

Bihar Board Class 12 Accountancy Set J 2025 Question Paper with Solutions

Time Allowed :3 Hours 15 Minutes	Maximum Marks :100	Total Questions :138
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General Instructions

Read the following instructions very carefully and strictly follow them:

1. The test is of 3 hours 15 Minutes duration.
2. The question paper consists of 138 questions.
3. Candidate must enter his / her Question Booklet Serial No. (10 Digits) in the OMR Answer Sheet.
4. Minimum 30% marks in each subject (30 out of 100 for theory, adjusted for practicals where applicable).
5. Use of any electronic appliances is strictly prohibited.
6. Candidates are required to give their answers in their own words wherever practicable
7. 15 minutes of extra time have been allotted for the candidates to read the questions carefully.

Section - A

1. In the absence of partnership deed, partners are not entitled to get

- (A) Salaries
- (B) Commission
- (C) Interest on capital
- (D) All of these

Correct Answer: (D) All of these

Solution:

Step 1: Understanding the Concept:

The Indian Partnership Act, 1932, provides specific rules that apply to a partnership firm when there is no formal partnership deed, or if the existing deed is silent on certain matters. These rules govern the relationship between the partners.

Step 2: Key Provisions of the Partnership Act, 1932 (in the absence of a deed):

- **Profit and Loss Sharing:** Profits and losses are to be shared equally among all partners, regardless of their capital contribution.
- **Remuneration to Partners:** No partner is entitled to receive any salary or commission for taking part in the conduct of the business.
- **Interest on Capital:** No interest is to be paid on the capital contributed by the partners.
- **Interest on Drawings:** No interest is to be charged on the drawings made by the partners.
- **Interest on Loan:** If a partner provides a loan to the firm, they are entitled to receive interest at a rate of 6% per annum.

Step 3: Final Answer:

Based on these provisions, partners are not entitled to get salaries, commission, or interest on capital. Therefore, "All of these" is the correct option.

Quick Tip

For exams, it is crucial to memorize the five main rules that apply in the absence of a partnership deed. A common question tests these provisions, especially the 6% interest on a partner's loan.

2. A new partner brings for his share of Goodwill

- (A) Cash
- (B) Capital
- (C) Both (A) and (B)
- (D) None of these

Correct Answer: (A) Cash

Solution:

Step 1: Understanding the Concept:

When a new partner is admitted into a firm, they are required to contribute two amounts:

1. **Capital:** To get a share in the future assets of the firm.
2. **Goodwill (or Premium for Goodwill):** To compensate the existing partners (sacrificing partners) for the share of future profits they are giving up.

Step 2: Analyzing the Question:

The question specifically asks what a new partner brings "for his share of Goodwill". Goodwill is brought to compensate old partners, and this compensation is typically paid in cash. Capital is a separate contribution made to acquire a stake in the firm's assets. While goodwill can sometimes be brought in kind (as an asset), "Cash" is the most direct and common form. "Capital" is not brought *for* goodwill; it is a separate requirement.

Step 3: Final Answer:

Therefore, a new partner brings Cash for his share of Goodwill.

Quick Tip

Always differentiate between the two components a new partner brings: Capital Contribution (for assets) and Premium for Goodwill (for profits). The journal entries for both are distinct and are treated separately in the firm's accounts.

3. Which of the following is a nature of goodwill?

- (A) Rat goodwill
- (B) Cat goodwill
- (C) Dog goodwill
- (D) All of these

Correct Answer: (D) All of these

Solution:**Step 1: Understanding the Concept:**

Goodwill, an intangible asset, can be classified into different types based on its nature and characteristics. This classification often uses animal analogies to describe how the goodwill is attached to the business.

Step 2: Detailed Explanation of Types:

- **(B) Cat Goodwill:** A cat is attached to its home or place, not its owner. Similarly, this type of goodwill is associated with the business establishment itself due to factors like a favorable location, strong brand name, or reputation. It remains with the business even if the owners change. This is considered the most valuable type of goodwill.
- **(C) Dog Goodwill:** A dog is loyal to its master (the owner). This type of goodwill is linked to the personal reputation, skills, and charisma of the owner(s). If the owner leaves the business, this goodwill largely departs with them.

- **(A) Rat Goodwill:** A rat is not attached to a person or a place; it is fleeting and moves around. This type of goodwill is not tied to either the owner or the location and is considered to have very little or no value.

Step 3: Final Answer:

Since Cat, Dog, and Rat goodwill are all recognized classifications describing the nature of goodwill, the correct answer is "All of these".

Quick Tip

Remember the animal analogies:

- **Cat:** Loyal to the **place** (business).
- **Dog:** Loyal to the **person** (owner).
- **Rat:** Loyal to **neither**; it's just passing through.

4. Under superprofit basis goodwill is calculated by

- (A) Purchase year $\times$ Average profit
- (B) Purchase year $\times$ Superprofit
- (C) Purchase year $+$ Average profit
- (D) None of these

Correct Answer: (B) Purchase year $\times$ Superprofit

Solution:

Step 1: Understanding the Concept:

The Super Profit method is a technique for valuing a firm's goodwill. It is based on the premise that a firm has goodwill only if it earns profits over and above the "normal" profits that are typically earned by similar firms in the same industry. This excess profit is called "Super Profit".

Step 2: Key Formula or Approach:

The formula to calculate goodwill under the Super Profit method is:

$$\text{Goodwill} = \text{Super Profit} \times \text{Number of Years' Purchase}$$

Where,

$$\text{Super Profit} = \text{Average Profit} - \text{Normal Profit}$$

$$\text{Normal Profit} = \text{Capital Employed} \times \frac{\text{Normal Rate of Return}}{100}$$

Step 3: Final Answer:

Comparing the formula with the given options, the correct method for calculating goodwill is "Purchase year $\times$ Superprofit". Option (A) describes the Average Profit method of goodwill valuation.

Quick Tip

Memorize the specific formulas for the main goodwill valuation methods:

- **Average Profit Method:** $\text{Goodwill} = \text{Average Profit} \times \text{No. of Years' Purchase}$
- **Super Profit Method:** $\text{Goodwill} = \text{Super Profit} \times \text{No. of Years' Purchase}$
- **Capitalization Method:** Two variations based on capitalizing Average or Super Profit.

5. Factor(s) that affect(s) goodwill is/are

- (A) Favourable location
- (B) Capital required
- (C) Efficiency of management
- (D) All of these

Correct Answer: (D) All of these

Solution:

Step 1: Understanding the Concept:

Goodwill is an intangible asset that represents the value of a business's reputation and its ability to earn super-normal profits. This value arises from various positive factors and advantages that the business possesses.

Step 2: Detailed Explanation of Factors:

- **(A) Favourable location:** A prime or easily accessible location can lead to higher customer traffic and increased sales, which contributes to higher profits and thus higher goodwill.
- **(C) Efficiency of management:** A skilled, experienced, and efficient management team can lead to better operational performance, cost savings, innovation, and customer satisfaction, all of which enhance profitability and goodwill.
- **(B) Capital required:** While less direct, the amount of capital required to generate profits is a factor. A business that earns high profits with less capital is considered more

efficient and will have higher goodwill.

Other factors include the quality of products/services, longevity of the business, market situation, and possession of special rights like patents or trademarks.

Step 3: Final Answer:

Since a favourable location, efficient management, and capital requirements are all factors that influence a firm's profitability and reputation, they all affect goodwill. Therefore, the correct answer is "All of these".

Quick Tip

Think of goodwill as the sum of all positive attributes of a business that are not reflected in its tangible assets. Any factor that gives a business a competitive edge and boosts its earning power will increase its goodwill.

6. What do you understand by superprofit ?

- (A) Total profit $\div$ No. of years
- (B) Average profit - Normal profit
- (C) Weighted profit $\times$ No. of years purchase
- (D) None of these

Correct Answer: (B) Average profit - Normal profit

Solution:

Step 1: Understanding the Concept:

Super profit is the excess profit that a business earns over the normal profit. It represents the firm's superior earning capacity compared to other firms in the same industry with similar capital investment.

Step 2: Key Formula or Approach:

The formula to calculate super profit is:

$$\text{Super Profit} = \text{Actual or Average Profit} - \text{Normal Profit}$$

Step 3: Detailed Explanation:

- **Average Profit:** This is the actual average profit earned by the firm over a specific period. The formula for this is Total Profit $\div$ No. of years, as mentioned in option (A).

- **Normal Profit:** This is the profit that a firm is expected to earn in its industry based on the capital invested and the normal rate of return prevailing in that industry.

Super profit is the difference between these two. Therefore, the expression "Average profit - Normal profit" correctly defines super profit. Option (C) is a formula for calculating goodwill, not super profit.

Step 4: Final Answer:

The correct definition of super profit is Average profit - Normal profit.

Quick Tip

The word "Super" means "above" or "in excess of." So, Super Profit is simply the profit that is *above* the *normal* profit. This logical connection makes the formula easy to remember.

7. General Reserve Account always shows

- (A) Debit Balance
- (B) Credit Balance
- (C) Both (A) and (B)
- (D) None of these

Correct Answer: (B) Credit Balance

Solution:

Step 1: Understanding the Concept:

A General Reserve is an appropriation of profit. It is an amount set aside from a company's profits to strengthen its financial position and meet future unforeseen liabilities or contingencies.

Step 2: Accounting Nature of General Reserve:

- From the perspective of the business entity, all reserves are a part of the owner's equity. They represent accumulated profits that belong to the owners (shareholders or partners).
- In accounting, Owner's Equity is treated as a liability of the business towards its owners.
- According to the modern rules of accounting, increases in liabilities and equity are credited, and decreases are debited.

Step 3: Final Answer:

Since a General Reserve is a form of equity/liability, it is created by crediting the General Reserve Account. Therefore, a General Reserve Account will always show a **Credit Balance**. It appears on the Liabilities side of the Balance Sheet.

Quick Tip

A simple rule to remember is: All items on the right-hand side (Liabilities & Equity side) of the Balance Sheet, such as Capital, Loans, and Reserves, have a natural credit balance. All items on the left-hand side (Assets) have a natural debit balance.

8. Revaluation Account is a

- (A) Personal A/c
- (B) Real A/c
- (C) Nominal A/c
- (D) None of these

Correct Answer: (C) Nominal A/c

Solution:

Step 1: Understanding the Concept:

Accounts are classified into three types: Personal, Real, and Nominal.

- **Personal Accounts:** Related to individuals, firms, or companies.
- **Real Accounts:** Related to tangible and intangible assets.
- **Nominal Accounts:** Related to all expenses, losses, incomes, and gains.

Step 2: Detailed Explanation:

A Revaluation Account is prepared at the time of reconstitution of a partnership firm (e.g., admission, retirement, or death of a partner) to record the changes in the value of the firm's assets and liabilities. The purpose of this account is to ascertain the net profit or loss arising from these revaluations. Since this account deals with gains (increase in asset value, decrease in liability value) and losses (decrease in asset value, increase in liability value), it is a **Nominal Account** in nature.

Step 3: Final Answer:

Therefore, a Revaluation Account is a Nominal Account.

Quick Tip

Remember the golden rule for Nominal Accounts: "Debit all expenses and losses, Credit all incomes and gains." This rule governs all entries in the Revaluation Account.

9. Excess of credit side over the debit side in Revaluation Account is called

- (A) Profit
- (B) Loss
- (C) Receipt
- (D) Expense

Correct Answer: (A) Profit

Solution:

Step 1: Understanding the Concept:

As a nominal account, the Revaluation Account records gains on its credit side and losses on its debit side.

- **Credit Side Items (Gains):** Increase in the value of assets, Decrease in the value of liabilities.
- **Debit Side Items (Losses):** Decrease in the value of assets, Increase in the value of liabilities.

Step 2: Detailed Explanation:

When the total of the credit side (total gains) is greater than the total of the debit side (total losses), it signifies a net gain from the revaluation process. This net gain is known as the "Profit on Revaluation." This profit is then transferred to the capital accounts of the old partners in their old profit-sharing ratio.

Step 3: Final Answer:

The excess of the credit side over the debit side in the Revaluation Account is called Profit.

Quick Tip

A simple way to remember: In any nominal account (like Revaluation or P&L), if Credits (Incomes/Gains) > Debits (Expenses/Losses), the result is a Profit. If Debits > Credits, the result is a Loss.

10. Equal profit ratio of three partners is

- (A) $1/2 : 1/3 : 1/6$
- (B) $4/9 : 1/9 : 2/9$
- (C) $1/3 : 1/3 : 1/3$
- (D) $1/2 : 1/4 : 1/4$

Correct Answer: (C) $1/3 : 1/3 : 1/3$

Solution:

Step 1: Understanding the Concept:

An equal profit-sharing ratio means that all partners share the profits and losses of the firm equally. To find the share of each partner, we divide the total share (which is 1) by the number of partners.

Step 2: Detailed Explanation:

For three partners sharing profits equally, each partner's share will be $1 \div 3 = 1/3$.

Therefore, the equal profit ratio for three partners is $1/3 : 1/3 : 1/3$. This can also be expressed as 1:1:1.

Let's check the other options:

- (A) $1/2 : 1/3 : 1/6$ is equivalent to 3:2:1 (not equal).
- (B) $4/9 : 1/9 : 2/9$ is equivalent to 4:1:2 (not equal).
- (D) $1/2 : 1/4 : 1/4$ is equivalent to 2:1:1 (not equal).

Step 3: Final Answer:

The correct representation of an equal profit ratio for three partners is $1/3 : 1/3 : 1/3$.

Quick Tip

An equal ratio for 'n' partners can be written as 1:1:...:1 (n times) or as $1/n : 1/n : \dots : 1/n$ (n times). Both represent the same equal distribution.

11. According to Companies (Share capital and Debenture) Rules, 2014 by which percentage of the amount of debentures will have to create Debenture Redemption Reserve, before the commencement of redemption of debentures ?

- (A) 25%
- (B) 50%
- (C) 100%
- (D) Zero

Correct Answer: (A) 25%

Solution:

Step 1: Understanding the Concept:

The Companies Act, 2013, along with the Companies (Share Capital and Debentures) Rules, 2014, mandates the creation of a Debenture Redemption Reserve (DRR) out of the company's profits available for distribution as dividend. The purpose of DRR is to safeguard the interests of debenture holders.

Step 2: Detailed Explanation:

As per the original Rule 18(7)(b) of the Companies (Share Capital and Debentures) Rules, 2014, a company was required to create a DRR equivalent to at least **25%** of the face value of the debentures issued before the redemption commences. This question refers to these specific rules.

(Note: These rules have since been amended in 2019, reducing the DRR requirement to 10% for unlisted companies and removing it for listed companies and NBFCs. However, based on the question citing the 2014 rules, 25% is the correct answer).

Step 3: Final Answer:

According to the 2014 rules, a company must create a DRR of 25% of the amount of debentures.

Quick Tip

In addition to DRR, companies are also required to create a Debenture Redemption Investment (DRI) by investing at least 15% of the amount of debentures maturing during the year in specified securities.

12. Deep Ltd. issued 10,00,000, 7% debentures of Rs. 100 each at a discount of 4%, redeemable after 5 years at a premium of 6%. Loss on the issue of debenture is

- (A) Rs. 10,00,000
- (B) Rs. 6,00,000
- (C) Rs. 4,00,000
- (D) None of these

Correct Answer: (A) Rs. 10,00,000

Solution:

Step 1: Understanding the Concept:

The "Loss on Issue of Debentures" is a capital loss that a company recognizes at the time of issuing debentures. It comprises two components:

1. **Discount on Issue:** The amount by which the issue price is less than the face value.

2. **Premium on Redemption:** The extra amount that the company promises to pay back to the debenture holders at the time of redemption, over and above the face value. This is an anticipated future loss, which is recognized at the time of issue itself due to the prudence concept.

Step 2: Key Formula or Approach:

$$\text{Total Loss on Issue} = \text{Discount on Issue} + \text{Premium on Redemption}$$

Step 3: Detailed Explanation:

The question text "issued 10,00,000, 7

- **Face Value of Debentures:** Rs. 1,00,00,000
- **Discount on Issue:** 4% of Rs. 1,00,00,000 = Rs. 4,00,000
- **Premium on Redemption:** 6% of Rs. 1,00,00,000 = Rs. 6,00,000
- **Total Loss on Issue:** Rs. 4,00,000 (Discount) + Rs. 6,00,000 (Premium) = Rs. 10,00,000

Step 4: Final Answer:

The total loss on the issue of debentures is Rs. 10,00,000.

Quick Tip

Always remember that Loss on Issue of Debentures includes *both* the immediate loss (discount) and the future anticipated loss (premium on redemption). This is a direct application of the prudence or conservatism principle in accounting.

13. The balance of 'Sinking Fund Account' after the redemption of debentures is transferred to

- (A) Profit & Loss Statement
- (B) General Reserve A/c
- (C) Sinking Fund A/c
- (D) None of these

Correct Answer: (B) General Reserve A/c

Solution:

Step 1: Understanding the Concept:

A Sinking Fund (also known as Debenture Redemption Fund) is a specific reserve created by

setting aside profits each year. The purpose of this fund is to accumulate enough resources to redeem the debentures on the maturity date.

Step 2: Detailed Explanation:

A Sinking Fund is an appropriation of profit, not a charge. It represents accumulated profits earmarked for a specific purpose (redemption). Once all the debentures have been successfully redeemed, the purpose for which the fund was created is fulfilled. The fund is no longer a specific reserve. Since it was created out of profits, it becomes a free reserve. Such free reserves are then transferred to a non-specific reserve, which is the **General Reserve Account**.

Step 3: Final Answer:

Therefore, after the redemption of debentures, the balance in the Sinking Fund Account is transferred to the General Reserve Account.

Quick Tip

Do not confuse the Sinking Fund Account with the Sinking Fund Investment Account. The investments are sold to provide cash for redemption. The Sinking Fund Account itself is a reserve on the liabilities side of the Balance Sheet, and its balance is ultimately transferred to the General Reserve.

14. When debentures are issued at par and are redeemable at a premium, the loss on such an issue is debited to

- (A) Profit & Loss Statement
- (B) Debenture Application & Allotment A/c
- (C) Loss on Issue of Debenture A/c
- (D) Premium on Redemption A/c

Correct Answer: (C) Loss on Issue of Debenture A/c

Solution:

Step 1: Understanding the Concept:

When debentures are to be redeemed at a premium, this premium represents a future liability for the company. According to the principle of prudence (or conservatism), all anticipated losses should be accounted for at the time they are foreseen. Therefore, the premium payable on redemption is recognized as a loss at the time of issuing the debentures.

Step 2: Journal Entry:

The journal entry for the issue of debentures at par, redeemable at a premium, is:

Bank A/c Dr. (With issue price, which is face value)

Loss on Issue of Debenture A/c Dr. (With the amount of premium on redemption)

To Debentures A/c (With face value)

To Premium on Redemption of Debentures A/c (With the amount of premium on redemption)

Step 3: Final Answer:

As shown in the journal entry, the loss arising from the premium payable on redemption is debited to a special account called the "Loss on Issue of Debenture Account".

Quick Tip

Remember the two sides of the same coin: the liability is credited to "Premium on Redemption of Debentures A/c" (a liability account), and the corresponding loss is debited to "Loss on Issue of Debenture A/c" (a capital loss account).

15. Method(s) of redemption of debenture is/are

- (A) Redemption by conversion
- (B) Redemption on instalments
- (C) Lumpsum payment method
- (D) All of these

Correct Answer: (D) All of these

Solution:

Step 1: Understanding the Concept:

Redemption of debentures means the repayment of the debenture amount by the company to the debenture holders. A company can redeem its debentures using several methods as specified in the terms of issue.

Step 2: Detailed Explanation of Methods:

- **(C) Lumpsum payment method:** The company repays the entire amount of the debentures in a single lump sum on the date of maturity.
- **(B) Redemption on instalments (or Draw of Lots):** The company redeems a certain portion of its debentures in instalments over a period of time. The specific debentures to be redeemed are usually selected by a draw of lots.
- **(A) Redemption by conversion:** The company gives an option to the debenture holders to convert their debentures into new shares or new debentures after a specified period.

Another method is the purchase of own debentures from the open market. Since all the listed options are valid methods of redemption, the correct answer is "All of these".

Step 3: Final Answer:

All the given options are valid methods for the redemption of debentures.

Quick Tip

The four main ways to redeem debentures are: Lumpsum payment, Payment in instalments (Draw of lots), Purchase from the open market, and Conversion into shares/new debentures.

16. Sale of marketable securities will be shown under

- (A) Operating activities
- (B) Financing activities
- (C) Investing activities
- (D) Cash & cash equivalent

Correct Answer: (C) Investing activities

Solution:

Step 1: Understanding the Concept:

A Cash Flow Statement classifies cash flows into three activities: Operating, Investing, and Financing. The classification of the sale of marketable securities depends on their purpose.

Step 2: Detailed Explanation:

- **Cash and Cash Equivalents:** As per Accounting Standard-3, "marketable securities" that are held as short-term, highly liquid investments readily convertible into a known amount of cash and subject to an insignificant risk of changes in value are treated as cash equivalents. A transaction between two cash equivalents (e.g., selling marketable securities for cash) is just a change in composition and is *not* reported as an activity.
- **Investing Activities:** These activities include the acquisition and disposal of long-term assets and other investments that are *not* included in cash equivalents.

In the context of a multiple-choice question where both "Investing activities" and "Cash & cash equivalent" are options, it is generally assumed that "marketable securities" refers to short-term investments that do not meet the strict definition of cash equivalents. Therefore, their purchase and sale are treated as investing activities. The sale would result in a cash inflow under this category. Option (D) describes a balance sheet category, not an activity itself.

Step 3: Final Answer:

Assuming the marketable securities are not classified as cash equivalents, their sale represents a cash inflow from **Investing activities**.

Quick Tip

For a non-financial company, buying and selling investments (shares, debentures, securities) is almost always an investing activity. For a financial company (like a bank or mutual fund), it would be an operating activity because it's their main business.

17. Provision for Tax is

- (A) Current liabilities
- (B) Internal reserve
- (C) Both (A) and (B)
- (D) None of these

Correct Answer: (A) Current liabilities

Solution:

Step 1: Understanding the Concept:

It's important to differentiate between a provision and a reserve.

- A **Provision** is a charge against profit made to provide for a known liability, the amount of which cannot be determined with substantial accuracy, or for a diminution in the value of an asset.
- A **Reserve** is an appropriation of profit, set aside to strengthen the financial position of the company or to meet future contingencies.

Step 2: Detailed Explanation:

Provision for Tax is created to account for the tax liability on the profits earned during an accounting period. The exact amount will be determined later upon assessment by tax authorities, but the liability is known to exist. Since this tax liability is expected to be paid within the next 12 months (the normal operating cycle), it is classified as a **Current Liability** in the Balance Sheet. It is a charge against profit, not an appropriation of profit, and therefore not a reserve.

Step 3: Final Answer:

Provision for Tax is a Current Liability.

Quick Tip

Remember the key difference: Provisions are for *known* liabilities (charge against profit), while Reserves are for *unknown* future needs (appropriation of profit). Since tax on current profit is a known obligation, a provision is created.

18. An annual report is issued by a company for

- (A) Directors
- (B) Management
- (C) Shareholders
- (D) Auditors

Correct Answer: (C) Shareholders

Solution:

Step 1: Understanding the Concept:

An annual report is a formal financial document published yearly by a company. It contains a comprehensive summary of the company's financial performance, activities, and position over the past year.

Step 2: Detailed Explanation:

The primary audience and purpose of the annual report is to communicate with the company's owners, who are the **shareholders**. The report allows shareholders to assess the performance of the company and the stewardship of the management team to whom they have entrusted their capital. While directors, management, and auditors are all involved in the preparation and review of the report, its ultimate purpose is to provide accountability to the shareholders. It is formally presented to them at the Annual General Meeting (AGM).

Step 3: Final Answer:

An annual report is issued by a company for its shareholders.

Quick Tip

Think about accountability. The management runs the company on behalf of the shareholders. The annual report is the primary tool through which management reports back to the shareholders on how the company has performed.

19. Financial Statement is

- (A) Anticipated fact
- (B) Recorded fact
- (C) Estimated fact
- (D) None of these

Correct Answer: (B) Recorded fact

Solution:

Step 1: Understanding the Concept:

Financial statements, such as the Balance Sheet and the Statement of Profit and Loss, are formal records of the financial activities of a business. They are prepared to present a true and fair view of the financial position and performance.

Step 2: Detailed Explanation:

The foundation of financial statements is the data that has been systematically recorded in the books of accounts (like the journal and ledger) throughout the accounting period. These entries are based on actual transactions and events that have already occurred. Therefore, financial statements are fundamentally based on **recorded facts**. While they do incorporate certain estimates (e.g., provision for doubtful debts, depreciation, useful life of assets), these estimates are applied to historical data. The primary nature of the statements is historical and based on recorded events, not anticipation or pure estimation.

Step 3: Final Answer:

A Financial Statement is primarily a presentation of recorded facts.

Quick Tip

One of the key characteristics (and limitations) of financial statements is that they are historical documents. They tell you where the company has been, not necessarily where it is going. They are a summary of past, recorded transactions.

20. Patents and copyrights fall under which category?

- (A) Current Assets
- (B) Liquid Assets
- (C) Intangible Assets
- (D) All of these

Correct Answer: (C) Intangible Assets

Solution:

Step 1: Understanding the Concept:

Assets are resources owned by a company that have future economic value. They can be broadly classified based on their physical existence.

Step 2: Detailed Explanation:

- **Tangible Assets:** Assets that have a physical substance and can be touched (e.g., buildings, machinery, inventory).
- **Intangible Assets:** Assets that do not have a physical substance but possess value due to the rights and privileges they confer upon the owner.

Patents (exclusive rights to an invention) and copyrights (exclusive rights to a creative work) are non-physical assets that provide legal rights and economic benefits to the business. Therefore, they fall under the category of **Intangible Assets**. Other examples include goodwill, trademarks, and brand names.

Step 3: Final Answer:

Patents and copyrights are Intangible Assets.

Quick Tip

A simple test to identify an intangible asset is to ask, "Can I physically touch it?" If the answer is no, but it still has value and provides a right or benefit, it's likely an intangible asset.

21. On death of a partner, the firm gets for joint life policy taken for all partners is

- (A) Policy amount
- (B) Surrender value
- (C) Policy amount of deceased partner
- (D) Surrender value of all partners

Correct Answer: (A) Policy amount

Solution:

Step 1: Understanding the Concept:

A Joint Life Policy (JLP) is an insurance policy taken out by a partnership firm on the joint lives of its partners. The firm pays the premium, and the policy amount is payable upon the death of any partner or on the maturity of the policy, whichever is earlier.

Step 2: Detailed Explanation:

There are two key values associated with a JLP:

- **Policy Amount (or Sum Assured):** This is the full amount the insurance company agrees to pay when the insured event (death of a partner) occurs.
- **Surrender Value:** This is the amount the firm would receive if it decides to terminate or "surrender" the policy before it matures.

When a partner dies, the policy matures. The insured event has occurred, so the insurance company pays the full **policy amount** to the firm. The surrender value is only relevant if the policy is discontinued before a partner's death, such as on the retirement of a partner.

Step 3: Final Answer:

On the death of a partner, the firm receives the full policy amount.

Quick Tip

Remember: **Death = Maturity = Policy Amount. Retirement/Discontinuation = Surrender = Surrender Value.** The amount received is distributed among all partners (including the deceased partner's estate) in their profit-sharing ratio.

22. On the death of a partner, final payment is made through

- (A) Capital A/c
- (B) Executor's A/c
- (C) Both (A) and (B)
- (D) Loan A/c

Correct Answer: (B) Executor's A/c

Solution:

Step 1: Understanding the Concept:

When a partner dies, the business owes a certain amount to the deceased partner's estate. This amount cannot be paid directly to the partner. Instead, it is paid to their legal representative, who is known as the executor.

Step 2: Accounting Procedure:

1. First, all amounts due to the deceased partner (such as their capital balance, share of reserves, share of profit up to the date of death, interest on capital, etc.) are calculated and credited to their **Capital Account**.
2. After all adjustments, the final credit balance of the deceased partner's Capital Account is transferred to a new account called the **Executor's Account**.
3. The final payment is then made from the firm's bank account to the executor, and the Executor's Account is debited.

Therefore, the payment is made *through* the Executor's Account, which acts as the liability account for the amount owed to the deceased partner's estate.

Step 3: Final Answer:

The final payment is made through the Executor's A/c.

Quick Tip

On retirement, the final amount is transferred to the retiring partner's Loan Account if not paid immediately. On death, it is transferred to the Executor's Account. This distinction is important.

23. When is the partner's executor account opened?

- (A) On retirement of partner
- (B) On death of partner
- (C) On admission of partner
- (D) None of these

Correct Answer: (B) On death of partner

Solution:

Step 1: Understanding the Concept:

An executor is a person or institution appointed by a testator to carry out the terms of their will. In the context of a partnership, the executor is the legal representative of a deceased partner's estate.

Step 2: Detailed Explanation:

The need for an executor, and therefore an Executor's Account, arises only when a partner dies. This account is created in the firm's books to record the amount due to the deceased partner's estate and to track the settlement of this amount.

- **On retirement:** The retiring partner is alive, so the settlement is made with them directly or through their Loan Account.
- **On admission:** A new partner is joining the firm, which does not involve any deceased partner's estate.

Step 3: Final Answer:

A partner's executor account is opened on the death of that partner.

Quick Tip

The word "executor" is a legal term directly associated with the execution of a will after someone's death. This makes the connection between "Executor Account" and "Death of a partner" very direct and easy to remember.

24. Legal expenses are recorded in which side of Realisation A/c?

- (A) Debit
- (B) Credit
- (C) Liabilities
- (D) Assets

Correct Answer: (A) Debit

Solution:

Step 1: Understanding the Concept:

A Realisation Account is prepared at the time of dissolution of a partnership firm to ascertain the profit or loss on the sale of assets and settlement of liabilities. It is a nominal account in nature.

Step 2: Accounting Rule

The rule for nominal accounts is "Debit all expenses and losses, Credit all incomes and gains". Legal expenses (also called dissolution or realisation expenses) are costs incurred during the process of winding up the firm. Therefore, they are an expense of realisation.

Step 3: Final Answer:

According to the rule for nominal accounts, legal expenses are treated as an expense and are thus recorded on the **Debit** side of the Realisation Account.

Quick Tip

Remember all costs associated with the dissolution process, whether it's the sale of assets or payment of liabilities (including unrecorded ones), are debited to the Realisation Account. All proceeds from the sale of assets are credited to it.

25. At the time of dissolution of firm, book value of assets is recorded in which side of Realisation Account?

- (A) Debit
- (B) Credit

- (C) Liability
- (D) None of these

Correct Answer: (A) Debit

Solution:

Step 1: Understanding the Concept:

The first step in preparing a Realisation Account is to close the books of accounts by transferring all assets (except cash, bank, and fictitious assets) and all third-party liabilities to the Realisation Account.

Step 2: Journal Entry for Transfer of Assets

To close the asset accounts, they must be credited. The corresponding debit is given to the Realisation Account. The journal entry for transferring assets to the Realisation Account is:

Realisation A/c Dr.
To Sundry Assets A/c (at their book values)

Step 3: Final Answer:

As shown in the journal entry, the book value of assets is recorded on the **Debit** side of the Realisation Account.

Quick Tip

A simple way to remember the initial transfers: Assets have a debit balance, so to close them, you credit them and debit Realisation. Liabilities have a credit balance, so to close them, you debit them and credit Realisation.

26. Amount realised from sales of assets, on dissolution of firm is recorded in

- (A) Realisation A/c
- (B) Liabilities A/c
- (C) Expenses A/c
- (D) None of these

Correct Answer: (A) Realisation A/c

Solution:

Step 1: Understanding the Concept:

When assets are sold during the dissolution of a firm, the cash or bank account increases, and this represents an income or gain in the context of the realisation process.

Step 2: Journal Entry for Sale of Assets

The cash received from the sale of assets is debited to the Cash/Bank account. The corresponding credit is given to the Realisation Account, as it represents the inflow from the assets that were previously transferred to this account. The journal entry is:

Cash/Bank A/c Dr.
To Realisation A/c

The question asks where the amount is recorded. The transaction is recorded by crediting the **Realisation A/c**.

Step 3: Final Answer:

The amount realised from the sale of assets is recorded in the Realisation A/c (on the credit side).

Quick Tip

All transactions related to the disposal of assets and settlement of liabilities during dissolution are routed through the Realisation Account. The account itself acts as the central hub for calculating the net profit or loss on the entire process.

27. When a partner takes responsibility to make payment of any outside liability of the firm, the account credited will be

- (A) Realisation A/c
- (B) Cash A/c
- (C) Partner's Capital A/c
- (D) None of these

Correct Answer: (C) Partner's Capital A/c

Solution:

Step 1: Understanding the Concept:

When an outside liability is settled, it is a realisation expense. Therefore, the Realisation Account is debited. The credit depends on who pays the liability.

Step 2: Journal Entry

If the firm paid the liability in cash, the entry would be: Realisation A/c Dr. To Cash A/c. However, in this case, a partner is personally settling the firm's liability. This means the firm now owes that money to the partner. This increases the partner's claim on the firm, which is reflected by increasing their capital. To increase a capital account, it must be credited. The journal entry is:

Realisation A/c Dr.
To Partner's Capital A/c

Step 3: Final Answer:

The question asks which account will be credited. The account credited is the **Partner's Capital A/c**.

Quick Tip

Think of it from the firm's perspective. The firm's liability to an outsider is gone, but a new liability to the partner has been created. This is done by crediting the partner's capital account.

28. Unrecorded liabilities when paid are shown in

- (A) Debit side of Realisation A/c
- (B) Debit side of Bank A/c
- (C) Credit side of Realisation A/c
- (D) Credit side of Bank A/c

Correct Answer: (A) Debit side of Realisation A/c

Solution:

Step 1: Understanding the Concept:

During dissolution, the firm must settle all its liabilities, whether they were previously recorded in the books or not. The payment of any liability is an expense of the realisation process.

Step 2: Journal Entry

Since the payment of a liability is an expense, the Realisation Account (being a nominal account) is debited. The payment is made out of the firm's cash or bank balance, so the Bank Account is credited. The journal entry for paying an unrecorded liability is:

Realisation A/c Dr.
To Cash/Bank A/c

Step 3: Final Answer:

The payment of an unrecorded liability is shown on the **Debit side of the Realisation A/c**.

Quick Tip

Remember this simple rule for Realisation A/c: All payments (for liabilities, expenses) are debited. All receipts (from assets) are credited. It doesn't matter if the asset or liability was previously recorded or unrecorded.

29. If at the time of dissolution nothing is said about liabilities, then

- (A) Never paid
- (B) Fully paid
- (C) Partly paid
- (D) None of these

Correct Answer: (B) Fully paid

Solution:

Step 1: Understanding the Concept:

There are standard accounting assumptions that apply during the dissolution of a firm if the problem is silent about the settlement of certain items.

Step 2: Accounting Assumption for Liabilities

A firm has a legal obligation to pay its outside liabilities. Therefore, if the question does not provide any information about the settlement of a recorded outside liability (like Creditors, Bills Payable, Bank Loan), it must be assumed that the liability has been paid in full at its book value.

Step 3: Final Answer:

If nothing is said about the payment of liabilities at the time of dissolution, it is assumed that they are **fully paid**.

Quick Tip

Contrast this with the assumption for assets. If the question is silent about the realisation of an asset (except cash and bank), it is assumed that nothing was realised from that asset (its realisation value is zero). So, for liabilities, assume full payment; for assets, assume zero realisation.

30. On dissolution of the firm, Partners' Capital Accounts are closed through

- (A) Realisation A/c
- (B) Drawings A/c

- (C) Bank A/c
(D) Loan A/c

Correct Answer: (C) Bank A/c

Solution:

Step 1: Understanding the Concept:

At the end of the dissolution process, after all assets have been sold and liabilities paid, the Partners' Capital Accounts are adjusted for their share of realisation profit or loss, drawings, etc. The final balance in each partner's capital account represents the amount of the final settlement.

Step 2: Closing Procedure

This final settlement is made in cash.

- If a partner's capital account shows a credit balance, it means the firm owes money to the partner. The firm makes a final payment, and the entry is: Partner's Capital A/c Dr. To Bank A/c.
- If a partner's capital account shows a debit balance, it means the partner owes money to the firm. The partner brings in the required cash, and the entry is: Bank A/c Dr. To Partner's Capital A/c.

In both cases, the final transaction that closes the capital account is routed through the **Bank Account**.

Step 3: Final Answer:

Partners' Capital Accounts are closed through the Bank Account.

Quick Tip

At the end of dissolution, all accounts must be closed. The Realisation Account is closed by transferring its balance to Capital Accounts. The Capital Accounts are closed by making final payments through the Bank Account. The Bank Account should then automatically balance, which serves as a check of arithmetical accuracy.

31. The term 'Financial Statement' includes

- (A) Statement of Profit and Loss
(B) Balance Sheet
(C) Both (A) and (B)
(D) None of these

Correct Answer: (C) Both (A) and (B)

Solution:

Step 1: Understanding the Concept:

Financial statements are formal reports that provide a summary of a company's financial activities and position. As per Section 2(40) of the Companies Act, 2013, a complete set of financial statements includes several components.

Step 2: Key Components of Financial Statements

The primary components of a company's financial statements are:

1. **Balance Sheet (or Statement of Financial Position):** Shows the company's assets, liabilities, and equity at a specific point in time.
2. **Statement of Profit and Loss (or Income Statement):** Shows the company's revenues, expenses, and profit or loss over a period of time.

Other components include the Cash Flow Statement, Statement of Changes in Equity, and Notes to Accounts.

Step 3: Final Answer:

Since both the Statement of Profit and Loss and the Balance Sheet are core financial statements, the correct option is **Both (A) and (B)**.

Quick Tip

Remember the two main questions that financial statements answer:

- "How did the company perform?" → Statement of Profit and Loss.
- "What is the company's position?" → Balance Sheet.

32. The form of Balance Sheet as per Companies Act, 2013 is

- (A) Horizontal
- (B) Vertical
- (C) Both (A) and (B)
- (D) None of these

Correct Answer: (B) Vertical

Solution:

Step 1: Understanding the Concept:

The Companies Act, 2013, prescribes a specific format for the preparation and presentation of financial statements for all companies registered in India. This format is laid out in Schedule

III of the Act.

Step 2: Format as per Schedule III

Schedule III mandates a **vertical** format for the Balance Sheet. In this format:

- All items under **Equity and Liabilities** are listed first.
- This is followed by all items under **Assets**.
- The total of Equity and Liabilities must equal the total of Assets.

The traditional T-shaped or **horizontal** format, where liabilities are on the left and assets are on the right, is no longer permitted for companies.

Step 3: Final Answer:

The prescribed form of the Balance Sheet as per the Companies Act, 2013, is **Vertical**.

Quick Tip

The vertical format is designed to facilitate analysis, particularly vertical (common-size) and horizontal (comparative) analysis, as figures for the current and previous reporting periods are presented in adjacent columns.

33. Fixed Assets are shown

- (A) At par value
- (B) At cost price less depreciation
- (C) At cost price
- (D) At realisable value less depreciation

Correct Answer: (B) At cost price less depreciation

Solution:

Step 1: Understanding the Concept:

According to the historical cost principle of accounting, assets are initially recorded at their acquisition cost. Fixed assets (now termed Property, Plant, and Equipment) lose value over time due to use, wear and tear, or obsolescence. This reduction in value is systematically allocated over the asset's useful life through a process called depreciation.

Step 2: Presentation in the Balance Sheet

In the Balance Sheet, fixed assets are presented at their **Book Value** (or Written Down Value). The book value is calculated as:

$$\text{Book Value} = \text{Original Cost Price} - \text{Accumulated Depreciation}$$

This presents a more realistic picture of the asset's remaining value to the business.

Step 3: Final Answer:

Fixed Assets are shown in the financial statements at their **cost price less depreciation**.

Quick Tip

Do not confuse 'cost price' with 'realisable value' or 'market value'. Assets are generally not shown at their market value in the Balance Sheet due to the historical cost principle. They are carried at their depreciated cost.

34. Parties interested in financial statements are

- (A) Managers
- (B) Financial institutions
- (C) Creditors
- (D) All of these

Correct Answer: (D) All of these

Solution:

Step 1: Understanding the Concept:

Financial statements are prepared to provide information to a wide variety of users (stakeholders) who use this information to make economic decisions. These users can be internal or external to the organization.

Step 2: Detailed Explanation of Users

- **(A) Managers:** They are internal users who need financial information for planning, controlling, and decision-making within the organization.
- **(B) Financial institutions:** These are external users, like banks, that analyze financial statements to assess the creditworthiness and financial health of a company before granting loans.
- **(C) Creditors:** These are external users who supply goods or services on credit. They are interested in the company's liquidity and its ability to pay its short-term debts.

Other interested parties include investors, shareholders, government and tax authorities, employees, and the general public.

Step 3: Final Answer:

Since managers, financial institutions, and creditors are all key users of financial statements,

the correct option is **All of these**.

Quick Tip

Users of financial statements can be grouped into two categories: **Internal** (management) and **External** (investors, creditors, government, etc.). Both groups rely on the same financial statements for their information needs.

35. When financial statements of two or more organisations are analysed, it is called

- (A) Intra-firm analysis
- (B) Inter-firm analysis
- (C) Vertical analysis
- (D) None of these

Correct Answer: (B) Inter-firm analysis

Solution:

Step 1: Understanding the Concept:

Financial analysis can be classified based on the number of entities being compared.

Step 2: Detailed Explanation

- **(A) Intra-firm analysis:** This involves comparing financial data of the *same* firm over different time periods. For example, comparing the sales of a company in 2022 with its sales in 2023. 'Intra' means within.
- **(B) Inter-firm analysis:** This involves comparing the financial data of *two or more* different firms for the same period. This is often done to benchmark performance against competitors in the same industry. 'Inter' means between.
- **(C) Vertical analysis:** This is a technique of analysis for a single period where items on a financial statement are expressed as a percentage of a base figure (e.g., sales or total assets).

The question describes the analysis of "two or more organisations," which is the definition of inter-firm analysis.

Step 3: Final Answer:

The analysis of financial statements of two or more organisations is called **Inter-firm analysis**.

Quick Tip

Remember the prefixes: **Intra-** means "within" (one company, multiple years). **Inter-** means "between" (multiple companies, one year).

36. Financial analysis is useful for

- (A) Investors
- (B) Shareholders
- (C) Debenture holders
- (D) All of them

Correct Answer: (D) All of them

Solution:

Step 1: Understanding the Concept:

Financial analysis is the process of evaluating a business's financial health and performance. This process is crucial for various stakeholders who have a financial interest in the company.

Step 2: Detailed Explanation of Users

- **(A) Investors:** Potential investors analyze financial statements to assess the profitability and risk of a company to decide whether to invest their money in it.
- **(B) Shareholders:** As the owners of the company, shareholders use financial analysis to evaluate the performance of the management and the return on their investment.
- **(C) Debenture holders:** As long-term lenders to the company, debenture holders are interested in the company's long-term solvency and its ability to pay interest regularly and repay the principal amount on maturity.

Step 3: Final Answer:

Since financial analysis provides vital information for investors, shareholders, and debenture holders to make informed decisions, it is useful for **All of them**.

Quick Tip

Think about what each party wants to know. Equity providers (investors, shareholders) are interested in profitability and growth. Debt providers (debenture holders, banks) are interested in solvency and liquidity (safety of their loan). Financial analysis helps answer both sets of questions.

37. Which year can be selected for calculating trend percentage ?

- (A) Current year
- (B) Previous year
- (C) Base year
- (D) None of these

Correct Answer: (C) Base year

Solution:

Step 1: Understanding the Concept:

Trend analysis (or trend percentage analysis) is a technique used to analyze financial data over a series of years. It involves selecting one year as a reference point and expressing the data of all other years as a percentage of that reference year.

Step 2: Detailed Explanation

The reference year selected for this comparison is called the **Base Year**. The data for the base year is taken as 100%, and the data for all subsequent years are expressed as a percentage of the base year's figures. This helps in identifying the direction and magnitude of trends over time. The current year and previous year are the years being analyzed, not the reference point itself.

Step 3: Final Answer:

The year selected as the point of reference for calculating trend percentages is the **Base year**.

Quick Tip

The selection of a base year is crucial. It should be a normal and representative year for the business, free from any abnormal events like strikes, economic depressions, or extraordinary profits, to ensure a meaningful comparison.

38. Sales less cost of goods sold is called

- (A) Operating profit
- (B) Gross profit
- (C) Net profit
- (D) Total profit

Correct Answer: (B) Gross profit

Solution:

Step 1: Understanding the Concept:

The calculation of profit in a business is done in stages, which are typically presented in the Statement of Profit and Loss.

Step 2: Key Formula

The first stage of profit calculation is to determine the profit from the primary trading activities of the business. The formula for this is:

$$\text{Gross Profit} = \text{Net Sales} - \text{Cost of Goods Sold (COGS)}$$

- **Sales:** Revenue from the sale of goods.
- **Cost of Goods Sold:** The direct costs attributable to the production of the goods sold (e.g., raw materials, direct labor).

Step 3: Final Answer:

The amount calculated by subtracting the cost of goods sold from sales is called **Gross Profit**.

Quick Tip

Remember the profit hierarchy:

1. Sales - COGS = **Gross Profit**
2. Gross Profit - Operating Expenses = **Operating Profit**
3. Operating Profit $\pm$ Non-Operating Items - Taxes = **Net Profit**

39. Which of the following is not the method of financial statement analysis ?

- (A) Ratio Analysis
- (B) Comparative Analysis
- (C) Trend Analysis
- (D) Capitalisation Method

Correct Answer: (D) Capitalisation Method

Solution:

Step 1: Understanding the Concept:

Financial statement analysis involves using various techniques or tools to evaluate a company's financial data and make informed judgments.

Step 2: Detailed Explanation of Methods

The primary tools and methods of financial statement analysis include:

- **(A) Ratio Analysis:** Calculating and interpreting various financial ratios (e.g., liquidity, profitability, solvency ratios) to assess performance and financial position.

- **(B) Comparative Analysis:** Comparing financial statements of two or more periods (horizontal analysis) to identify changes and trends.
- **(C) Trend Analysis:** A form of horizontal analysis where data for several years is analyzed to determine the direction of change.

Other methods include Common-Size Statement Analysis and Cash Flow Analysis.

(D) Capitalisation Method is a technique used specifically for the valuation of assets, particularly goodwill or shares, by capitalizing the average or super profits. It is a valuation method, not a general method for analyzing the entire set of financial statements.

Step 3: Final Answer:

The **Capitalisation Method** is not a general method of financial statement analysis.

Quick Tip

Think of the scope. Ratio, Comparative, and Trend analysis can be applied to the entire financial statements (Balance Sheet and P&L). The Capitalisation Method is a very specific tool used for a single purpose: valuation of goodwill or shares.

40. Common size financial statements are mostly prepared in the form of

- (A) Ratio
- (B) Percentage
- (C) Both (A) and (B)
- (D) None of these

Correct Answer: (B) Percentage

Solution:

Step 1: Understanding the Concept:

Common-size financial statements (also known as vertical analysis) are a tool used to analyze and compare companies by restating all items on a financial statement in a common format.

Step 2: Detailed Explanation

This common format is achieved by expressing each line item as a **percentage** of a base figure from the same statement.

- In a **Common-Size Balance Sheet**, each item is shown as a percentage of Total Assets (or Total Equity and Liabilities).
- In a **Common-Size Income Statement**, each item is shown as a percentage of Net Sales or Revenue.

This conversion to percentages removes the effect of size, allowing for easier comparison between companies of different sizes or for the same company over time. A ratio expresses the relationship between two numbers, while a percentage in a common-size statement expresses the relationship of every number to one base number.

Step 3: Final Answer:

Common size financial statements are prepared in the form of a **Percentage**.

Quick Tip

Remember: Common-size analysis is also called "100 percent statement" because the base figure (Total Assets or Net Sales) is always represented as 100%. All other items are a percentage of this base.

41. Legacies should be treated as

- (A) Liability
- (B) Revenue Receipt
- (C) Asset
- (D) Income

Correct Answer: (A) Liability

Solution:

Step 1: Understanding the Concept:

Legacies are donations received by a Not-for-Profit Organisation (NPO) as per the will of a deceased person. Their accounting treatment depends on their nature and the specific instructions given.

Step 2: Accounting Treatment

- **General Legacy (Small Amount):** If the legacy is a small amount and for general purposes, it is often treated as an income (a Revenue Receipt) for the period and is shown on the credit side of the Income and Expenditure Account.
- **Specific Legacy or Large Amount:** If the legacy is given for a specific purpose (e.g., to build a library) or if it is a large, non-recurring amount, it is treated as a **Capital Receipt**. Capital receipts are not considered income. Instead, they are added directly to the Capital Fund (or a specific fund) on the **Liabilities** side of the Balance Sheet.

In the absence of specific information, a legacy is generally considered a capital receipt due to its non-recurring nature. As a capital receipt, it increases the capital fund of the NPO, which is shown on the liability side of the Balance Sheet. Therefore, treating it as a liability is the

most appropriate general answer.

Step 3: Final Answer:

Legacies of a capital nature are treated as a **Liability** (by adding them to the Capital Fund).

Quick Tip

For exam purposes, unless the amount is specified as small or for general use, assume a legacy is a capital receipt. Capital receipts are added to the Capital Fund, which is on the Liability side of the Balance Sheet.

42. All receipts of capital nature are shown in

- (A) Income and Expenditure A/c
- (B) Balance Sheet
- (C) Profit and Loss A/c
- (D) Cash Flow Statement

Correct Answer: (B) Balance Sheet

Solution:

Step 1: Understanding Capital vs. Revenue Receipts

- **Revenue Receipts:** These are recurring receipts from the normal course of business operations (e.g., sales, fees, subscriptions). They are shown in the Income Statement (P&L A/c or Income & Expenditure A/c).
- **Capital Receipts:** These are non-recurring receipts that either increase a liability or decrease an asset (e.g., raising a loan, sale of a fixed asset, capital contribution).

Step 2: Accounting Treatment of Capital Receipts

Capital receipts are not part of the regular income of an organization. Therefore, they are not recorded in the income statement. Instead, their effect is shown directly in the **Balance Sheet**. For example:

- A loan taken increases the 'Loans' liability.
- Capital contributed by an owner increases 'Capital'.
- Sale of a fixed asset reduces the value of 'Fixed Assets'.

Step 3: Final Answer:

All receipts of a capital nature are shown in the **Balance Sheet**.

Quick Tip

A simple rule: If a receipt relates to the profit-earning activities of the current period, it's revenue (goes to P&L). If it relates to the financing or long-term asset structure of the business, it's capital (goes to the Balance Sheet).

43. Subscription received in advance is

- (A) Asset
- (B) Income
- (C) Expense
- (D) Liability

Correct Answer: (D) Liability

Solution:

Step 1: Understanding the Concept:

Subscription is a primary source of revenue for Not-for-Profit Organisations. When a subscription is received for a future period (e.g., receiving the 2024 subscription in 2023), it is considered "income received in advance."

Step 2: Application of Accrual Principle

According to the accrual principle of accounting, revenue should only be recognized when it is earned, not when the cash is received. Since the service against this subscription will be provided in the next accounting period, it cannot be treated as income for the current period. Instead, it represents an **obligation** or a duty for the organization to provide services in the future.

Step 3: Final Answer:

An obligation to provide future services is a **Liability**. Therefore, subscription received in advance is shown on the liabilities side of the Balance Sheet.

Quick Tip

Remember the matching rules for income and expenses:

- Income received in advance = **Liability**.
- Income accrued (earned but not received) = **Asset**.
- Expense paid in advance (prepaid) = **Asset**.
- Expense accrued (outstanding) = **Liability**.

44. In which year did the Partnership Act come into force ?

- (A) 1932
- (B) 1956
- (C) 1947
- (D) 2013

Correct Answer: (A) 1932

Solution:

Step 1: Factual Information

This question asks for the year of enactment of the primary legislation governing partnership firms in India.

Step 2: Relevant Legislation

The law that governs partnership firms in India is the **Indian Partnership Act, 1932**.

For reference:

- The Companies Act, 1956 was the old act for companies, now replaced.
- The Companies Act, 2013 is the current act for companies.
- 1947 is the year of India's independence.

Step 3: Final Answer:

The Partnership Act came into force in **1932**.

Quick Tip

It is essential to remember the years of key business legislations for accountancy exams:

- Indian Partnership Act: **1932**
- Companies Act (Current): **2013**

45. For the firm, interest on partner's drawing is a/an

- (A) Expenditure
- (B) Income
- (C) Loss
- (D) Receipt

Correct Answer: (B) Income

Solution:

Step 1: Understanding the Concept:

Drawings refer to the amount of cash or goods withdrawn by a partner from the firm for personal use. To discourage excessive drawings, the partnership deed may provide for charging interest on these drawings.

Step 2: Perspective of the Firm

The question asks for the nature of this interest from the firm's point of view. When the firm charges interest from a partner, it is effectively receiving a payment from the partner for the use of the firm's funds. This receipt is a source of gain or **income** for the business.

From the partner's perspective, it is an expense.

Step 3: Accounting Treatment

Interest on drawings is credited to the Profit and Loss Appropriation Account, as it is an income for the firm.

Step 4: Final Answer:

For the firm, interest on a partner's drawing is an **Income**.

Quick Tip

Always analyze such transactions from two perspectives:

- **Interest on Capital:** Expense for the firm, Income for the partner.
- **Interest on Drawings:** Income for the firm, Expense for the partner.

46. In partnership, preparation of partnership agreement is

- (A) Compulsory
- (B) Voluntary
- (C) Optional
- (D) None of these

Correct Answer: (B) Voluntary

Solution:

Step 1: Understanding the Concept:

A partnership is formed by an agreement between two or more persons. This agreement can be either oral or written. The written agreement among the partners is called a Partnership Deed.

Step 2: Legal Requirement

According to the Indian Partnership Act, 1932, it is not legally mandatory to have a written partnership agreement. A partnership can exist based on a verbal agreement. Therefore, the

preparation of a partnership deed is **voluntary** or **optional**. However, it is always advisable to have a written deed to avoid future disputes and misunderstandings among partners.

Step 3: Final Answer:

The preparation of a partnership agreement is voluntary.

Quick Tip

While not compulsory by law, a written Partnership Deed is practically essential. It acts as evidence in court and clearly defines the rights, duties, and liabilities of each partner.

47. When capital is fixed, the capital accounts of partners show

- (A) Debit balance
- (B) Credit balance
- (C) Profit
- (D) Loss

Correct Answer: (B) Credit balance

Solution:

Step 1: Understanding the Concept:

Under the Fixed Capital method, two accounts are maintained for each partner: a Capital Account and a Current Account. The Capital Account records only the initial capital contribution, any additional capital introduced, and any permanent withdrawal of capital. All other transactions (like interest on capital, drawings, salary, share of profit/loss) are recorded in the Current Account.

Step 2: Nature of the Fixed Capital Account

Since the Capital Account primarily represents the partner's investment in the firm, it is a form of owner's equity. From the firm's perspective, this is a liability owed to the partner. Liabilities and equity accounts typically have a credit balance. As this account remains unchanged (fixed) except in rare circumstances, it will almost always show a **Credit balance**.

Step 3: Final Answer:

When capital is fixed, the capital accounts of partners show a credit balance.

Quick Tip

Remember the difference: Under the **Fixed Capital Method**, the Capital Account is stable and has a credit balance, while the Current Account can have either a debit or credit balance. Under the **Fluctuating Capital Method**, all transactions go through the Capital Account, which can then have a debit or credit balance.

48. To become a partner it is essential to be

- (A) Adult
- (B) Minor
- (C) Both (A) and (B)
- (D) None of these

Correct Answer: (A) Adult

Solution:

Step 1: Understanding the Concept:

A partnership is based on a contract between partners. According to the Indian Contract Act, 1872, only a person who is competent to contract can enter into a valid partnership agreement.

Step 2: Competency to Contract

A person is competent to contract if they are:

- Of the age of majority (i.e., an **adult**).
- Of sound mind.
- Not disqualified from contracting by any law.

A minor (a person who has not attained the age of majority) is not competent to contract and therefore cannot become a full-fledged partner. However, a minor can be admitted to the *benefits* of an existing partnership with the consent of all other partners, but they will not be personally liable for the firm's debts.

Step 3: Final Answer:

Since a partner must be able to enter into a contract, it is essential for them to be an **Adult**.

Quick Tip

Remember the special rule for minors in a partnership: A minor cannot be a partner but can be a beneficiary. This means they can share in the profits but not the losses, and their liability is limited to their share in the firm.

49. In the absence of partnership deed, partner

- (A) shall be paid salaries
- (B) shall not be paid salaries
- (C) active partner shall be paid salaries
- (D) none of these

Correct Answer: (B) shall not be paid salaries

Solution:

Step 1: Understanding the Concept:

When a partnership deed does not exist or is silent on the matter of remuneration, the provisions of the Indian Partnership Act, 1932, apply automatically.

Step 2: Provision of the Act

Section 13 of the Indian Partnership Act, 1932, clearly states that, subject to a contract between the partners, no partner is entitled to receive remuneration (such as salary, commission, etc.) for taking part in the conduct of the business. This rule applies to all partners, including those who are actively involved in managing the firm's affairs.

Step 3: Final Answer:

Therefore, in the absence of a partnership deed, a partner **shall not be paid salaries**.

Quick Tip

Memorize the key rules that apply in the absence of a deed:

1. Profit/Loss sharing is equal.
2. No interest on capital.
3. No interest on drawings.
4. No salary or commission to any partner.
5. 6% p.a. interest is allowed on a partner's loan to the firm.

50. The balance of Current Account can be

- (A) Positive
- (B) Negative
- (C) Zero
- (D) All of these

Correct Answer: (D) All of these

Solution:

Step 1: Understanding the Concept:

A Partner's Current Account is maintained under the Fixed Capital Method to record all transactions between the partner and the firm, other than capital introduction and withdrawal.

Step 2: Items in the Current Account

- **Credit Items (increase the balance):** Interest on capital, salary, commission, share of profit.
- **Debit Items (decrease the balance):** Drawings, interest on drawings, share of loss.

Step 3: Possible Balances

Depending on the net effect of these transactions:

- If the credit items are more than the debit items, the account will have a **Positive** (Credit) balance.
- If the debit items (like heavy drawings) are more than the credit items, the account will have a **Negative** (Debit) balance.
- If the credit and debit items are exactly equal, the account can have a **Zero** balance.

Step 4: Final Answer:

Therefore, the balance of a Current Account can be positive, negative, or zero. The correct option is **All of these**.

Quick Tip

The Current Account is "current" because it fluctuates with the yearly transactions. Contrast this with the Fixed Capital Account, which is stable and almost always has a positive (credit) balance.

51. Which of the following items is not taken into consideration while computing current ratio ?

- (A) Creditors
- (B) Debtors
- (C) Furniture
- (D) Bank overdraft

Correct Answer: (C) Furniture

Solution:

Step 1: Understanding the Concept:

The current ratio is a liquidity ratio that measures a company's ability to pay its short-term obligations.

Step 2: Key Formula or Approach:

The formula for the current ratio is:

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

Where:

- **Current Assets** are assets expected to be converted into cash within one year (e.g., Debtors, Stock, Cash).
- **Current Liabilities** are obligations due to be paid within one year (e.g., Creditors, Bank overdraft).

Step 3: Detailed Explanation:

Let's classify the given items:

- (A) Creditors: A Current Liability.
- (B) Debtors: A Current Asset.
- (D) Bank overdraft: A Current Liability.
- (C) Furniture: A **Non-Current Asset** (specifically, Property, Plant, and Equipment). It is not expected to be converted into cash in the normal course of business within a year.

Since furniture is a non-current asset, it is not included in the calculation of the current ratio.

Step 4: Final Answer:

Furniture is not taken into consideration while computing the current ratio.

Quick Tip

To solve ratio analysis questions, first write down the formula. Then, classify each item given in the options as a component of the formula or not. Items that don't fit the formula's components are the answer.

52. Liquid assets include

- (A) Bills Receivable
- (B) Debtor
- (C) Cash
- (D) All of these

Correct Answer: (D) All of these

Solution:

Step 1: Understanding the Concept:

Liquid assets (also known as quick assets) are a subset of current assets that can be converted into cash very quickly, typically within 90 days, without a significant loss in value.

Step 2: Key Formula or Approach:

The formula to calculate liquid assets is:

$$\text{Liquid Assets} = \text{Current Assets} - \text{Inventory (Stock)} - \text{Prepaid Expenses}$$

Step 3: Detailed Explanation:

Let's analyze the given options:

- (A) Bills Receivable: These are short-term promissory notes that can be easily discounted with a bank to get cash. They are liquid assets.
- (B) Debtor (Trade Receivables): These represent money owed to the company and are expected to be collected in the short term. They are considered liquid assets.
- (C) Cash: This is the most liquid asset by definition.

Since Bills Receivable, Debtors, and Cash are all components of liquid assets, the correct option is "All of these".

Step 4: Final Answer:

Liquid assets include Bills Receivable, Debtor, and Cash.

Quick Tip

The two main items excluded from current assets to get liquid assets are Inventory and Prepaid Expenses. This is because inventory may not sell quickly, and prepaid expenses cannot be converted to cash at all.

53. Tangible assets of a company are increased from Rs. 4,00,000 to Rs. 5,00,000. What is the percentage of change?

- (A) 20%
- (B) 25%
- (C) $33\frac{1}{3}\%$
- (D) 50%

Correct Answer: (B) 25%

Solution:

Step 1: Understanding the Concept:

Percentage change is a measure of the relative change between an old value and a new value.

Step 2: Key Formula or Approach:

The formula for percentage change is:

$$\text{Percentage Change} = \frac{\text{New Value} - \text{Old Value}}{\text{Old Value}} \times 100$$

Or

$$\text{Percentage Change} = \frac{\text{Amount of Change}}{\text{Base Amount}} \times 100$$

Step 3: Detailed Explanation:

Given:

- Old Value (Base Amount) = Rs. 4,00,000
- New Value = Rs. 5,00,000

First, calculate the amount of change:

$$\text{Amount of Change} = 5,00,000 - 4,00,000 = \text{Rs. } 1,00,000$$

Now, apply the formula:

$$\text{Percentage Change} = \frac{1,00,000}{4,00,000} \times 100 = \frac{1}{4} \times 100 = 25\%$$

Step 4: Final Answer:

The percentage of change is 25%.

Quick Tip

Always ensure you use the original or "old" value as the denominator (base) when calculating percentage change. A common mistake is to use the new value as the base.

54. Operating ratio is

- (A) Profitability ratio
- (B) Activity ratio
- (C) Solvency ratio
- (D) None of these

Correct Answer: (A) Profitability ratio

Solution:

Step 1: Understanding the Concept:

Accounting ratios are broadly classified into categories based on what they measure. The Operating Ratio is a key indicator of a company's operational efficiency.

Step 2: Key Formula or Approach:

The formula for the Operating Ratio is:

$$\text{Operating Ratio} = \frac{\text{Cost of Goods Sold} + \text{Operating Expenses}}{\text{Net Sales}} \times 100$$

This ratio shows the percentage of sales that has been used to cover the main operational costs of the business. It is inversely related to the Operating Profit Ratio (Operating Profit Ratio = 100% - Operating Ratio). Since it measures the relationship between costs and sales to ultimately determine operational profit margin, it falls under the category of **Profitability ratios**.

Step 3: Final Answer:

The Operating Ratio is a Profitability Ratio.

Quick Tip

Remember the main categories of ratios:

- **Liquidity Ratios:** Measure short-term solvency (e.g., Current Ratio).
- **Solvency Ratios:** Measure long-term solvency (e.g., Debt-Equity Ratio).
- **Activity (or Turnover) Ratios:** Measure efficiency of asset use (e.g., Inventory Turnover Ratio).
- **Profitability Ratios:** Measure earning capacity (e.g., Gross Profit Ratio, Operating Ratio, Net Profit Ratio).

55. Current assets include only those assets which are expected to be realised within

- (A) 3 months
- (B) 6 months
- (C) 1 year
- (D) 2 years

Correct Answer: (C) 1 year

Solution:

Step 1: Understanding the Concept:

Current assets are a category of assets on the Balance Sheet that represent resources a company

expects to convert into cash, sell, or consume within a specific period.

Step 2: Definition as per Accounting Standards

According to Schedule III of the Companies Act, 2013, and general accounting principles, an asset is classified as a current asset if it is expected to be realised (i.e., converted into cash or its equivalent) within the company's operating cycle or within twelve months from the reporting date, whichever is longer. For most businesses, the operating cycle is assumed to be one year.

Step 3: Final Answer:

Based on the standard definition, current assets are expected to be realised within **1 year**.

Quick Tip

The "1-year rule" is a fundamental concept that separates current items from non-current items on the Balance Sheet, for both assets and liabilities. This distinction is crucial for assessing a company's short-term liquidity.

56. Creditors turnover ratio includes

- (A) Total credit purchase
- (B) Total credit sales
- (C) Total cash sales
- (D) Total cash purchase

Correct Answer: (A) Total credit purchase

Solution:

Step 1: Understanding the Concept:

The Creditors Turnover Ratio (also known as Trade Payables Turnover Ratio) is an activity ratio that measures how quickly a company pays its suppliers (creditors).

Step 2: Key Formula or Approach:

The formula for this ratio is:

$$\text{Creditors Turnover Ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Trade Payables (Creditors + Bills Payable)}}$$

The numerator of this formula is the **Net Credit Purchases** for the period. Sales (credit or cash) are related to Debtors Turnover Ratio, and cash purchases do not create creditors.

Step 3: Final Answer:

The Creditors Turnover Ratio includes **Total credit purchase** in its calculation.

Quick Tip

To remember which transaction goes with which ratio, think about the relationship:

- **Debtors** are created from **Credit Sales**.
- **Creditors** are created from **Credit Purchases**.

57. Cash Flow Statement is prepared from

- (A) Balance Sheet
- (B) Profit & Loss A/c
- (C) Additional information
- (D) All of these

Correct Answer: (D) All of these

Solution:

Step 1: Understanding the Concept:

A Cash Flow Statement explains the movement of cash and cash equivalents during a period. To prepare it, one needs to analyze changes in the company's financial position and performance.

Step 2: Information Sources

The preparation of a Cash Flow Statement requires the following sources of information:

- **(A) Balance Sheet:** Comparative Balance Sheets (for the beginning and end of the period) are needed to determine the changes in assets, liabilities, and equity, which are used to calculate cash flows from operating and financing activities.
- **(B) Profit & Loss A/c:** The Statement of Profit and Loss for the current period is needed to find the net profit, which is the starting point for calculating cash flow from operating activities, and to identify non-cash expenses (like depreciation).
- **(C) Additional information:** Notes to accounts and other details are required to understand specific transactions, such as the purchase or sale of fixed assets, payment of dividends, or issue of shares.

Step 3: Final Answer:

Since all three sources are essential for preparing a complete and accurate Cash Flow Statement, the correct answer is **All of these**.

Quick Tip

Think of the Cash Flow Statement as a bridge connecting the Income Statement (performance over time) and the Balance Sheet (position at two points in time). You need all three pieces of information (P&L, two Balance Sheets, and notes) to build it correctly.

58. While preparing the Cash Flow Statement, the 'cash purchase of building' will be classified as

- (A) Operating activity
- (B) Financing activity
- (C) Investing activity
- (D) None of these

Correct Answer: (C) Investing activity

Solution:

Step 1: Understanding the Concept:

The Cash Flow Statement categorizes all cash inflows and outflows into three main activities: Operating, Investing, and Financing.

Step 2: Classification of Activities

- **Operating Activities:** These are the principal revenue-producing activities of the business (e.g., cash from sales, cash paid to suppliers).
- **Investing Activities:** These include the acquisition and disposal of long-term assets and other investments not included in cash equivalents (e.g., purchase/sale of machinery, property, or shares of another company).
- **Financing Activities:** These are activities that result in changes in the size and composition of the owners' capital and borrowings (e.g., issue of shares, repayment of loans).

Step 3: Final Answer:

A building is a long-term asset (Property, Plant, and Equipment). The purchase of such an asset is a cash outflow related to long-term investment. Therefore, the 'cash purchase of building' is classified as an **Investing activity**.

Quick Tip

A simple way to classify transactions:

- Does it relate to day-to-day business operations? → **Operating**.
- Does it relate to buying/selling long-term assets or investments? → **Investing**.
- Does it relate to raising/repaying funds from owners or lenders? → **Financing**.

59. Which of the following is not an application of cash ?

- (A) Increase in Debtors
- (B) Increase in Creditors
- (C) Increase in Stock
- (D) Increase in prepaid expenses

Correct Answer: (B) Increase in Creditors

Solution:

Step 1: Understanding the Concept:

In the context of cash flow, "application of cash" means a use of cash, or a cash outflow. "Source of cash" means a cash inflow. The question asks to identify the item that is a source of cash, not an application.

Step 2: Detailed Explanation

Let's analyze the effect of each item on cash:

- **(A) Increase in Debtors:** This means the company made more sales on credit than it collected in cash. This ties up cash and is an **application** (use) of cash.
- **(B) Increase in Creditors:** This means the company purchased more goods on credit than it paid for in cash. This is effectively a short-term, interest-free loan from suppliers, which conserves cash. It is a **source** of cash.
- **(C) Increase in Stock:** This means the company purchased more inventory than it sold, resulting in a cash outflow. It is an **application** of cash.
- **(D) Increase in prepaid expenses:** This means the company paid cash for expenses whose benefit will be received in the future. It is an **application** of cash.

Step 3: Final Answer:

An increase in creditors is a source of cash, not an application of cash.

Quick Tip

Remember the general rule for changes in current assets and liabilities (excluding cash):

- Increase in a Current Asset → Use of Cash.
- Decrease in a Current Asset → Source of Cash.
- Increase in a Current Liability → Source of Cash.
- Decrease in a Current Liability → Use of Cash.

60. An example of cash flow from financing activities is

- (A) Sale of goods
- (B) Sale of investment
- (C) Cash receipt from issue of shares
- (D) Interest received

Correct Answer: (C) Cash receipt from issue of shares

Solution:

Step 1: Understanding the Concept:

Financing activities are transactions with the owners and long-term lenders of a company. They relate to how a company raises and repays its capital.

Step 2: Detailed Explanation

Let's classify each option:

- **(A) Sale of goods:** This is the principal revenue-generating activity, so it's an **Operating Activity**.
- **(B) Sale of investment:** This is the disposal of a long-term asset, so it's an **Investing Activity**.
- **(C) Cash receipt from issue of shares:** When a company issues shares, it is raising capital from its owners (shareholders). This directly affects the capital structure and is a classic example of a **Financing Activity**.
- **(D) Interest received:** This is a return on an investment (like a loan given or an interest-bearing deposit). It is an **Investing Activity** for a non-financial company.

Step 3: Final Answer:

Cash receipt from the issue of shares is an example of a cash flow from financing activities.

Quick Tip

To identify financing activities, ask: "Is this transaction changing the company's debt or equity?" If the answer is yes (e.g., issuing shares, taking a loan, paying dividends, repaying a loan), it's a financing activity.

61. A company is incorporated by

- (A) A Special Act of Parliament
- (B) Companies Act
- (C) Agreement of investors
- (D) Both (A) and (B)

Correct Answer: (D) Both (A) and (B)

Solution:

Step 1: Understanding the Concept:

Incorporation is the legal process used to form a corporate entity or a company. In India, there are primarily two ways a company can be formed by law.

Step 2: Detailed Explanation

- **(B) Companies Act:** The vast majority of companies (both public and private) are formed by registering them with the Registrar of Companies under the provisions of the **Companies Act, 2013** (or its predecessors). These are known as registered companies.
- **(A) A Special Act of Parliament:** Certain large public utility or industrial undertakings are established by a separate Act passed by the Parliament or a State Legislature. These are known as **Statutory Corporations** or statutory companies. Examples include the Life Insurance Corporation of India (LIC), the Reserve Bank of India (RBI), and the State Bank of India (SBI).

Since both are valid methods of legal incorporation, the most comprehensive answer is that a company can be incorporated by either the Companies Act or a Special Act of Parliament.

Step 3: Final Answer:

A company can be incorporated by a Special Act of Parliament or the Companies Act. Thus, **Both (A) and (B)** is the correct choice.

Quick Tip

Remember the distinction: Most companies you encounter (like Reliance, Tata Motors) are registered under the Companies Act. A few special, large, often government-backed bodies (like LIC, RBI) are created by their own special laws.

62. Discount on issue of shares is

- (A) Capital gain
- (B) Capital loss
- (C) Revenue gain
- (D) Revenue loss

Correct Answer: (B) Capital loss

Solution:

Step 1: Understanding the Concept:

Transactions are classified as either capital or revenue in nature. Capital transactions relate to

the long-term financial structure and assets of the business, while revenue transactions relate to the day-to-day operations. The issue of shares is a transaction to raise long-term capital for the company.

Step 2: Detailed Explanation

When a company issues shares at a discount (at a price less than their face value), it receives less cash than the nominal value of the capital it is issuing. This shortfall is a loss incurred in the process of raising capital. Since the transaction itself is capital in nature, the resulting loss is a **Capital Loss**. This loss is typically written off against securities premium or from the Statement of Profit and Loss over a period of time.

(Note: As per Section 53 of the Companies Act, 2013, a company is generally prohibited from issuing shares at a discount, except for sweat equity shares.)

Step 3: Final Answer:

Discount on issue of shares is a **Capital loss**.

Quick Tip

Think of the source of the transaction:

- Transactions related to raising capital (shares, debentures) → **Capital Nature**. Any profit (like premium on issue) is a Capital Profit, and any loss (like discount) is a Capital Loss.
- Transactions related to selling goods/services → **Revenue Nature**.

63. A company issues its shares at a premium under which section of Indian Companies Act, 2013?

- (A) 78
- (B) 52
- (C) 53
- (D) None of these

Correct Answer: (B) 52

Solution:

Step 1: Understanding the Concept:

The Companies Act, 2013, provides specific regulations for the issue of shares and debentures by a company. This includes rules about issuing shares at a premium (above face value) or at a discount (below face value).

Step 2: Relevant Sections of the Companies Act, 2013:

- **Section 52 - Application of premiums received on issue of shares:** This section governs the issue of shares at a premium. It states that a company can issue shares at a premium and specifies that the premium amount must be transferred to a "Securities Premium Account". It also details the purposes for which this account can be utilized.
- **Section 53 - Prohibition on issue of shares at discount:** This section prohibits companies from issuing shares at a discount, with the exception of sweat equity shares.
- **Section 78 of the old Companies Act, 1956** was the equivalent section dealing with premiums, but the question specifically asks about the 2013 Act.

Step 3: Final Answer:

A company issues its shares at a premium under the provisions of **Section 52** of the Companies Act, 2013.

Quick Tip

Remember these key sections related to share issues:

- **Section 52:** For issue at **Premium**.
- **Section 53:** For the prohibition of issue at **Discount**.
- **Section 54:** For issue of **Sweat Equity Shares**.

64. The liability of members in a company is

- (A) Limited
- (B) Unlimited
- (C) Stable
- (D) Fluctuating

Correct Answer: (A) Limited

Solution:

Step 1: Understanding the Concept:

One of the most fundamental and attractive features of a company as a form of business organization is the concept of limited liability. This is a key distinction between a company and other forms of business like a sole proprietorship or a partnership (which typically have unlimited liability).

Step 2: Detailed Explanation

The liability of the members (shareholders) of a company is **limited** to the amount, if any, unpaid on the shares respectively held by them. This means that if a shareholder has fully paid for their shares, their personal assets cannot be used to pay off the company's debts.

Their maximum loss is restricted to the amount they invested in the company's shares. While unlimited liability companies can exist, the vast majority of companies are incorporated with limited liability.

Step 3: Final Answer:

The liability of members in a company is generally **Limited**.

Quick Tip

The word "Limited" or "Ltd." at the end of a private company's name, and the absence of it for a public company which is still limited by shares, signifies this very important feature of limited liability for its members.

65. The amount received over and above the par value is credited to which account?

- (A) Share Capital A/c
- (B) Calls-in-advance A/c
- (C) Securities Premium A/c
- (D) Share Forfeiture A/c

Correct Answer: (C) Securities Premium A/c

Solution:

Step 1: Understanding the Concept:

When a company issues shares at a premium, it receives cash that is more than the nominal or par value (face value) of the shares. The accounting treatment for this excess amount is specifically governed by the Companies Act.

Step 2: Journal Entry and Explanation

The amount received on the issue of shares is broken down into two parts:

- The amount corresponding to the par value is credited to the **Share Capital Account**.
- The excess amount received over and above the par value is credited to a separate account called the **Securities Premium Account**.

The journal entry for receiving application money (including premium) would be:

Bank A/c Dr.

To Share Application A/c

And on allotment:

Share Application A/c Dr.

To Share Capital A/c (with par value)

To Securities Premium A/c (with premium amount)

Step 3: Final Answer:

The amount received over and above the par value is credited to the **Securities Premium A/c**.

Quick Tip

Securities Premium is a capital receipt and is shown under "Reserves and Surplus" on the liabilities side of the Balance Sheet. It is not available for distribution as a dividend and its use is restricted by Section 52 of the Companies Act, 2013.

66. Balance of Share Forfeiture A/c is shown in the Balance Sheet under the item

- (A) Share Capital A/c
- (B) Current Liabilities and Provision
- (C) Unsecured loan
- (D) Reserve and Surplus

Correct Answer: (A) Share Capital A/c

Solution:

Step 1: Understanding the Concept:

The Share Forfeiture Account represents the amount received from a shareholder on shares that have been forfeited due to non-payment of calls. This amount is a capital gain for the company. The question asks about its presentation in the Balance Sheet *before* the forfeited shares are re-issued.

Step 2: Presentation in the Balance Sheet

As per Schedule III of the Companies Act, 2013, the balance in the Share Forfeiture Account is shown as an addition to the company's paid-up share capital. It is disclosed under the head "Share Capital" in the "Notes to Accounts" section of the Balance Sheet. The presentation is as follows:

Share Capital

Subscribed Capital

Less: Calls-in-arrear

Add: Share Forfeiture A/c

This total is then shown on the face of the Balance Sheet. It is not shown under Reserves and Surplus until the shares are re-issued and a profit on re-issue is realized.

Step 3: Final Answer:

The balance of the Share Forfeiture A/c is shown under the item **Share Capital A/c**.

Quick Tip

Remember the journey of the Share Forfeiture balance:

1. On forfeiture → Added to Paid-up Capital in the Balance Sheet.
2. On re-issue → Used to cover the discount on re-issue.
3. After re-issue → Any remaining balance is a capital profit and is transferred to **Capital Reserve** (which is then shown under Reserves and Surplus).

67. Which of the following should be deducted from the called-up capital to find out paid-up capital?

- (A) Call-in-advance
- (B) Calls-in-arrear
- (C) Share forfeiture
- (D) Premium

Correct Answer: (B) Calls-in-arrear

Solution:

Step 1: Understanding the Concepts:

- **Called-up Capital:** The portion of the subscribed capital that the company has asked the shareholders to pay.
- **Paid-up Capital:** The portion of the called-up capital that the shareholders have actually paid.

Step 2: Key Formula or Approach:

The relationship between these two is:

$$\text{Paid-up Capital} = \text{Called-up Capital} - \text{Calls-in-arrear}$$

Calls-in-arrear represents the amount that has been called by the company but has not yet been paid by the shareholders. Therefore, to find the actual amount paid by shareholders, we must deduct the unpaid amount (Calls-in-arrear) from the total amount demanded (Called-up Capital).

Step 3: Final Answer:

Calls-in-arrear should be deducted from the called-up capital to find out paid-up capital.

Quick Tip

Think of the terms logically: "Paid-up" capital is what's actually paid. It's the "called-up" (demanded) amount minus what's "in arrear" (unpaid).

68. Sweat equity shares are issued to

- (A) Employees
- (B) Directors
- (C) Both (A) and (B)
- (D) None of them

Correct Answer: (C) Both (A) and (B)

Solution:

Step 1: Understanding the Concept:

As per Section 2(88) of the Companies Act, 2013, "sweat equity shares" means equity shares issued by a company to its directors or employees at a discount or for consideration other than cash.

Step 2: Detailed Explanation

These shares are issued as a reward for their contribution in the form of know-how, intellectual property rights, or value additions to the company. The purpose is to retain talent and incentivize key personnel by making them owners of the company. Since the definition explicitly includes both **employees** and **directors** of the company, both are eligible to receive sweat equity shares.

Step 3: Final Answer:

Sweat equity shares are issued to both employees and directors.

Quick Tip

The term "sweat equity" refers to the "sweat" or hard work put in by employees and directors. The shares are a way of compensating them for this valuable, often intangible, contribution.

69. A company issued 10,000 shares of Rs. 10 each at a premium of 10%. The amount of premium will be

- (A) Rs. 10,000
- (B) Rs. 20,000

- (C) Rs. 8,000
(D) Rs. 5,000

Correct Answer: (A) Rs. 10,000

Solution:

Step 1: Understanding the Concept:

Securities premium is the amount received by a company over and above the face value (par value) of its shares. The premium is usually expressed as a percentage of the face value.

Step 2: Key Formula or Approach:

$$\text{Total Premium Amount} = \text{Number of Shares} \times \text{Premium per Share}$$

$$\text{Premium per Share} = \text{Face Value per Share} \times \text{Premium Percentage}$$

Step 3: Detailed Explanation:

Given:

- Number of Shares = 10,000
- Face Value per Share = Rs. 10
- Premium Percentage = 10%

First, calculate the premium per share:

$$\text{Premium per Share} = \text{Rs. } 10 \times 10\% = \text{Rs. } 1$$

Now, calculate the total premium amount:

$$\text{Total Premium Amount} = 10,000 \text{ shares} \times \text{Rs. } 1 \text{ per share} = \text{Rs. } 10,000$$

Step 4: Final Answer:

The total amount of premium will be Rs. 10,000.

Quick Tip

Always calculate the premium on the face value of the share, not the issue price. The issue price is the face value plus the premium. In this case, the issue price is Rs. 10 + Rs. 1 = Rs. 11.

70. To whom is dividend given at a fixed rate in a company ?

- (A) Equity shareholders
(B) Preference shareholders
(C) Debenture holders

(D) Promoters

Correct Answer: (B) Preference shareholders

Solution:

Step 1: Understanding the Concept:

Dividend is the distribution of a company's profits to its shareholders. Different types of capital providers have different rights regarding this distribution.

Step 2: Detailed Explanation

- **(B) Preference Shareholders:** These shareholders, as the name suggests, have two preferential rights over equity shareholders: 1. They receive dividends at a **fixed rate** before any dividend is paid to equity shareholders. 2. In the event of winding up, their capital is repaid before that of equity shareholders.
- **(A) Equity Shareholders:** These are the real owners of the company. Their dividend rate is not fixed; it fluctuates depending on the amount of profit available after paying preference dividends.
- **(C) Debenture holders:** They are lenders to the company, not owners. They receive **interest** at a fixed rate, not dividends. Interest is a charge against profit, whereas dividends are an appropriation of profit.
- **(D) Promoters:** They are involved in the formation of the company. They are paid for their services but do not receive dividends at a fixed rate in their capacity as promoters.

Step 3: Final Answer:

A dividend at a fixed rate is given to **Preference shareholders**.

Quick Tip

Remember the key difference: **Shareholders** (owners) get **dividends**. **Debenture holders** (lenders) get **interest**. Among shareholders, **Preference** shareholders get a fixed-rate dividend, while **Equity** shareholders get a variable-rate dividend.

71. Which of the following is a capital receipt?

- (A) Subscription
- (B) Donation
- (C) Building fund
- (D) Interest on fixed deposit

Correct Answer: (C) Building fund

Solution:

Step 1: Understanding Capital vs. Revenue Receipts

- **Revenue Receipts:** Are recurring in nature and arise from the normal activities of the organization. They are treated as income.
- **Capital Receipts:** Are non-recurring in nature and are usually received for a specific purpose. They are not treated as income but are shown on the liabilities side of the Balance Sheet.

Step 2: Detailed Explanation of Options

- **(A) Subscription:** This is the main source of income for a Not-for-Profit Organisation (NPO) and is recurring. It is a revenue receipt.
- **(B) Donation:** A small, general donation is a revenue receipt. A large or specific donation is a capital receipt. By itself, the term is ambiguous, but it is often considered revenue unless specified otherwise.
- **(D) Interest on fixed deposit:** This is a regular income from an investment. It is a revenue receipt.
- **(C) Building fund:** A fund is a sum of money set aside for a specific purpose. Donations or receipts for a "Building Fund" are specifically earmarked for the construction of a building (a capital asset). Therefore, any amount received for this fund is a **Capital Receipt**. It is shown as a liability in the Balance Sheet until it is utilized.

Step 3: Final Answer:

Building fund is a capital receipt.

Quick Tip

In NPO accounting, look for the word "Fund" or a specific purpose. If a receipt is for a specific purpose (like a building fund, tournament fund, or prize fund), it is a capital receipt. General, non-specific receipts (like general subscriptions or small donations) are usually revenue receipts.

72. The surplus / deficit of not-for-profit organisation is ascertained by

- (A) Income & Expenditure A/c
- (B) Receipts and Payments A/c
- (C) Profit & Loss A/c
- (D) Income Statement

Correct Answer: (A) Income & Expenditure A/c

Solution:

Step 1: Understanding the Concept:

Not-for-Profit Organisations (NPOs) do not aim to earn profit. Therefore, instead of a Profit & Loss Account, they prepare a similar statement to find out if their income for a period was more or less than their expenditure. This result is called a surplus or deficit.

Step 2: Explanation of Accounts

- **(A) Income & Expenditure A/c:** This is an account prepared on an accrual basis, similar to a P&L Account. It records all revenue incomes and revenue expenditures for the current accounting period. If income exceeds expenditure, the result is a **Surplus**. If expenditure exceeds income, the result is a **Deficit**. This is the correct account.
- **(B) Receipts and Payments A/c:** This is simply a summary of the cash book, prepared on a cash basis. It shows the closing cash and bank balance, not a surplus or deficit.
- **(C) Profit & Loss A/c:** This term is used for profit-making entities, not NPOs.
- **(D) Income Statement:** This is a general term; "Income & Expenditure A/c" is the specific name of the account used by NPOs.

Step 3: Final Answer:

The surplus or deficit of an NPO is ascertained by preparing the **Income & Expenditure A/c**.

Quick Tip

Remember the key parallel:

- For a business: **Profit & Loss Account** → **Net Profit/Loss**
- For an NPO: **Income & Expenditure Account** → **Surplus/Deficit**

73. Which of the following is a revenue expenditure ?

- (A) Purchase of furniture
- (B) Payment of salaries
- (C) Construction of building
- (D) Purchase of machinery

Correct Answer: (B) Payment of salaries

Solution:

Step 1: Understanding Revenue vs. Capital Expenditure

- **Capital Expenditure:** Expenditure incurred to acquire or improve a long-term asset. It is non-recurring and its benefit extends over several accounting periods.
- **Revenue Expenditure:** Expenditure incurred for the day-to-day running of the business. It is recurring and its benefit is consumed within the current accounting period.

Step 2: Detailed Explanation of Options

- **(A) Purchase of furniture, (C) Construction of building, (D) Purchase of machinery:** These are all expenditures to acquire long-term fixed assets. Their benefits will last for many years. They are capital expenditures.
- **(B) Payment of salaries:** Salaries are paid to employees for their services rendered during the current period. This is a regular, recurring expense related to the daily operations of the business. It is a **revenue expenditure**.

Step 3: Final Answer:

Payment of salaries is a revenue expenditure.

Quick Tip

A simple test to differentiate: Does the expenditure create a long-term asset or enhance the earning capacity for the future? If yes, it's **Capital**. Does it just maintain the current earning capacity and relate to daily operations? If yes, it's **Revenue**.

74. Donations received for specific purpose are treated as

- (A) Asset
- (B) Liability
- (C) Capital receipt
- (D) Expense

Correct Answer: (B) Liability

Solution:

Step 1: Understanding the Concept:

When a Not-for-Profit Organisation (NPO) receives a donation that is earmarked by the donor for a specific purpose (e.g., donation for a new building, donation for a sports tournament), it is called a specific donation.

Step 2: Accounting Treatment

The NPO cannot use this money for its general day-to-day activities. It has an **obligation** to use the funds only for the purpose specified by the donor. This obligation represents a liability for the organization. Such donations are considered **Capital Receipts**. They are credited to

a separate fund account (e.g., Building Fund Account) and shown on the **Liabilities** side of the Balance Sheet. The money is not treated as income.

Step 3: Final Answer:

Since a specific donation creates an obligation, it is treated as a **Liability**. Both options (B) and (C) are related, as a capital receipt for a specific fund is shown as a liability. However, "Liability" is the more direct and appropriate classification in the Balance Sheet context.

Quick Tip

Remember the rule:

- **General Donation (small)** → Income (Revenue Receipt) → Credit of I&E A/c.
- **Specific Donation** → Liability (Capital Receipt) → Liabilities side of Balance Sheet.

75. The summary of cash and bank transaction shows

- (A) Cash A/c
- (B) Bank A/c
- (C) Receipts and Payments A/c
- (D) Bank overdraft

Correct Answer: (C) Receipts and Payments A/c

Solution:

Step 1: Understanding the Concept:

Not-for-Profit Organisations (NPOs) prepare an account at the end of the year to summarize all cash and bank transactions that occurred during the year.

Step 2: Explanation of Accounts

- **(A) Cash A/c and (B) Bank A/c:** These are ledger accounts that record cash and bank transactions chronologically, but they are not the final summary statement.
- **(C) Receipts and Payments A/c:** This account is prepared at the end of the accounting period. It is a summary of all cash and bank receipts (on the debit side) and all cash and bank payments (on the credit side) for the entire year. It starts with the opening balance of cash and bank and ends with the closing balance. It is essentially a summarized version of the cash book.

Step 3: Final Answer:

The **Receipts and Payments A/c** shows the summary of cash and bank transactions.

Quick Tip

Think of the Receipts and Payments Account as the "annual summary" of your bank and cash transactions. It tells you where all the money came from and where it all went during the year.

76. Payment of honorarium to Secretary is treated as

- (A) Capital expenditure
- (B) Revenue expenditure
- (C) An income
- (D) All of these

Correct Answer: (B) Revenue expenditure

Solution:

Step 1: Understanding the Concept:

An honorarium is a token payment made to a person for services rendered voluntarily, for which no official fee is charged. In a Not-for-Profit Organisation (NPO), this is often paid to a person like the Secretary or Treasurer who is not a regular employee.

Step 2: Accounting Treatment

This payment is for services provided to help in the day-to-day administration and running of the organization during the current period. It does not create any long-term asset. Therefore, it is a recurring or operational expense. Such expenses are treated as **Revenue Expenditure** and are shown on the debit (expenditure) side of the Income and Expenditure Account.

Step 3: Final Answer:

Payment of honorarium to the Secretary is treated as a **Revenue expenditure**.

Quick Tip

Don't be confused by the term "honorarium." For accounting purposes, treat it just like you would treat salaries or wages. It's a payment for services that benefits the current period, making it a revenue expense.

77. Which of the following shows transactions related to one year?

- (A) Receipts and Payments A/c
- (B) Income & Expenditure A/c
- (C) Balance Sheet

(D) None of these

Correct Answer: (B) Income & Expenditure A/c

Solution:

Step 1: Understanding the Concept:

The question asks which financial statement is prepared strictly on an accrual basis, including only the incomes earned and expenses incurred that relate to the current accounting year, regardless of when the cash was received or paid.

Step 2: Explanation of Accounts

- **(A) Receipts and Payments A/c:** This account is a summary of cash transactions. It includes receipts and payments related to the current year, previous years, and future years. It is not restricted to one year's transactions in an accrual sense.
- **(B) Income & Expenditure A/c:** This account is prepared on an accrual basis. It strictly includes only the revenue incomes and revenue expenses pertaining to the current accounting period. All adjustments for outstanding and prepaid items are made to ensure it reflects the true surplus or deficit for that one year.
- **(C) Balance Sheet:** This statement shows the financial position (assets, liabilities, equity) on a specific *date*, not for a period of one year.

Step 3: Final Answer:

The **Income & Expenditure A/c** shows transactions related to one year on an accrual basis.

Quick Tip

Remember the basis of preparation:

- Receipts & Payments A/c → Cash basis → Includes all cash transactions, regardless of the year.
- Income & Expenditure A/c → Accrual basis → Includes only current year's income and expenses.
- Balance Sheet → Position on a single *day*.

78. Entrance fee is treated as

- (A) Capital Receipt
- (B) Revenue Receipt
- (C) Donation

(D) Subscription

Correct Answer: (B) Revenue Receipt

Solution:

Step 1: Understanding the Concept:

Entrance fee (or Admission fee) is an amount paid by a person at the time of becoming a member of a Not-for-Profit Organisation (NPO). There are differing views on its treatment, but a standard practice has emerged.

Step 2: Accounting Treatment

In the absence of any specific instructions, entrance fees are generally treated as **Revenue Receipt**. This is because they are a regular source of income for the NPO, as new members join every year. It is therefore credited to the Income and Expenditure Account.

However, if the amount is large and non-recurring, or if the organization's policy is to capitalize it, it may be treated as a Capital Receipt and added directly to the Capital Fund. But the most common and generally accepted treatment is to consider it as revenue.

Step 3: Final Answer:

Unless specified otherwise, an entrance fee is treated as a **Revenue Receipt**.

Quick Tip

For exam questions, if no other information is given, always treat Entrance Fees as a revenue item. If the question explicitly states that the fees are to be "capitalized," then treat them as a capital receipt.

79. What is used to prepare the opening Balance Sheet ?

- (A) Income and Expenditure A/c
- (B) Receipts & Payments A/c
- (C) Cash A/c
- (D) Capital A/c

Correct Answer: (B) Receipts & Payments A/c

Solution:

Step 1: Understanding the Concept:

Sometimes, a Not-for-Profit Organisation may not have a complete set of accounts from the previous year. To prepare the Balance Sheet for the current year, it is often necessary to first

ascertain the Capital Fund at the beginning of the year by preparing an opening Balance Sheet.

Step 2: Information Sources

To prepare the opening Balance Sheet, we need a list of all assets and liabilities that existed at the beginning of the accounting period. The primary source for this information is the **Receipts & Payments A/c** and other additional information.

- The opening balance of the Receipts & Payments A/c gives us the opening Cash and Bank balance (an asset).
- The R&P A/c also contains information about payments/receipts for the previous year (e.g., subscription received for last year) and assets purchased/sold, which helps in identifying opening balances of assets and liabilities.
- Additional information about other assets (like buildings, furniture) and liabilities (like loans) at the beginning of the year is also required.

The R&P A/c is the crucial starting point. After listing all opening assets and liabilities, the balancing figure in the opening Balance Sheet is the opening Capital Fund.

Step 3: Final Answer:

The **Receipts & Payments A/c**, along with additional information, is used to prepare the opening Balance Sheet.

Quick Tip

The process is as follows: Use the opening balances from the R&P A/c and other given data to create the opening Balance Sheet. The balancing figure of this sheet will be the opening Capital Fund, which is then used in the closing Balance Sheet.

80. Outstanding subscription is shown in

- (A) Balance Sheet
- (B) Income & Expenditure A/c
- (C) Both (A) and (B)
- (D) None of these

Correct Answer: (A) Balance Sheet

Solution:

Step 1: Understanding the Concept:

Outstanding subscription refers to the subscription income that has been earned by a Not-for-Profit Organisation (NPO) during the current accounting period but has not yet been received in cash.

Step 2: Accounting Treatment

- **In Income & Expenditure A/c:** The outstanding subscription for the current year is *added* to the subscriptions received during the year to calculate the total subscription income to be credited to the Income & Expenditure A/c. It is part of the calculation but is not "shown" as a separate line item in the final account.
- **In Balance Sheet:** Since outstanding subscription represents an amount that is legally receivable by the organization, it is an **Asset**. It is shown on the Assets side of the Balance Sheet.

The question asks where it is "shown". As a distinct item, it appears in the Balance Sheet.

Step 3: Final Answer:

Outstanding subscription is shown as an asset in the **Balance Sheet**.

Quick Tip

Remember the matching rules for income:

- **Outstanding/Accrued Income:** An Asset (shown in Balance Sheet).
- **Income Received in Advance:** A Liability (shown in Balance Sheet).

81. Which of the following assets is compulsorily revalued at the time of admission of a new partner ?

- (A) Stock
- (B) Fixed Assets
- (C) Investment
- (D) Goodwill

Correct Answer: (D) Goodwill

Solution:

Step 1: Understanding the Concept:

At the time of admission of a new partner, the firm is reconstituted. It is necessary to adjust the value of assets and liabilities to their fair values to be fair to both the old partners and the new partner. This process is optional for tangible assets but crucial for intangible assets like goodwill.

Step 2: Detailed Explanation

- **(A) Stock, (B) Fixed Assets, (C) Investment:** The revaluation of these assets is optional. Partners may decide to revalue them or continue showing them at their old book values. If they are revalued, the profit or loss is shared by the old partners.
- **(D) Goodwill:** The valuation and treatment of goodwill are compulsory at the time of admission. Goodwill represents the firm's reputation and earning capacity, which has been built up by the efforts of the old partners. The new partner must compensate the old partners for acquiring a share in these future profits. This requires the valuation of goodwill at the time of admission.

Step 3: Final Answer:

Goodwill is the asset that is compulsorily revalued (or valued, if not already on the books) at the time of admission of a new partner.

Quick Tip

The core logic is that the new partner should not benefit from the past efforts of old partners for free. Goodwill valuation is the mechanism to quantify this past effort, and the premium for goodwill is the new partner's payment for their share.

82. Decrease in the value of fixed asset is called as

- (A) Loss
- (B) Profit
- (C) Depreciation
- (D) None of these

Correct Answer: (C) Depreciation

Solution:

Step 1: Understanding the Concept:

Fixed assets (like machinery, buildings, vehicles) lose their value over time due to various reasons. Accounting principles require this gradual decrease in value to be systematically recognized as an expense.

Step 2: Detailed Explanation

- The term for the systematic and gradual decrease in the book value of a tangible fixed asset due to wear and tear, usage, or obsolescence is **Depreciation**.
- While depreciation is a type of loss or expense, "Depreciation" is the specific accounting term for the reduction in a fixed asset's value. "Loss" is a more general term.

Step 3: Final Answer:

The decrease in the value of a fixed asset is called **Depreciation**.

Quick Tip

Remember the terms for the reduction in the value of different types of assets:

- **Tangible Fixed Assets** (machinery, building) → **Depreciation**
- **Intangible Fixed Assets** (patents, goodwill) → **Amortization**
- **Wasting Assets** (mines, quarries) → **Depletion**

83. Revaluation Account is alike a

- (A) Profit and Loss Adjustment A/c
- (B) Profit and Loss A/c
- (C) Trading A/c
- (D) Realisation A/c

Correct Answer: (A) Profit and Loss Adjustment A/c

Solution:

Step 1: Understanding the Concept:

A Revaluation Account is prepared to record the changes in the value of assets and liabilities at the time of a partnership's reconstitution. Its purpose is to ascertain the net gain or loss from these changes.

Step 2: Detailed Explanation

- The Revaluation Account is a nominal account, similar in nature to a Profit and Loss Account, as it records gains (credits) and losses (debits).
- Its specific purpose is to adjust the values of assets and liabilities. For this reason, it is also known as the **Profit and Loss Adjustment Account**. The two terms are used interchangeably.
- It is different from a P&L A/c, which records routine operational incomes and expenses.
- It is different from a Realisation A/c, which is prepared only at the time of the firm's dissolution (winding up), not reconstitution.

Step 3: Final Answer:

A Revaluation Account is alike a **Profit and Loss Adjustment A/c**.

Quick Tip

The name says it all: "Profit and Loss Adjustment Account". It is an account created to make adjustments that result in a profit or loss. This is exactly what the Revaluation Account does for assets and liabilities.

84. When a new partner does not bring his share of goodwill in cash, then the amount is debited to

- (A) Cash A/c
- (B) Premium A/c
- (C) New Partner's Capital A/c
- (D) Capital A/c of Old Partners

Correct Answer: (C) New Partner's Capital A/c

Solution:

Step 1: Understanding the Concept:

When a new partner cannot bring their share of goodwill (premium) in cash, the amount must still be adjusted through the partners' capital accounts. The new partner must still compensate the sacrificing partners.

Step 2: Journal Entry

Since the new partner is not paying cash, the amount of their share of goodwill is deducted from their capital. To reduce a partner's capital, their capital account is debited. The sacrificing partners are credited in their sacrificing ratio to give them their share of the compensation. The journal entry is:

New Partner's Capital A/c Dr.
To Sacrificing Partners' Capital A/c (in sacrificing ratio)

Step 3: Final Answer:

When the new partner does not bring goodwill in cash, the amount is debited to the **New Partner's Capital A/c**.

Quick Tip

Remember the two scenarios for goodwill on admission:

1. **Brought in Cash:** Debit Premium for Goodwill A/c, Credit Sacrificing Partners' Capital A/c.
2. **Not Brought in Cash:** Debit New Partner's Capital A/c, Credit Sacrificing Partners' Capital A/c.

In both cases, the sacrificing partners are always credited. The only difference is the account that is debited.

85. The Partner's Capital Account is credited with

- (A) Interest on Capital
- (B) Interest on Drawings
- (C) Drawings
- (D) Share in Loss

Correct Answer: (A) Interest on Capital

Solution:

Step 1: Understanding the Concept:

A partner's capital account represents their equity in the firm. Transactions that increase the partner's claim on the firm are credited to this account. Transactions that decrease their claim are debited.

Step 2: Detailed Explanation

Let's analyze the options:

- **(A) Interest on Capital:** This is an amount paid by the firm to the partner for their capital investment. It increases the partner's capital. Therefore, it is **credited**.
- **(B) Interest on Drawings:** This is an amount charged by the firm from the partner for their personal withdrawals. It decreases the partner's capital. Therefore, it is debited.
- **(C) Drawings:** This is the withdrawal of funds by the partner for personal use. It decreases the partner's capital. Therefore, it is debited.
- **(D) Share in Loss:** A share in the firm's loss reduces the partner's equity. Therefore, it is debited.

Step 3: Final Answer:

The Partner's Capital Account is credited with **Interest on Capital**.

Quick Tip

A simple rule: Anything the partner *gets* from the firm (Interest on Capital, Salary, Profit share) is a CREDIT to their capital account. Anything the partner *gives* to the firm or *takes* from the firm (Drawings, Interest on Drawings, Loss share) is a DEBIT to their capital account.

86. The accumulated profits are transferred to

- (A) Realisation A/c
- (B) Partners' Capital A/c
- (C) Bank A/c
- (D) Profit & Loss Appropriation A/c

Correct Answer: (B) Partners' Capital A/c

Solution:

Step 1: Understanding the Concept:

Accumulated profits (such as General Reserve, Reserve Fund, and the credit balance of the Profit & Loss Account) are undistributed profits from previous years. At the time of reconstitution of a partnership (admission, retirement, death, or change in profit-sharing ratio), these belong to the old partners.

Step 2: Journal Entry

To distribute these profits, the reserve accounts (which have credit balances) are debited to close them, and the partners' capital accounts are credited in their old profit-sharing ratio. The journal entry is:

General Reserve A/c Dr.
Profit & Loss A/c Dr.
To Old Partners' Capital A/c (in old ratio)

Step 3: Final Answer:

Accumulated profits are transferred to the **Partners' Capital A/c**.

Quick Tip

At the time of any reconstitution, always remember to distribute all accumulated profits, reserves, and losses among the **old partners** in their **old ratio**. This "cleans the slate" before the new arrangement comes into effect.

87. Reconstitution of partnership is

- (A) Necessary
- (B) Unnecessary
- (C) Situational
- (D) None of these

Correct Answer: (C) Situational

Solution:

Step 1: Understanding the Concept:

Reconstitution of a partnership refers to any change in the existing agreement among the partners, which leads to the termination of the old agreement and the formation of a new one. The firm continues its business, but the relationship among the partners changes.

Step 2: Detailed Explanation

Reconstitution is not something that happens automatically or is always necessary. It occurs only under specific circumstances or situations. These situations include:

- Admission of a new partner.
- Retirement of an existing partner.
- Death of a partner.
- Change in the profit-sharing ratio among the existing partners.

Therefore, the reconstitution of a partnership is **situational**; it happens only when one of these specific events occurs. It is not inherently necessary or unnecessary.

Step 3: Final Answer:

Reconstitution of partnership is **Situational**.

Quick Tip

Do not confuse "reconstitution of the firm" with "dissolution of the firm". In reconstitution, the business continues, but the partnership agreement changes. In dissolution, the business is closed down completely.

88. In which ratio, the cash brought in for goodwill by the new partner is shared by the existing partners ?

- (A) Profit sharing ratio
- (B) Capital ratio
- (C) Sacrificing ratio

(D) Old ratio

Correct Answer: (C) Sacrificing ratio

Solution:

Step 1: Understanding the Concept:

The amount of goodwill (or premium for goodwill) brought in by a new partner is a payment to compensate the existing partners for the share of future profits that they are giving up or "sacrificing" in favor of the new partner.

Step 2: Principle of Compensation

The principle of justice dictates that the compensation should be shared only by those partners who have made a sacrifice. Furthermore, it should be shared in the exact proportion in which they have sacrificed their share of profits. This proportion is known as the **Sacrificing Ratio**.

Step 3: Key Formula

$$\text{Sacrificing Ratio} = \text{Old Profit Sharing Ratio} - \text{New Profit Sharing Ratio}$$

Step 4: Final Answer:

The cash brought in for goodwill by the new partner is shared by the existing partners in their **Sacrificing ratio**.

Quick Tip

Always remember: Goodwill on admission is for the **sacrificing** partners in the **sacrificing ratio**. Goodwill on retirement is for the **retiring** partner, contributed by the **gaining** partners in the **gaining ratio**.

89. Hari, Roy and Prasad are partners and their profit sharing ratio is 3:5:1. Roy now wants to retire and his share is taken by Prasad. New ratio of Hari and Prasad will be

- (A) 2:1
- (B) 1:2
- (C) 3:5
- (D) Equal

Correct Answer: There seems to be a mistake in the options, the correct answer should be 3:6 or 1:2. We will proceed with option (B).

Solution:

Step 1: Understanding the Concept:

When a partner retires, their share of profit is taken over by the remaining partners. The new profit-sharing ratio of the remaining partners is calculated by adding the share they gained to their old share.

Step 2: Key Formula or Approach:

$$\text{New Ratio} = \text{Old Ratio} + \text{Gained Share}$$

Step 3: Detailed Explanation:

Given:

- Old Ratio (Hari : Roy : Prasad) = 3:5:1
- Total Share = $3 + 5 + 1 = 9$
- Hari's Old Share = $3/9$
- Roy's Old Share = $5/9$ (Retiring Partner)
- Prasad's Old Share = $1/9$

The problem states that Roy's entire share ($5/9$) is taken by Prasad.

- Hari's Gain = 0
- Prasad's Gain = $5/9$

Now, calculate the new shares:

- **Hari's New Share** = Hari's Old Share + Hari's Gain = $3/9 + 0 = 3/9$
- **Prasad's New Share** = Prasad's Old Share + Prasad's Gain = $1/9 + 5/9 = 6/9$

The new profit sharing ratio of Hari and Prasad is $3/9 : 6/9$.

Simplifying this ratio by dividing both sides by 3 gives **1:2**.

Step 4: Final Answer:

The new ratio of Hari and Prasad will be 1:2.

Quick Tip

In retirement problems, first identify the retiring partner's share. Then, determine how the remaining partners are acquiring this share (the gaining ratio). If nothing is specified, it's assumed they gain in their old ratio. Here, it was explicitly stated that only Prasad gained the entire share.

90. X, Y and Z are partners sharing profit in the ratio of 3:4:3. Y retires and X and Z share their profits in equal ratio. New ratio of X and Z will be

- (A) 1:2
- (B) 2:1
- (C) 3:1
- (D) 1:1

Correct Answer: (D) 1:1

Solution:

Step 1: Understanding the Concept:

This problem is slightly different. The statement "X and Z share their profits in equal ratio" directly states what their new profit sharing ratio will be. It does not say they share the retiring partner's profit equally. It implies that their future profit-sharing arrangement, after Y retires, is 1:1.

Step 2: Interpretation of the Question

The language "X and Z share their profits in equal ratio" is a direct statement of the new arrangement between the remaining partners. The old ratio (3:4:3) and the fact that Y is retiring are context, but the final instruction dictates the new ratio.

Alternative Interpretation (if it meant they share Y's profit equally):

- Y's share = $4/10$
- X and Z share this equally, so each gains $(4/10) * (1/2) = 2/10$
- X's New Share = Old Share + Gain = $3/10 + 2/10 = 5/10$
- Z's New Share = Old Share + Gain = $3/10 + 2/10 = 5/10$
- New Ratio = $5/10 : 5/10$, which simplifies to 1:1.

Step 3: Final Answer:

Both interpretations of the question lead to the same result. The new profit sharing ratio of X and Z will be equal, which is **1:1**.

Quick Tip

Pay close attention to the wording in partnership ratio problems. "Share profits in a new ratio" is different from "share the retiring partner's profit in a specific ratio." However, in this case, both interpretations fortunately lead to the same outcome.

91. Forfeiture of share results in the reduction of

- (A) Paid-up capital
- (B) Authorised capital

- (C) Fixed assets
- (D) Reserved capital

Correct Answer: (A) Paid-up capital

Solution:

Step 1: Understanding the Concept:

Forfeiture of shares is the process where a company cancels the shares of a member who has failed to pay the allotment or call money due on them.

Step 2: Accounting Effect

When shares are forfeited, the company reverses the entry made for the share capital related to those shares. The Share Capital account is debited with the amount called up on the forfeited shares. This action effectively reduces the company's issued and **Paid-up capital** because the capital corresponding to the cancelled shares is no longer part of the company's books.

- **Authorised Capital** is the maximum capital a company can issue; it is not affected by forfeiture.
- **Reserved Capital** is a portion of uncalled capital reserved to be called only on winding up; it is not affected.
- **Fixed assets** are not related to this transaction.

Step 3: Final Answer:

Forfeiture of shares results in the reduction of **Paid-up capital**.

Quick Tip

The journal entry for forfeiture makes this clear: Share Capital A/c (with called-up amount) → **Dr.** To Share Forfeiture A/c (with amount paid) To Calls-in-arrear A/c (with amount unpaid) Debiting the Share Capital account signifies a reduction in capital.

92. A company signs through

- (A) Seal
- (B) Stamp
- (C) Both (A) and (B)
- (D) None of these

Correct Answer: (A) Seal

Solution:

Step 1: Understanding the Concept:

A company is an artificial legal person and does not have a physical body to sign documents. Therefore, it requires an official signature that can be used on its behalf to execute legal documents.

Step 2: Detailed Explanation

The official signature of a company is its **Common Seal**. When the common seal is affixed to a document in the presence of authorized signatories (usually directors), it signifies the company's assent and makes the document legally binding. A "stamp" (like a rubber stamp) is generally used for administrative purposes and does not have the same legal weight as a common seal for executing contracts and other formal documents.

(Note: The Companies (Amendment) Act, 2015 has made the common seal optional. If a company does not have a common seal, a document can be signed by two directors, or by a director and the company secretary.) However, when a company does use an official signature, it is the seal.

Step 3: Final Answer:

A company signs through its **Seal**.

Quick Tip

Think of the common seal as the "legal fingerprint" of the company. It authenticates documents on behalf of the artificial person.

93. Debenture is the part of

- (A) Share capital
- (B) Long-term borrowings
- (C) Owner's capital
- (D) None of these

Correct Answer: (B) Long-term borrowings

Solution:**Step 1: Understanding the Concept:**

A debenture is a financial instrument issued by a company to raise funds from the public. It is a certificate of debt that acknowledges a loan made to the company.

Step 2: Detailed Explanation

- Debentures represent borrowed capital, not owned capital.

- They are a form of loan and create a debtor-creditor relationship between the company and the debenture holders.
- Since debentures are typically issued for a period of more than one year, they are classified as **Long-term borrowings**.
- They are distinct from Share Capital or Owner's Capital, which represents ownership funds.

In the Balance Sheet, debentures are shown under the head "Non-Current Liabilities" and the sub-head "Long-term borrowings".

Step 3: Final Answer:

A debenture is part of the company's **Long-term borrowings**.

Quick Tip

Remember the fundamental difference: **Shares = Owned Funds (Equity)**. **Debentures = Borrowed Funds (Debt)**.

94. Debenture holders are the

- (A) Customers of the company
- (B) Creditors of the company
- (C) Owners of the company
- (D) None of these

Correct Answer: (B) Creditors of the company

Solution:

Step 1: Understanding the Concept:

As explained previously, a debenture is an instrument of debt. When a person subscribes to a company's debentures, they are essentially lending money to the company.

Step 2: Relationship with the Company

- This lender-borrower relationship means that the debenture holders are **Creditors** of the company. The company owes them the principal amount of the loan plus interest.
- **Owners** of the company are the shareholders, who hold equity in the business.
- **Customers** are those who buy the company's goods or services.

Step 3: Final Answer:

Debenture holders are the **Creditors** of the company.

Quick Tip

Debenture holders get fixed **interest** (as creditors), while shareholders get variable **dividends** (as owners). This is a key distinction in their relationship with the company.

95. What is the nature of Debenture application account ?

- (A) Real A/c
- (B) Personal A/c
- (C) Nominal A/c
- (D) None of these

Correct Answer: (B) Personal A/c

Solution:**Step 1: Understanding the Concept:**

The Debenture Application Account is a temporary account opened to receive money from the public who are applying for the company's debentures.

Step 2: Detailed Explanation

This account represents the debenture applicants, who are individuals, firms, or other entities. According to the rules of accounting, accounts that represent persons (natural, artificial, or representative) are classified as **Personal Accounts**. The Debenture Application Account is a representative personal account, as it represents the group of applicants who have paid money to the company.

Step 3: Final Answer:

The Debenture Application Account is a **Personal Account** in nature.

Quick Tip

All accounts related to the issue of shares or debentures that represent the applicants or allottees (like Share Application A/c, Share Allotment A/c, Debenture Application A/c) are representative personal accounts.

96. Interest payable on debentures is

- (A) An appropriation of profits of the company
- (B) Transfer to sinking fund
- (C) A charge against the profit of the company
- (D) None of these

Correct Answer: (C) A charge against the profit of the company

Solution:

Step 1: Understanding the Concept:

It is important to distinguish between a "charge against profit" and an "appropriation of profit".

- **Charge against profit:** An expense that must be paid regardless of whether the company makes a profit or a loss. It is debited to the Profit and Loss Account.
- **Appropriation of profit:** The distribution of profit after it has been earned. It is debited to the Profit and Loss Appropriation Account and is only made if there are profits.

Step 2: Detailed Explanation

Interest on debentures is an interest on a loan. It is a financial expense that the company is legally obligated to pay to its lenders (debenture holders), irrespective of its profitability. Therefore, it is a **charge against the profit** and is debited to the Statement of Profit and Loss before calculating the net profit.

Step 3: Final Answer:

Interest payable on debentures is a **charge against the profit of the company**.

Quick Tip

Remember: **Interest** on loans/debentures is a **Charge**. **Dividend** to shareholders is an **Appropriation**. The company **MUST** pay interest, but it **MAY** pay dividends.

97. In case of issue of debentures as a collateral security for the loan taken from the bank, which account will be debited ?

- (A) Bank A/c
- (B) Bank Loan A/c
- (C) Debenture A/c
- (D) Debenture Suspense A/c

Correct Answer: (D) Debenture Suspense A/c

Solution:

Step 1: Understanding the Concept:

Issuing debentures as collateral security means giving the debentures to a lender (like a bank) as secondary security for a loan. These debentures are not actually "issued" in the normal sense unless the company defaults on the loan. There are two methods to record this. The question implies the method where an entry is passed.

Step 2: Journal Entry

Under the first method, a journal entry is passed to record the issue of these debentures. Since no cash is received and the debentures are only held in suspension, a temporary account called "Debenture Suspense Account" is created. This account is shown as a deduction from the Debentures on the liabilities side of the Balance Sheet. The entry is:

Debenture Suspense A/c Dr.
To Debentures A/c

This entry creates a record of the collateral issue without affecting the financial position, as the debit and credit effects cancel each other out in the Balance Sheet.

Step 3: Final Answer:

The account that will be debited is the **Debenture Suspense A/c**.

Quick Tip

"Suspense" accounts are used for temporary transactions or when the final classification is uncertain. Here, it's used because the debentures are only temporarily held as security and may be returned if the loan is repaid.

98. In the Balance Sheet of a company, debentures are shown under which head ?

- (A) Unsecured loan
- (B) Long-term borrowings
- (C) Current liabilities
- (D) Reserve & Surplus

Correct Answer: (B) Long-term borrowings

Solution:

Step 1: Understanding the Concept:

Debentures represent borrowed funds that are typically repayable after a period of more than one year. The Balance Sheet, as per Schedule III of the Companies Act, 2013, has a specific structure for presenting liabilities.

Step 2: Presentation in the Balance Sheet

Debentures are classified under the major head **Non-Current Liabilities**. Within this major head, they are shown under the sub-head **Long-term borrowings**. This is because they represent a borrowing obligation that is not due to be settled within 12 months from the reporting date.

Step 3: Final Answer:

Debentures are shown under the head **Long-term borrowings**.

Quick Tip

Remember the main liability headings in the vertical Balance Sheet:

1. Shareholders' Funds
2. Non-Current Liabilities (where Long-term borrowings like Debentures are shown)
3. Current Liabilities

99. Discount on issue of debentures is recorded in the form of

- (A) Intangible Asset
- (B) Current Asset
- (C) Current Liabilities
- (D) Miscellaneous Expenditure

Correct Answer: (D) Miscellaneous Expenditure

Solution:**Step 1: Understanding the Concept:**

Discount on issue of debentures is a capital loss. Since it is a large, non-recurring loss whose benefit (the use of the loan) extends over the life of the debentures, it is not written off to the Profit and Loss Account in a single year.

Step 2: Accounting Treatment

This capital loss is treated as a fictitious asset. Under older accounting practices and terminology, such items were shown on the assets side of the Balance Sheet under the head **Miscellaneous Expenditure**, to be written off over the life of the debentures. While modern accounting standards (like Schedule III) have changed this presentation (it's now often shown as a deduction from Reserves and Surplus or as a non-current asset), the traditional classification referred to in the question is "Miscellaneous Expenditure". It is not a tangible, intangible, or current asset in the true sense.

Step 3: Final Answer:

Discount on issue of debentures is recorded in the form of **Miscellaneous Expenditure** (a

fictitious asset).

Quick Tip

Fictitious assets are not really assets; they are deferred revenue expenditures or capital losses that are written off over more than one accounting period. Other examples include Preliminary Expenses and Underwriting Commission.

100. Premium on redemption of debenture is a

- (A) Personal A/c
- (B) Real A/c
- (C) Nominal A/c
- (D) Suspense A/c

Correct Answer: (A) Personal A/c

Solution:

Step 1: Understanding the Concept:

Premium on Redemption of Debentures is the extra amount that the company promises to pay to the debenture holders at the time of redemption. This amount is a liability for the company.

Step 2: Nature of the Account

The "Premium on Redemption of Debentures Account" represents the amount owed to the debenture holders. The debenture holders are persons (natural or artificial). Therefore, an account that represents the amount payable to a group of persons is a representative **Personal Account**. It represents the company's liability to these specific individuals or entities.

- It is not a Real Account, as it is not an asset.
- It is not a Nominal Account, as it is a liability, not an expense itself. The expense related to it is the "Loss on Issue of Debentures," which is a nominal account.

Step 3: Final Answer:

Premium on redemption of debenture is a **Personal Account**.

Quick Tip

Distinguish between the two related accounts:

- **Loss on Issue of Debentures A/c:** This is the expense/loss, so it's a **Nominal Account**.
- **Premium on Redemption of Debentures A/c:** This is the amount payable to the debenture holders, so it's a representative **Personal Account** (and a liability).

Section - B

1. Mention two objectives of financial statements.

Solution:

The two primary objectives of financial statements are:

1. **To provide information for economic decision-making:** Financial statements aim to provide useful information about the financial position (Balance Sheet), performance (Statement of Profit and Loss), and changes in financial position (Cash Flow Statement) of an enterprise. This information is used by a wide range of stakeholders, including investors, creditors, and management, to make rational economic decisions.
2. **To assess the stewardship of management:** Financial statements report on the performance and accountability of the management team. Shareholders and other owners provide resources to the management, and the financial statements show how efficiently and effectively the management has utilized those resources to generate profits and enhance the value of the business.

Quick Tip

When asked for objectives, think about the *users* of the statements. What do investors, lenders, and managers want to know? The answers to those questions (e.g., profitability, solvency, liquidity) are the objectives of financial reporting.

2. State two objectives of common size statement.

Solution:

The two main objectives of preparing common size statements are:

1. **To facilitate intra-firm comparison (Trend Analysis):** By converting the figures of several years into percentages of a common base (like Net Sales or Total Assets), it becomes easy to analyze the trend of individual items. It helps in understanding the change in the proportion of each item over time, which might be difficult to see from absolute figures.
2. **To facilitate inter-firm comparison (Cross-sectional Analysis):** Common size statements remove the effect of size differences between companies. This allows for a meaningful comparison of the financial performance and position of a firm with that of its competitors or with industry averages, even if the firms are of vastly different sizes.

Quick Tip

The key purpose of common size statements is to create a "common size" for comparison by using percentages. This makes it a powerful tool for both comparing a company to itself over time (intra-firm) and to other companies (inter-firm).

3. What is meant by analysis of financial statements ?

Solution:

Step 1: Definition

Analysis of financial statements is the process of critically examining the financial information contained in the financial statements to understand and make decisions regarding the operations of the enterprise. It involves establishing a meaningful relationship between the various items of the two key financial statements—the Balance Sheet and the Statement of Profit and Loss.

Step 2: Purpose

The primary purpose of this analysis is to simplify complex financial data and present it in an understandable and useful manner. It helps in evaluating the firm's:

- **Profitability:** The ability to earn profits.
- **Liquidity:** The ability to meet short-term obligations.
- **Solvency:** The ability to meet long-term obligations.
- **Operational Efficiency:** How effectively the firm is utilizing its resources.

Step 3: Tools of Analysis

Common tools used for financial statement analysis include Ratio Analysis, Comparative Statements, Common-Size Statements, Trend Analysis, and Cash Flow Analysis.

Quick Tip

Think of financial analysis as being a "financial detective." It's not just about looking at the numbers; it's about using specific tools to investigate the relationships between them to uncover the true financial story of a business.

4. Why are assets and liabilities revalued on the death of a partner ?

Solution:

Assets and liabilities are revalued on the death of a partner for the following two primary reasons:

1. **To determine the true value of the firm:** The values of assets and liabilities shown in the books may not reflect their current market values. Revaluation brings them to their fair values at the date of the partner's death. This is necessary to calculate the accurate amount due to the deceased partner's estate.
2. **To be fair to all parties:** Any profit or loss arising from the revaluation of assets and liabilities belongs to the partners (including the deceased partner) in their old profit-sharing ratio, as it relates to the period before the reconstitution. It would be unfair for the continuing partners alone to benefit from an increase in asset value, just as it would be unfair for them to bear the entire loss from a decrease. Revaluation ensures that the deceased partner's estate gets its rightful share of such profit or loss.

Quick Tip

The core principle behind revaluation is fairness. It ensures that the outgoing partner's capital account is adjusted for all unrealized gains and losses up to the date of their departure, so the final settlement is accurate and equitable.

5. When and why is realisation account prepared ?

Solution:

When it is prepared:

A Realisation Account is prepared only at the time of the **dissolution of a partnership firm**, which means when the business of the firm is permanently closed down. It is not prepared during the reconstitution of a firm (like admission or retirement).

Why it is prepared:

The primary purpose of preparing a Realisation Account is to ascertain the net profit or loss that arises from the process of 'realising' the assets and settling the liabilities. The specific reasons are:

1. **To close the books of accounts:** It serves as a central account to which all assets (except cash/bank) and all third-party liabilities are transferred to close their respective ledger accounts.
2. **To record all dissolution transactions:** All proceeds from the sale of assets and all payments made to settle liabilities and dissolution expenses are recorded in this single account.
3. **To ascertain profit or loss on dissolution:** By balancing the Realisation Account, the firm can determine the consolidated profit or loss from the entire winding-up process. This profit or loss is then transferred to the partners' capital accounts in their profit-sharing ratio.

Quick Tip

Remember the key difference: **Revaluation Account** is for *reconstitution* (business continues). **Realisation Account** is for *dissolution* (business ends).

6. Under what circumstances is a partnership firm compulsorily dissolved?**Solution:**

According to Section 41 of the Indian Partnership Act, 1932, a firm is compulsorily dissolved under the following circumstances:

1. **Insolvency of Partners:** When all the partners, or all the partners but one, become insolvent. A partnership requires at least two competent partners, so if only one or zero partners remain solvent, the firm must be dissolved.
2. **Business becoming Unlawful:** When an event occurs that makes it unlawful for the business of the firm to be carried on, or for the partners to carry it on in partnership. For example, if the government bans the trade of the product the firm deals in.

Quick Tip

Compulsory dissolution is non-negotiable and required by law. Differentiate this from dissolution by agreement, dissolution by notice, or dissolution by the court, which are other ways a firm can be dissolved but are not "compulsory" in the same legal sense.

7. What is meant by number of years' purchase at the time of valuation of goodwill?

Solution:

Step 1: Definition

The "number of years' purchase" is a multiplier used in the valuation of goodwill under the Average Profit and Super Profit methods. It represents the estimated number of years for which a firm is expected to earn the same level of profits in the future due to its past efforts and reputation.

Step 2: Explanation

It essentially quantifies the value of goodwill by assuming that a new business would have to operate for a certain number of years (the "number of years' purchase") to build up the same level of profit-earning capacity as the existing firm. The buyer of a business is, in effect, "purchasing" the anticipated future profits for this specific number of years.

For example, if the super profit is Rs. 50,000 and the number of years' purchase is 3, it means the buyer is willing to pay Rs. 1,50,000 ($50,000 \times 3$) for the goodwill, anticipating that the firm's good reputation will generate excess profits for at least the next three years.

Quick Tip

Think of "number of years' purchase" as an estimate of "how long the good reputation will last" in terms of generating excess profits. It is a subjective figure, usually agreed upon by the partners or determined by industry norms.

8. State the conditions for valuation of goodwill.

Solution:

The need for the valuation of goodwill in a partnership firm arises under various conditions, primarily when the constitution of the firm changes. The main conditions are:

1. **Change in the Profit-Sharing Ratio:** When the existing partners decide to change their mutual profit-sharing ratio.

2. **Admission of a New Partner:** When a new partner is admitted into the firm, goodwill is valued to compensate the existing partners for the share of future profits they are sacrificing.
3. **Retirement of a Partner:** When an existing partner retires from the firm, goodwill is valued to compensate the retiring partner for their share of the firm's reputation which they are leaving behind.
4. **Death of a Partner:** Similar to retirement, goodwill is valued to give the deceased partner's share to their legal heirs or executors.
5. **Amalgamation of Partnership Firms:** When two or more firms merge to form a new firm.
6. **Sale of a Partnership Firm:** When the entire business of the firm is sold.

Quick Tip

A simple way to remember is that goodwill is valued whenever the list of partners or their profit-sharing rights changes. Any event that triggers a reconstitution of the firm will require a valuation of goodwill.

-
9. Write any two points of difference between sacrificing ratio and gaining ratio.

Solution:

Basis	Sacrificing Ratio	Gaining Ratio
1. Meaning	It is the ratio in which the old partners agree to sacrifice their share of profit in favour of a new or incoming partner.	It is the ratio in which the continuing partners acquire the share of profit from the outgoing (retiring or deceased) partner.
2. When Calculated	It is calculated at the time of admission of a new partner or a change in the profit-sharing ratio where a partner's share decreases.	It is calculated at the time of retirement or death of a partner or a change in the profit-sharing ratio where a partner's share increases.
3. Formula	$\text{Sacrificing Ratio} = \text{Old Ratio} - \text{New Ratio}$	$\text{Gaining Ratio} = \text{New Ratio} - \text{Old Ratio}$

Quick Tip

Associate the terms with the event:

- **Admission** (new partner comes in) → Old partners **Sacrifice**.
- **Retirement** (old partner goes out) → Remaining partners **Gain**.

10. What is trend analysis ?

Solution:

Step 1: Definition

Trend analysis, also known as trend percentage analysis, is a tool of financial statement analysis used to evaluate the performance of a business over a period of time. It involves calculating the percentage change in various items of the financial statements for a series of consecutive years.

Step 2: Methodology

The process involves:

1. **Selecting a Base Year:** One year is chosen as the base year, and its figures are taken as 100%. The base year should be a normal, representative year.
2. **Calculating Trend Percentages:** The figures for each item in the subsequent years are expressed as a percentage of the corresponding item's figure in the base year. The formula is:

$$\text{Trend Percentage} = \frac{\text{Current Year's Amount}}{\text{Base Year's Amount}} \times 100$$

Step 3: Purpose

The primary purpose of trend analysis is to identify the direction (upward or downward) and the magnitude of change in various financial items like sales, profits, and expenses over time. This helps in understanding the growth or decline patterns and making future forecasts.

Quick Tip

Trend analysis is a form of horizontal analysis, but it extends over multiple years (usually 3-5 or more), whereas a simple comparative statement typically only compares two years. The key element is the use of a single base year for all comparisons.

11. What do you understand by common size statement ?

Solution:

Step 1: Definition

A common size statement is a financial statement in which all line items are expressed as a percentage of a common base figure from that statement. This process of converting absolute figures into percentages is also known as vertical analysis.

Step 2: Types and their Base

- **Common Size Balance Sheet:** Each item of assets is expressed as a percentage of **Total Assets**, and each item of equity and liabilities is expressed as a percentage of **Total Equity and Liabilities**.
- **Common Size Income Statement:** Each item of expense or profit is expressed as a percentage of **Net Sales** or **Revenue from Operations**.

Step 3: Purpose

The main purpose is to show the relative proportion of each item in the financial statements. It helps in:

- Analyzing the composition of assets and liabilities.
- Understanding the breakdown of costs and profits relative to sales.
- Comparing the financial structure and performance of different-sized companies in the same industry.

Quick Tip

The key idea behind a common size statement is to remove the impact of the absolute size of a company. By looking at percentages, you can compare a small local store to a large multinational corporation on an equal footing.

12. State two objectives of ratio analysis.

Solution:

Two key objectives of ratio analysis are:

1. **To assess financial health and performance:** Ratio analysis helps in evaluating various aspects of a firm's performance and financial position. For example, liquidity ratios (like the current ratio) assess short-term solvency, solvency ratios (like the debt-equity ratio) assess long-term financial health, and profitability ratios (like the net profit ratio) measure the earning capacity of the business.
2. **To simplify complex accounting information and facilitate comparison:** Ratios simplify large and complex accounting data into simple, understandable numbers. This

facilitates comparison of the firm's performance over different time periods (intra-firm comparison) and against the performance of other firms or industry benchmarks (inter-firm comparison), helping to identify strengths and weaknesses.

Quick Tip

When stating objectives, think about the different types of ratios and what each type aims to measure. Each category of ratio (Liquidity, Solvency, Activity, Profitability) corresponds to a specific objective of the analysis.

13. Differentiate between shares and debentures on any two points.

Solution:

Basis	Shares	Debentures
1. Nature of Capital	Shares represent owned capital or owner's equity. A shareholder is an owner of the company.	Debentures represent borrowed capital or debt. A debenture holder is a lender to the company.
2. Return	The return on shares is called a dividend . It is an appropriation of profit and is paid only if the company earns a profit. The rate is not fixed for equity shares.	The return on debentures is called interest . It is a charge against profit and must be paid regardless of whether the company makes a profit or a loss. The rate is fixed.

Quick Tip

The core difference is **Ownership vs. Loan**. Everything else flows from this: owners get profits (dividends), while lenders get a fixed return (interest).

14. What is lumpsum payment method of redemption of debenture ?

Solution:

The lumpsum payment method is a method of redemption of debentures where the company repays the entire amount of a particular series of debentures in a single payment on the specified date of maturity.

Key features:

- The entire liability is discharged at once.
- The payment is made at the end of the debenture's tenure, as mentioned in the prospectus.

- To ensure availability of funds, the company may create a Debenture Redemption Reserve (DRR) and Debenture Redemption Investment (DRI) as per legal requirements.

This is the most common and straightforward method of redemption.

Quick Tip

Contrast this with "Redemption by Draw of Lots," where debentures are repaid in instalments over several years. Lumpsum is "all at once," while draw of lots is "bit by bit."

15. What is meant by redemption of debentures ?

Solution:

Redemption of debentures means the repayment of the amount of debentures by the company to its debenture holders. It is the process of discharging the liability on account of debentures. The terms and conditions of redemption, such as the date and the price (at par, premium, or discount), are stated in the prospectus at the time of their issue. A company can redeem its debentures by various methods, including a lumpsum payment, payment in instalments, purchase in the open market, or by converting them into new shares or debentures.

Quick Tip

In simple terms, "redemption of debentures" means "paying back the loan" that the company took from the debenture holders.

16. Write the formula of calculating gaining ratio.

Solution:

The gaining ratio is the ratio in which the continuing partners acquire the share of profit from the outgoing (retiring or deceased) partner.

The formula for calculating the gaining ratio is:

$$\text{Gaining Ratio} = \text{New Profit Sharing Ratio} - \text{Old Profit Sharing Ratio}$$

Quick Tip

This is the exact opposite of the sacrificing ratio formula (Old Ratio - New Ratio). An easy way to remember: to find a "gain," you subtract the "old" from the "new" to see the increase.

17. X and Y are partners. They share profits and losses in the ratio of 2:1. They admit Z into partnership by giving 1/4th share in future profits. Calculate the new profit sharing ratio.

Solution:

Step 1: Determine the total share and the shares of old partners.

Old Ratio (X : Y) = 2:1

Total Share = 1

X's Old Share = $\frac{2}{3}$

Y's Old Share = $\frac{1}{3}$

Step 2: Determine the share given to the new partner and the remaining share.

Z's Share = $\frac{1}{4}$

Remaining Share for X and Y = Total Share - Z's Share

$$\text{Remaining Share} = 1 - \frac{1}{4} = \frac{3}{4}$$

Step 3: Distribute the remaining share between the old partners in their old ratio.

The problem does not state how X and Y will share the remaining profit. In the absence of such information, it is assumed that the old partners will share the remaining profit in their old profit-sharing ratio (2:1).

X's New Share = X's share of the remaining profit = $\frac{2}{3}$ of $\frac{3}{4}$

$$\text{X's New Share} = \frac{2}{3} \times \frac{3}{4} = \frac{6}{12}$$

Y's New Share = Y's share of the remaining profit = $\frac{1}{3}$ of $\frac{3}{4}$

$$\text{Y's New Share} = \frac{1}{3} \times \frac{3}{4} = \frac{3}{12}$$

Step 4: Combine the new shares to form the new ratio.

Z's Share = $\frac{1}{4}$. To get a common denominator of 12, we multiply by $\frac{3}{3}$:

$$\text{Z's Share} = \frac{1}{4} \times \frac{3}{3} = \frac{3}{12}$$

New Ratio (X : Y : Z) = $\frac{6}{12} : \frac{3}{12} : \frac{3}{12}$

Simplifying by dividing all parts by 3, we get:

New Profit Sharing Ratio = 2 : 1 : 1

Quick Tip

When the new partner's share is given but the sacrificing ratio is not, always follow this three-step process: (1) Find the remaining share. (2) Distribute the remaining share among old partners in their old ratio. (3) Combine the shares to get the new ratio.

18. What is called accumulated profit ?

Solution:

Accumulated profits are the profits that have been earned by a business over the years but have not been distributed to the owners (partners or shareholders) as dividends or drawings. Instead, these profits are retained and accumulated in the business.

They are also known as undistributed profits or retained earnings. In the context of a partnership firm, they typically appear on the liabilities side of the Balance Sheet under names like:

- General Reserve
- Reserve Fund
- Profit and Loss Account (Credit Balance)

These accumulated profits belong to the partners and are distributed among them at the time of any reconstitution of the firm.

Quick Tip

Think of accumulated profits as the "savings" of the business. Just like personal savings, they have been built up over time from past income that was not spent.

19. How is Capital Fund calculated ?

Solution:

The Capital Fund (also known as General Fund) is the equivalent of the Capital Account for a Not-for-Profit Organisation (NPO). It represents the accumulated surplus of income over expenditure.

It is calculated by preparing an opening Balance Sheet (a Balance Sheet at the beginning of the accounting period). The calculation is based on the fundamental accounting equation:

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

Rearranging this for the Capital Fund:

$$\text{Capital Fund} = \text{Total Assets (at the beginning)} - \text{Total Outside Liabilities (at the beginning)}$$

The Capital Fund is the balancing figure in the opening Balance Sheet. During the year, this fund is increased by any surplus, capital receipts (like legacies, life membership fees), and decreased by any deficit.

Quick Tip

If an NPO does not provide an opening Capital Fund, your first step is always to prepare an opening Balance Sheet. List all opening assets on one side and all opening outside liabilities on the other. The difference is your opening Capital Fund.

20. Distinguish between charge against profit and appropriation of profit.

Solution:

Basis	Charge Against Profit	Appropriation of Profit
1. Meaning	It is an expense that is deducted from revenues to determine the net profit or loss for the period.	It is the distribution or allocation of the net profit among various heads (e.g., partners or reserves).
2. Necessity	It is mandatory to make a charge against profit, even if the firm incurs a loss.	It is made only if the firm earns a profit. It is an application of profit.
3. Accounting Treatment	It is debited to the Profit and Loss Account .	It is debited to the Profit and Loss Appropriation Account .
4. Examples	Interest on loan (from partner or bank), Rent paid to a partner, Manager's commission.	Salary to a partner, Commission to a partner, Interest on capital, Transfer to general reserve.

Quick Tip

The key question to ask is: "Do we have to pay this even if we make a loss?" If the answer is YES, it's a **Charge**. If the answer is NO (we can only pay it out of profits), it's an **Appropriation**.

21. What is partnership deed ?

Solution:

A partnership deed, also known as a partnership agreement, is a written legal document that contains the terms and conditions agreed upon by all the partners for conducting the business of the firm.

It is a formal agreement that governs the relationship between the partners and regulates their rights, duties, and liabilities. While it is not legally compulsory to have a written deed, it is highly advisable to avoid future disputes.

It typically contains details such as:

- Name and address of the firm and its partners.

- Nature of the business.
- Capital contribution of each partner.
- Profit and loss sharing ratio.
- Rules regarding interest on capital, interest on drawings, and salaries to partners.
- Procedures for admission, retirement, and settlement of accounts.

Quick Tip

Think of the partnership deed as the "constitution" of the partnership firm. It lays down all the fundamental rules that the partners must follow.

22. X, Y and Z are partners sharing profit in the ratio of 3:2:2. Y retires. X and Z decide to share profit in future in the ratio of 4:3. Calculate gaining ratio.

Solution:

Step 1: State the formula for Gaining Ratio.

$$\text{Gaining Ratio} = \text{New Ratio} - \text{Old Ratio}$$

Step 2: List the Old and New Ratios of the continuing partners (X and Z).

Old Ratio (X : Y : Z) = 3:2:2. Total share = 7.

- X's Old Share = $\frac{3}{7}$
- Z's Old Share = $\frac{2}{7}$

New Ratio (X : Z) = 4:3. Total share = 7.

- X's New Share = $\frac{4}{7}$
- Z's New Share = $\frac{3}{7}$

Step 3: Calculate the gain for each continuing partner.

X's Gain = X's New Share - X's Old Share

$$\text{X's Gain} = \frac{4}{7} - \frac{3}{7} = \frac{1}{7}$$

Z's Gain = Z's New Share - Z's Old Share

$$\text{Z's Gain} = \frac{3}{7} - \frac{2}{7} = \frac{1}{7}$$

Step 4: Determine the Gaining Ratio.

The gaining ratio is the ratio of the gains of X and Z.

Gaining Ratio (X : Z) = $\frac{1}{7} : \frac{1}{7}$

Simplifying, the ratio is **1 : 1**.

Quick Tip

After calculating the gains, you can verify your answer. The sum of the gains of the continuing partners must be equal to the share of the retiring partner. Here, X's gain $(1/7) + Z$'s gain $(1/7) = 2/7$, which is equal to Y's (the retiring partner's) share.

23. What is joint life policy?

Solution:

A Joint Life Policy (JLP) is an insurance policy taken out by a partnership firm on the joint lives of all its partners.

Key features:

- The firm pays the insurance premium, which is treated as a business expense.
- The policy amount (sum assured) becomes payable to the firm either on the death of any one of the partners or on the maturity of the policy, whichever occurs earlier.
- The primary purpose of a JLP is to provide the firm with ready funds to settle the amount due to a deceased or retiring partner without putting a strain on the firm's financial resources.
- The amount received from the insurance company is distributed among all the partners (including the deceased/retiring partner) in their profit-sharing ratio.

Quick Tip

Think of a JLP as a financial safety net for a partnership. It ensures that the unexpected death of a partner doesn't create a financial crisis for the firm when it has to pay out the deceased partner's share.

24. State the items which are debited to deceased partner's capital account.

Solution:

The deceased partner's capital account is debited with all amounts that reduce the firm's liability to the partner's estate. The main items are:

1. **Drawings:** The amount of cash or value of goods withdrawn by the partner from the firm for personal use up to the date of their death.
2. **Interest on Drawings:** The interest charged by the firm on the partner's drawings up to the date of death.

3. **Share of Loss:** The deceased partner's share of any operating loss incurred by the firm up to the date of death.
4. **Share of Revaluation Loss:** The partner's share of the net loss arising from the revaluation of the firm's assets and liabilities.
5. **Share of Accumulated Losses:** The partner's share of any past accumulated losses appearing on the assets side of the Balance Sheet (e.g., Debit balance of Profit & Loss A/c).
6. **Share of Existing Goodwill to be Written Off:** If goodwill already exists in the books, the deceased partner's share is debited to their capital account to write it off.

Quick Tip

A simple rule to remember the debit items: Anything the partner *owes* to the firm or any *loss* that reduces their claim is debited. This includes what they took out (drawings) and their share of any negative results (losses).

25. Name any two solvency ratios.

Solution:

Solvency ratios are used to measure a company's ability to meet its long-term financial obligations. Two important solvency ratios are:

1. **Debt to Equity Ratio:** This ratio measures the relationship between long-term debt and shareholders' equity. It indicates the proportion of debt and equity used in financing the company's assets.

$$\text{Debt to Equity Ratio} = \frac{\text{Long-term Debt}}{\text{Shareholders' Equity}}$$

2. **Total Assets to Debt Ratio:** This ratio measures the extent to which the company's assets have been financed by debt. It indicates the safety margin available to the lenders.

$$\text{Total Assets to Debt Ratio} = \frac{\text{Total Assets}}{\text{Long-term Debt}}$$

Quick Tip

Other key solvency ratios include the Proprietary Ratio (Equity / Total Assets) and the Interest Coverage Ratio (EBIT / Interest Expense).

26. What are the objectives of preparing Cash Flow Statement?

Solution:

The primary objectives of preparing a Cash Flow Statement are:

1. **To provide information about cash flows:** It provides detailed information about the historical changes in cash and cash equivalents by classifying them into operating, investing, and financing activities. This helps users understand the sources (inflows) and applications (outflows) of cash during a period.
2. **To assess the ability to generate cash:** It helps in assessing the ability of the enterprise to generate cash and cash equivalents in the future. This information is crucial for evaluating the firm's liquidity and solvency.
3. **To evaluate financial decisions:** It enables users to evaluate the investing and financing decisions made by the management by showing how the company has used its funds for long-term assets and how it has raised its capital.
4. **To reconcile Net Profit with Cash Flow:** It helps to explain the difference between the net profit (as per the accrual-based P&L statement) and the net cash flow from operating activities.

Quick Tip

The main purpose is to answer the simple but crucial question: "Where did the cash come from, and where did it go?" It focuses purely on the movement of cash, which can often tell a different story than the profit-based income statement.

27. Give two examples of cash outflow from investing activities.

Solution:

Investing activities relate to the acquisition and disposal of long-term assets and other investments. Two examples of cash outflows (payments) from investing activities are:

1. **Purchase of Fixed Assets:** Cash paid to acquire tangible fixed assets like land, buildings, machinery, or furniture.

2. **Purchase of Investments:** Cash paid to purchase investments in other companies, such as buying shares or debentures, or cash given as loans and advances to third parties.

Quick Tip

To identify investing activities, ask if the transaction involves buying or selling long-term assets. If you buy, it's a cash outflow. If you sell, it's a cash inflow.

28. What is Sweat equity share?

Solution:

According to Section 2(88) of the Companies Act, 2013, sweat equity shares are equity shares issued by a company to its **directors or employees** under specific conditions.

These shares are issued:

- **At a discount**, or
- **For consideration other than cash.**

The purpose of issuing sweat equity shares is to reward them for their contribution, such as providing know-how, making available intellectual property rights, or other value additions to the company. It serves as an incentive to retain valuable employees and directors by making them stakeholders in the company.

Quick Tip

The name "sweat equity" itself is a clue. It's equity (shares) given in exchange for the "sweat" (hard work, knowledge, and value addition) of employees and directors, rather than just for cash.

29. Why does company forfeit shares ?

Solution:

A company forfeits shares for one primary reason: **the failure of a shareholder to pay the allotment money or any subsequent call money** due on the shares held by them within the specified time.

The process is as follows:

1. When a shareholder fails to pay a call, the company sends a reminder notice.

2. If the payment is still not made, the Board of Directors can pass a resolution to forfeit (i.e., cancel) the shares.
3. This action is only possible if the company's Articles of Association authorize it.

Upon forfeiture, the shareholder loses their membership in the company and the amount they have already paid on the shares is not refunded.

Quick Tip

Forfeiture is the ultimate penalty for a shareholder who defaults on their payment obligations. It's the company's right to take back ownership of the shares due to non-payment.

30. What is Redeemable Debenture ?

Solution:

A redeemable debenture is a type of debenture that is issued by a company with the condition that it will be repaid by the company at a future date. The company is liable to pay back the principal amount to the debenture holders on the date of maturity or after a specified period. The terms of redemption, including the date and the price (whether at par or at a premium), are specified at the time of issue in the prospectus. Virtually all debentures issued by companies are redeemable in nature, as perpetual (irredeemable) debentures are very rare.

Quick Tip

Think of "redeemable" as "repayable". A redeemable debenture is simply a loan (debenture) that has a specific repayment date.

31. What is Receipts and Payments Account ? How is it different from Income and Expenditure Account ?

Solution:

Part 1: What is Receipts and Payments Account?

A Receipts and Payments Account is a summary of the cash book of a Not-for-Profit Organisation (NPO) prepared at the end of an accounting period. It records all cash and bank transactions that occurred during the year.

Key Features:

- It starts with the opening balance of cash and bank.
- All cash receipts (whether capital or revenue, and whether they relate to the current, previous, or next year) are shown on the debit (Receipts) side.

- All cash payments (whether capital or revenue, and whether they relate to the current, previous, or next year) are shown on the credit (Payments) side.
- It ends with the closing balance of cash and bank.
- It is a real account in nature.

Part 2: Difference between Receipts & Payments A/c and Income & Expenditure A/c

Basis	Receipts and Payments Account	Income and Expenditure Account
Nature	It is a summary of the cash book. It is a Real Account .	It is similar to a Profit and Loss Account. It is a Nominal Account .
Basis of Accounting	It is prepared on a cash basis . It records only actual cash receipts and payments.	It is prepared on an accrual basis . It records incomes and expenses related to the current year, whether paid/received or not.
Period	It includes receipts and payments related to past, current, and future periods.	It includes only incomes and expenses related to the current period .
Type of Items	It records both capital and revenue items.	It records only revenue items.
Balance	The closing balance represents the closing cash and bank balance .	The balancing figure represents either a Surplus (excess of income over expenditure) or a Deficit (excess of expenditure over income).

Quick Tip

Think of the Receipts & Payments Account as your annual bank statement summary (all cash movements). Think of the Income & Expenditure Account as a report card for the year's performance (only this year's income and expenses).

32. What is partnership firm ? State its main characteristics.

Solution:

Part 1: What is a Partnership Firm?

According to Section 4 of the Indian Partnership Act, 1932, a partnership is "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all." The persons who have entered into partnership are individually called 'partners' and collectively a 'firm'.

Part 2: Main Characteristics

The main characteristics of a partnership firm are:

1. **Two or More Persons:** There must be at least two persons to form a partnership. The maximum number of partners is 50, as prescribed by the Companies (Miscellaneous) Rules, 2014.
2. **Agreement:** A partnership comes into existence through an agreement (either written or oral) among the partners. The written agreement is called a Partnership Deed.
3. **Lawful Business:** The agreement must be to carry on a lawful business with the intention of earning profits. Joint ownership of property does not by itself constitute a partnership.
4. **Profit Sharing:** The partners must agree to share the profits of the business. Sharing of losses is implied, but sharing of profits is essential.
5. **Business Carried on by All or Any of them Acting for All (Mutual Agency):** This is the cardinal principle of partnership law. Each partner is both an agent and a principal. They can bind all other partners by their acts done in the ordinary course of business, and they are, in turn, bound by the acts of other partners.
6. **Unlimited Liability:** The liability of each partner for the debts of the firm is unlimited. Their personal assets can be used to pay off the firm's liabilities if the firm's assets are insufficient.

Quick Tip

The "Mutual Agency" clause is the true test of a partnership. If this element is absent, there is no partnership, even if all other conditions are met.

33. What is meant by comparative income statement ? How is it prepared ?

Solution:

Part 1: Meaning of Comparative Income Statement

A comparative income statement is a tool of financial analysis that shows the items of the Income Statement (Statement of Profit and Loss) for two or more consecutive accounting periods in adjacent columns. It helps in analyzing the changes in income, expenses, and profits over time by showing both the absolute change and the percentage change for each item. This allows users to understand the trend and growth of the business's operating results.

Part 2: How it is prepared

A comparative income statement is prepared in a columnar format as follows:

1. **Column 1 (Particulars):** This column lists the various items of the Income Statement, such as Revenue from Operations, Other Income, various Expenses, and Profit.
2. **Column 2 (Previous Year's Figures):** The absolute figures for each item from the preceding accounting year are listed here. This is the base year for comparison.

3. **Column 3 (Current Year's Figures):** The absolute figures for each item from the current accounting year are listed here.
4. **Column 4 (Absolute Change):** This column shows the increase or decrease in the absolute figures of the current year as compared to the previous year. It is calculated as: (Current Year's Figure - Previous Year's Figure).
5. **Column 5 (Percentage Change):** This column shows the absolute change as a percentage of the previous year's figure. It is calculated as:

$$\text{Percentage Change} = \frac{\text{Absolute Change}}{\text{Previous Year's Figure}} \times 100$$

Quick Tip

This type of analysis is also known as horizontal analysis, as it involves comparing figures horizontally across different time periods. The key is to analyze not just the absolute change but the percentage change, which provides a better perspective on the magnitude of the change.

34. What is Cash Flow Statement ? Describe its uses.

Solution:

Part 1: What is a Cash Flow Statement?

A Cash Flow Statement is a financial statement that provides a summary of the cash inflows (receipts) and cash outflows (payments) of a company during a specific accounting period. It reconciles the opening and closing balances of cash and cash equivalents. The statement classifies all cash flows into three main activities:

- **Operating Activities:** The principal revenue-producing activities of the business.
- **Investing Activities:** The acquisition and disposal of long-term assets and other investments.
- **Financing Activities:** Activities that result in changes in the size and composition of the owners' capital and borrowings.

Part 2: Uses of a Cash Flow Statement

The primary uses of a Cash Flow Statement are:

1. **Assessing Liquidity and Solvency:** It provides crucial information about a company's ability to generate cash to meet its short-term and long-term obligations, pay dividends, and make new investments.
2. **Evaluating Management Decisions:** It helps users to evaluate the investing and financing decisions made by the management and their impact on the company's cash position.

3. **Explaining the Difference between Profit and Cash:** It reconciles the net profit (an accrual-based figure) with the net cash generated from operations, helping to assess the quality of earnings. A company can be profitable but still face a cash crunch, and this statement highlights such issues.
4. **Cash Flow Planning and Budgeting:** By analyzing historical cash flows, management can better plan for future cash needs and prepare cash budgets.

Quick Tip

The most important use of a Cash Flow Statement is that it shows the "real" money movement, which is not always apparent from the accrual-based Income Statement. As the saying goes, "Profit is an opinion, cash is a fact."

35. The total capital of the firm of Sourabh, Mohit and Nikhil was Rs. 1,00,000. The net profits for the last three years were: 2019-20 Rs. 40,000; 2020-21 Rs. 46,000 and 2021-22 Rs. 52,000. There was an abnormal loss of Rs. 3,000 in 2020-21. Goodwill of the firm was to be valued at 2 years' purchase of the average profit of last three years. Calculate the goodwill of the firm.

Solution:

Step 1: Calculate the Adjusted Profit for each year.

To calculate goodwill, we must use normal business profits. Any abnormal losses should be added back, and any abnormal gains should be deducted.

- Profit for 2019-20 = Rs. 40,000 (No adjustment)
- Profit for 2020-21 = Rs. 46,000
An abnormal loss of Rs. 3,000 occurred this year. This should be added back to find the normal profit.
Adjusted Profit for 2020-21 = Rs. 46,000 + Rs. 3,000 = Rs. 49,000
- Profit for 2021-22 = Rs. 52,000 (No adjustment)

Step 2: Calculate the Total Adjusted Profit for the three years.

$$\text{Total Adjusted Profit} = 40,000 + 49,000 + 52,000 = \text{Rs. } 1,41,000$$

Step 3: Calculate the Average Adjusted Profit.

$$\text{Average Profit} = \frac{\text{Total Adjusted Profit}}{\text{Number of Years}} = \frac{1,41,000}{3} = \text{Rs. } 47,000$$

Step 4: Calculate the Goodwill.

The formula for goodwill is: $\text{Goodwill} = \text{Average Profit} \times \text{Number of Years' Purchase}$
Given, Number of Years' Purchase = 2

$$\text{Goodwill} = 47,000 \times 2 = \text{Rs. } 94,000$$

Final Answer: The goodwill of the firm is **Rs. 94,000**.

Quick Tip

The first and most important step in goodwill calculation using the profit method is to "normalize" the profits. Always check for and adjust any abnormal gains or losses to find the true maintainable profit of the business.

36. What journal entries would you pass for the following transactions on the dissolution of a firm of A and B?

- i) Dissolution expenses amounted to Rs. 500.
- ii) Unrecorded assets realised Rs. 2,500.
- iii) Stock worth Rs. 2,000 already transferred to realisation account was taken over by a partner A.
- iv) Creditors, already transferred to realisation account were paid Rs. 3,000.
- v) Profit on realisation Rs. 4,000 is to be distributed between A and B in the ratio of 3:1.

Solution:

Journal Entries

Date Credit (Rs.)	Particulars	L.F.	Debit (Rs.)
(i)	Realisation A/c Dr.		500
500	To Cash/Bank A/c		
	<i>(Being dissolution expenses paid)</i>		
(ii)	Cash/Bank A/c Dr.		2,500
2,500	To Realisation A/c		
	<i>(Being unrecorded assets realised)</i>		
(iii)	A's Capital A/c Dr.		2,000
2,000	To Realisation A/c		
	<i>(Being stock taken over by partner A)</i>		
(iv)	Realisation A/c Dr.		3,000
3,000	To Cash/Bank A/c		
	<i>(Being creditors paid)</i>		
(v)	Realisation A/c Dr.		4,000
3,000	To A's Capital A/c ($4,000 \times 3/4$)		
1,000	To B's Capital A/c ($4,000 \times 1/4$)		
	<i>(Being profit on realisation distributed)</i>		

Quick Tip

For dissolution, remember the logic of the Realisation Account:

- Debit all expenses/losses (payment of liabilities, expenses, assets taken by partners at a loss).
- Credit all incomes/gains (realisation of assets, liabilities taken by partners).

All transactions must flow through the Realisation Account.

37. Cemto Ltd. forfeited 6,000 shares of Rs. 10 each issued at a premium of Rs. 2 per share for the non-payment of final call of Rs. 3 per share. 300 of the forfeited shares were re-issued for Rs. 8 per share as fully paid up. Pass necessary journal entries for the forfeiture and re-issue of shares. Also prepare share forfeited account.

Solution:

Part 1: Journal Entries

Journal of Cemto Ltd.			
Date	Particulars	L.F.	Debit (Rs.)
1.	For Forfeiture of 6,000 Shares		
	Share Capital A/c (6,000 × Rs. 10) Dr.		60,000
	To Share Forfeiture A/c (6,000 × Rs. 7)		
42,000	To Calls-in-Arrear A/c (6,000 × Rs. 3)		
18,000	<i>(Being 6,000 shares forfeited for non-payment of final call of Rs. 3 per share)</i>		
2.	For Re-issue of 300 Shares		
	Bank A/c (300 × Rs. 8) Dr.		2,400
	Share Forfeiture A/c (300 × Rs. 2) Dr.		600
	To Share Capital A/c (300 × Rs. 10)		
3,000	<i>(Being 300 forfeited shares re-issued at Rs. 8 per share as fully paid up)</i>		
3.	For Transfer of Profit on Re-issue to Capital Reserve		
	Share Forfeiture A/c Dr.		1,500
	To Capital Reserve A/c		
1,500	<i>(Being the profit on re-issue of 300 shares transferred to Capital Reserve)</i>		

Working Note: Calculation of Profit on Re-issue

Amount forfeited per share = Called-up Amount - Unpaid Amount = Rs. 10 - Rs. 3 = Rs. 7

Discount on re-issue per share = Face Value - Re-issue Price = Rs. 10 - Rs. 8 = Rs. 2

Profit on re-issue per share = Amount Forfeited per share - Discount on re-issue per share

Profit per share = Rs. 7 - Rs. 2 = Rs. 5

Total profit transferred to Capital Reserve = Profit per share × Number of shares re-issued

Total profit = Rs. 5 × 300 = Rs. 1,500

Part 2: Share Forfeiture Account

Dr. Share Forfeiture Account		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Share Capital A/c (Discount)	600	By Share Capital A/c	42,000
To Capital Reserve A/c	1,500		
To Balance c/d	39,900		
	42,000		42,000

Quick Tip

When forfeiting shares issued at a premium, check if the premium has been received. If the default is on a call made *after* the premium was due (usually with allotment), the Securities Premium account is not debited during forfeiture, as the premium has already been collected.

38. A Ltd. provides the following information :

i) Closing Stock Rs. 1,00,000

ii) Creditors Rs. 86,000

iii) Cash Rs. 20,000

iv) Bills Receivable Rs. 18,000

v) Sales Rs. 6,00,000

vi) Fixed Assets Rs. 1,20,000

vii) Bank Rs. 42,000

viii) Overdraft Rs. 34,000

You are required to calculate the following ratios :

(a) Current Ratio, (b) Quick Ratio, (c) Stock Turnover Ratio, (d) Fixed Asset Turnover Ratio.

Solution:

Calculations:

(a) Current Ratio

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

Current Assets = Closing Stock + Cash + Bills Receivable + Bank

= 1,00,000 + 20,000 + 18,000 + 42,000 = Rs. 1,80,000

$$\begin{aligned}\text{Current Liabilities} &= \text{Creditors} + \text{Overdraft} \\ &= 86,000 + 34,000 = \text{Rs. } 1,20,000\end{aligned}$$

$$\text{Current Ratio} = \frac{1,80,000}{1,20,000} = 1.5 : 1$$

(b) Quick Ratio

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

$$\begin{aligned}\text{Quick Assets} &= \text{Current Assets} - \text{Closing Stock} \\ &= 1,80,000 - 1,00,000 = \text{Rs. } 80,000\end{aligned}$$

$$\text{Quick Ratio} = \frac{80,000}{1,20,000} = 0.67 : 1$$

(c) Stock Turnover Ratio

$$\text{Stock Turnover Ratio} = \frac{\text{Cost of Goods Sold}}{\text{Average Stock}}$$

Assumption 1: Since Cost of Goods Sold is not given, Sales will be used as an approximation.

Assumption 2: Since only Closing Stock is given, it will be used in place of Average Stock.

$$\text{Stock Turnover Ratio} = \frac{6,00,000}{1,00,000} = 6 \text{ times}$$

(d) Fixed Asset Turnover Ratio

$$\text{Fixed Asset Turnover Ratio} = \frac{\text{Net Sales}}{\text{Fixed Assets}}$$

$$\text{Net Sales} = \text{Rs. } 6,00,000$$

$$\text{Fixed Assets} = \text{Rs. } 1,20,000$$

$$\text{Fixed Asset Turnover Ratio} = \frac{6,00,000}{1,20,000} = 5 \text{ times}$$

Final Answers:

- (a) Current Ratio = **1.5 : 1**
- (b) Quick Ratio = **0.67 : 1**
- (c) Stock Turnover Ratio = **6 times** (based on assumptions)
- (d) Fixed Asset Turnover Ratio = **5 times**

Quick Tip

When calculating ratios, if a piece of data (like opening stock or cost of goods sold) is missing, clearly state the assumption you are making to proceed with the calculation. For example, using closing stock instead of average stock, or sales instead of COGS.