	1,50,000		
31-3-09	+ 1st Instalment	74,000	24,000	50,000
		2,24,000		
	(–) Interest $\left(\frac{12}{112}\times 2{,}24{,}000\right)$	24,000		
	Balance of Cash Price	2,00,000		
	+ Down Payment	1,00,000		1,00,000
	Total	3,00,000		3,00,000

Total Cash Price = ` 3,00,000

Ledger of Chandra Transport Co.

Dr. **S. K. Motors Account** *Cr.*

	Particulars	`		Particulars	`
1.4.08	To Bank A/c	1,00,000	1.4.08	By Mini Truck A/c	3,00,000
31.3.09	To Bank A/c	74,000	31.3.09	By Interest A/c	24,000
	To Balance c/d	1,50,000			
		3,24,000			3,24,000
31.3.10	To Bank A/c	93,000	1.4.09	By Balance b/d	1,50,000
	To Balance c/d	75,000	31.3.09	By Interest A/c	18,000
		1,68,000			1,68,000
31.3.11	To Bank A/c	84,000	1.4.10	By Balance b/d	75,000
			31.3.11	By Interest A/c	9,000
		84,000			84,000

Dr. **Mini Truck Account** *Cr.*

	Particulars	`		**Particulars**	`
1.4.08	To S. K. Motors A/c	3,00,000	31.3.09	By Depreciation A/c	60,000
				By Balance c/d	2,40,000
		3,00,000			3,00,000
1.4.09	To Balance b/d	2,40,000	31.3.10	By Depreciation A/c	48,000
				By Balance c/d	1,92,000
		2,40,000			2,40,000
1.4.10	To Balance b/d	1,92,000	31.3.11	By Depreciation A/c	38,400
				By Balance c/d	1,53,600
		1,92,000			1,92,000

Answer 6. (b)

Difference between Hire Purchase System and Instamment Purchase System

Hire Purchase System	**Instalment Purchase System**
(i) It is an agreement of hiring of goods	It is an agreement of sale of goods.
(ii) The title of the goods is transferred to the buyer after payment of last instalment	The title of goods is passed on to the buyer at the signing of agreement.
(iii) If the buyer fails to pay any of the instalment the goods can be repossessed by the seller	The seller can not repossess the goods.
(iv) The buyer can not hire out, sell, transfer, destroy, pledge the goods.	The buyer can hire out, sell, transfer, destroy and pledge the goods
(v) The buyer may return the goods without further payment, except for the instalment overdue.	Except seller's default, goods can not be returned
(vi) In cae of default, the total amount of instalment paid is forfeited and treated as hire charge.	In case of default, the total amount of instalmens paid by the buyer can not be forfeited

Answer 6. (c)

Entries in Books of Head Office

		Dr. Amount (₹)	*Cr.* Amount (₹)
(i) Branch A/c	Dr.	7,500	
To Purchase A/c			7,500
(H.O. purchase a/c was wrongly debited instead of Branch a/c, now rectified)			
(ii) Salaries A/c	Dr.	6,500	
To Branch a/c			6,500
(Being Salaries was paid by Branch to H.O. official)			
(iii) Branch A/c	Dr.	11,250	
To Branch Shop A/c			11,250
(Being Depreciation on Branch Shop written off)			
(iv) Branch A/c	Dr.	5,600	
To Expenses A/c			5,600
(Being expenses charged to Branch)			
(v) Goods in Transit A/c	Dr.	25,000	
To Branch A/c			25,000
(Being goods sent to Branch still in transit)			

Q. 7. (a) State the various limitations of Ratio Analysis (mention at least 5 points). [5]

(b) Using the following information, complete the Balance Sheet of Shekhar Ltd. as on 31st March, 2011: [7]

(i) Sales ₹ 36,00,000

(ii) Gross Profit Ratio 25%;

(iii) Total Assets Turnover: 3 times

(iv) Fixed Assets Turnover: 5 times

(v) Current Assets Turnover: 7.5 times

(vi) Inventory Turnover: 20 times

(vii) Debtors' Turnover: 18 times

(viii) Current Ratio 1.8 : 1

(ix) Total Assets/Net worth-2.25: 1

(x) Debt (long term)-Equity 0.75:1

Turnover ratios are based on cost of goods sold except Debtors' turnover

Balance Sheet as on 31st March, 2011

Liabilities	Amount `	Assets	Ammount `
Equity (net worth) Long term Debt Current liabilities		Fixed Assets Current Assets Inventories Debtors Cash in hand & bank	

(c) Classify the following expenditures into Capital Expenditure and Revenue Expenditure: [3]

(i) Expenses on a foreign tour to purchase a machinery

(ii) Annual maintenance fee of a machine

(iii) Money spent to reduce working cost

(iv) Compensation paid to workers under voluntary retirement scheme

(v) Legal expenses to recover dues from customers

(vi) Salaries paid to Engineering staff in erecting a machine

Answer 7. (a)

Some of the limitations of Ratio Analysis are discussed below :

(i) Completely based on comparison : It is not possible to analyse any particular matter with the help of a single ratio. Such analysis is possible by making comparison of at least two or more ratios. Whether a particular trend indicated by any ratio is good or bad, favourable or unfavorable that can only be judged through comparative analysis. Comparison is only one of the techniques of making analysis, but in case of ratio analysis it is the sole technique. For this reason it is said that ratio analysis is only a partial analytical process, not a complete one.

(ii) Difficult to fix up definite standards : The real significance of a particular ratio can be understood by comparing it with any ideal or standard norm of that ratio. But the standard already fixed on for a ratio may change over time. Moreover, standard ratios of the industry to which the firm belongs may be fixed up on different basis and may vary widely with the computed ratios of the firm. Standards may also differ according to the nature of the situations. So fixing up acceptable standards for all the ratios is no doubt an uphill task.

(iii) Dependence on financial statements : Ratios are always based on information disclosed in basic financial statements like the Profit and Loss Account and the Balance Sheet. Financial statements have their own limitations. So ratios computed on the basis of information disclosed in those financial statements cannot also be free from such limitations. For getting rid of these limitations before computing ratios some adjustments are required to be made in the information disclosed in financial statements. In reality it is not done and so ratios always suffer from the limitations of the financial statements.

(iv) Problem of inter-firm comparison : In case there is significant variations in accounting policies adopted by different firms belonging to the same industry the inter-firm comparison through ratio analysis does not become effective. For example it can be said that if the policies relating to inventory valuation, depreciation, treatment of contingent liabilities, etc. of two firms under the same industry are different the trend indicated by an inter-firm comparison through ratios does not carry any effective meaning.

(v) Personal influence : The utility of ratio analysis depends a lot on the skill and judgment of the interpreter. If the personal sense of judgment and analytical power of different interpreters vary a particular ratio may indicate different trends. So presence of personal aptitude reduces the effectiveness of ratio analysis. Moreover, the interpreters may exert undue influence on their analysis with unfair motives.

(vi) Only quantitative analysis : Ratios are often called quantitative tools because their computations are based on only quantitative or numerical figures. The qualitative aspects of the concerned numerals are totally ignored in the process of ratio analysis. Ignoring qualitative aspect may mislead the users of ratios. For example, a high current ratio indicates a satisfactory loan repayment capacity of a firm. But if its current assets consist of a large quantity of obsolete stock or its debtors are slow in paying the satisfactory trend of loan repayment capacity as indicated by the current ratio may prove to be only a paper jugglery.

(vii) Ratios indicate trend, do not prove : A common criticism against the ratio analysis technique is that it only indicates trend but does not prove anything. By comparing the computed ratios with the ideal or standard ratios, last year's ratios and similar ratios of other firms belonging to the same industry, the inference that is arrived at by the interpreter is nothing but a trend on any particular event. Whether the trend of the item of consideration is favourable or unfavourable, satisfactory or unsatisfactory a general notion as to that can be inferred upon through ratio analysis. Whether the item is really favourable or unfavourable, satisfactory or unsatisfactory that can never be authenticated or proved through such analysis. The considerations that are needed for coming to such a conclusive decision are not taken care of in ratio analysis.

Answer 7. (b)

Working Notes :

(i) Cost of goods sold = Sales ` 36,00,000 – 25% of ` 36,00,000 = ` 27,00,000

(ii) Total Assets = Cost of goods sold/Total Assets turnover = ` 27,00,000/3 = ` 9,00,000

(iii) Fixed Assets = Cost of goods sold/Fixed Assets Turnover = ` 27,00,000/5 = ` 5,40,000

(iv) Current Assets = Cost of goods sold/current assets turnover = ` 27,00,000/7.5 = ` 3,60,000
{or, Total Assets - Fixed Assets = ` 9,00,000 – 5,40,000 = ` 3,60,000}

(v) Inventories = Cost of goods sold/Inventory Turnover = ` 27,00,000/20 = ` 1,35,000

(vi) Debtors = Sales/Debtor's Turnover = ` 36,00,000/18 = ` 2,00,000

(vii) Current Liabilities = Current Assets/Current Ratio = ` 3,60,000/1.8 = ` 2,00,000

(viii) Net worth = Total Assets/Total Assets to Net worth ratio = ` 9,00,000/2.25 = ` 4,00,000

(ix) Long Term Debt = Net worth or Equity × 0.75 = ` 4,00,000 × 0.75 = ` 3,00,000
{or, Total Assets – Net worth – Current Liabilities = ` 9,00,000 – ` 4,00,000 – ` 2,00,000}

(x) Cash and bank = [Current Assets – Inventory – Debtors] = ` 3,60,000 – 1,35,000 – 2,00,000
= ` 25,000

Shekhar Ltd.
Balance Sheet as at 31.12.2010

Liabilities	`	Assets		`
Equity/Net worth	4,00,000	Fixed Assets		5,40,000
Long Term Debt	3,00,000	Current Assets		
Current Liabilities	2,00,000	Inventories	1,35,000	
		Debtors	2,00,000	
		Cash & Bank	25,000	3,60,000
	9,00,000			9,00,000

Answer 7. (c)

(i) Capital Expenditure
(ii) Revenue Expenditure
(iii) Capital Expenditure
(iv) Revenue Expenditure
(v) Revenue Expenditure
(vi) Capital Expenditure

Q. 8. Write Short Notes on *any three* : [3×5=15]

(a) Earning per share (AS 20);
(b) Sources for payment of Dividend;
(c) Conditions for buy back of shares;
(d) Managerial Remuneration;
(e) Money measurement concept.

Answer 8. (a) Earning per share (AS 20) :

(i) The applicability of the AS 20 is mandatory with effect from accounting year commencing on or after 01-04-2001 in respect of enterprises whose equity shares or potential equity shares are listed on a recognized stock exchange in India.

(ii) However under Part IV of Schedule VI of the Companies' Act '56 every company is required to disclose EPS in accordance with AS-20, whether listed on a recognized stock exchange or not.

(iii) Presentation of EPS is required to be made both on the basis of consolidated financial statement, as well as individual financial statements of the parent company.

(iv) Presentation should be made in terms of Basic and Diluted EPS on the face of 'the Profit & Loss Account for each class of equity share that has a different right to share in the net profit for the accounting period. For equity shares having different nominal value but carrying same voting rights should be converted into equivalent number of shares of the same nominal value.

(v) Both Basic and Diluted EPS should be presented with equal prominence for all periods even if the amounts are negative (a loss per share).

(vi) In addition to above, following are also disclosed :

1. the amount used as the numerator and a reconciliation of those amounts to the net profit/loss for the accounting period.
2. the weighted average number of equity shares used as the denominator and a reconciliation of those denominator to each other.
3. the nominal value of shares along with EPS figure.

(vii) Disclosure may also be made of terms and conditions of contracts generating potential equity which affect the basic and diluted EPS both on the weighted average number of shares outstanding and any consequent adjustments to net profit attributable to equity shareholders, following the computation of the denominator in accordance with AS-20.

Basic EPS is worked out by dividing the net profit /loss for the accounting period by the equity share using weighted average number of equity shares outstanding during the same period.

Diluted EPS indicates the potential variability or risk attached to the basic EPS as a consequence of the issue of potential equity shares and potential dilutive securities having significant impact on lowering EPS.

Answer 8. (b)

Section 205 of Companies Act, 1956 deals with the sources for payment of dividend and other conditions. The sources for payment of dividend are :

(i) **Dividend out of current year's profits :** Dividend out of current year's profits can be declared only after providing for depreciation in accordance with the provisions of S. 205(2).

(ii) **Dividend out of previous year or years profits :** Dividend from out of previous year or year's profits which falls or fall after the commencement of the Companies (Amendment) Act, 1960. Again depreciation should have been provided out of the profits of that financial year or from out of the profits of any other previous year or years.

(iii) **Dividend out of aggregate profits :** Dividend can be declared out of the aggregate of profits mentioned in *(i)* and *(ii)* above.

(iv) **Dividend out of State subsidies :** Dividend can be declared out of money provided by the Central Government or a State Government for the payment of dividend in accordance with guarantees given.

Capital profits :

Besides the above sources mentioned in S. 205(1) profits made on sale of assets can also be used for the payment of dividend but the following three conditions are to be satisfied :

(1) The profits must have been realized and not the result of revaluation.

(2) Articles of the company should permit for such distribution.

(3) Surplus must remain after the revaluation of all assets and liabilities.

Answer 8. (c)

Conditions of buy-back.

As per Section 77A(2) of the Companies Act,1956 the conditions for buy-back are:

The company's articles should authorize the buy-back. If not, the same has to be amended to include a provision to that effect;

A special resolution should be passed in the general meeting authorizing the buy-back;

(i) The buy-back should be less than 25% of the total paid-up capital and free reserves of the company;

(ii) The buy-back of equity shares in any financial year should not exceed 25% of its total paid-up equity capital in that financial year;

(iii) The Companies (Amendment) Act, 2001 has authorized the buy-back by means of a resolution at the company's Board provided the buy-back does not exceed 10% of the total paid-up equity capital and free reserves of the company. But, there cannot be more than one such buy-back in a period of 365 days.

(iv) Debt-equity ratio shall not exceed 2:1 after such buy-back. The Central Government may however, prescribe a higher ratio for a class or classes of companies;

(v) All the shares or other specified securities are fully paid up;

(vi) The buy-back of the shares or other securities listed on any recognized stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;

(vii) The buy-back of shares or other securities not listed on any recognized stock exchange is in accordance with the guidelines as may be prescribed.

Answer 8. (d)

Managerial Remuneration :

The Act not defined the word managerial personnel. Considering S. 197 A, S. 309 (3) and section I of Part II of Schedule XXIII, it appears that managerial personnel refer to Managing/Whole-time director and Manager. From Sec-198 together with Sec- 309 it may conclude that Directors also to be included under this category. Section 198 prescribes 11% as the overall limit for managerial personnel. The limit become 10%, if only Whole-time/Managing Directors are considered.

Remuneration paid to managerial personnel, viz. part-time and whole time directors, managing director or manager, is subject to overall limits as well as separate limits for each category of managerial personnel. Under S. 197 A of the Act a company can have either Managing Director or Manager and not both. (Amendment Act, 2000).

As per Schedule XIII of the companies act a company having profits in any financial year may pay remuneration by way of salary, dearness allowance, perquisites and other allowances.

Such remuneration should not exceed 5% of the net profits of the company for single managerial personnel and 10% for all of them together.

Answer 8. (e)

Money Measurement Concept :

The money measurement concept underlines the fact that in accounting every worth recording event happening or transaction is recorded in terms of money. In other words, a fact or a happening which cannot be expressed in terms of money is not recorded in the accounting books. General health condition of the Chairman of the company, working condition in which a worker has to work, sales policy pursued by the enterprise, quality of products introduced by the enterprise, etc., cannot be expressed in money terms and therefore are not recorded in the books. In view of the above condition this concept puts a serious handicap on the usefulness of accounting records for management decisions.

This concept has another serious limitation and is currently attracting the attention of the accountants all over the world.

As per this concept, a transaction is recorded at its money value on the date of occurance and the subsequent changes in the money value are conveniently ignored.