

**PLUS TWO ACCOUNTANCY
2022-2023**

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Thanks to My Amma

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Unit 1 Accounts from incomplete records

Opening capital + Additional capital + Profit/ – Loss – Drawings = Closing capital
 Profit/Loss = Closing capital + Drawings – Additional capital – Opening capital

Statement of profit or loss for the year ended

Particulars	
Capital at the end of the year	xxx
Add: Drawings during the year	xxx
	xxx
Less: Additional capital introduced during the year	xxx
Adjusted closing capital	xxx
Less: Opening Capital	xxx
Profit or loss for the year	xxx

Capital = Assets – Liabilities

Format of statement of affairs

In the books of ----- Statement of affairs as on -----

Liabilities		Assets	
Sundry creditors	xxx	Cash in hand	xxx
Bills payable	xxx	Cash at bank	xxx
Outstanding expenses	xxx	Sundry debtors	xxx
Bank overdraft	xxx	Bills receivable	xxx
Capital (Balancing figure)	xxx	Stock-in-trade	xxx
Prepaid expenses			xxx
Fixed assets			xxx
	xxx		xxx

(i) Format of total debtors account

Dr. Total debtors account Cr.

Particulars		Particulars	
To Balance b/d	xxx	By Cash A/c (received)	xxx
(opening balance)		By Bank A/c (cheques)	xxx

	received)		
To Sales A/c (credit sales)	xxx	By Discount allowed A/c	xxx
To Bank A/c (cheque dishonoured)	xxx	By Sales returns A/c	xxx
To Bills receivable A/c (bills dishonoured)	xxx	By Bad debts A/c	xxx
(bills received)		By Bills receivable A/c	xxx
By Balance c/d (closing balance)			xxx
	xxx		xxx

Total Sales = Cash Sales + Credit Sales

(ii) Format of bills receivable account

Dr. Bills receivable account Cr.

Particulars		Particulars	
To Balance b/d (opening balance)	xxx	By Cash / Bank A/c (Bills receivable honoured)	xxx
To Sundry debtors A/c (Bills receivable received during the year)	xxx	By Sundry debtors A/c (Bills receivable dishonoured)	xxx
(closing balance)			xxx
	xxx	By Balance c/d	xxx

(iii) Format of total creditors account

Dr. Total creditors account Cr.

Particulars		Particulars	
To Cash A/c (paid)	xxx	By Balance b/d (opening balance)	xxx
To Bank A/c (cheques paid)	xxx		
To Bills payable A/c (bills accepted)	xxx	By Purchases (credit purchases) A/c	xxx
To Discount received A/c	xxx	By Bank A/c	xxx
To Purchase returns A/c	xxx	(cheques dishonoured)	
To Balance c/d (closing balance)	xxx	By Bills payable A/c (dishonoured)	xxx
	xxx		xxx

Total purchases = Cash purchases + Credit purchases

(iv) Format of bills payable account**Dr. Bills payable account Cr.**

Particulars		Particulars	
To Cash / Bank A/c (bills payable paid)	xxx	By Balance b/d (opening balance)	xxx
To Sundry creditors A/c (bills payable dishonoured)	xxx	By Sundry creditors A/c (bills accepted)	xxx
To Balance c/d (closing balance)			xxx
	xxx		xxx

Closing Capital + Drawings – Additional Capital – Opening Capital = Profit/ Loss

Student activity

Closing capital`	Fill in the missing information			Opening capital`	Profit / Loss`
	Drawings`	Additional capital`			
1,00,000	40,000	20,000	90,000	?	
?	30,000	40,000	80,000	20,000	
70,000	?	30,000	40,000	10,000	
60,000	20,000	?	50,000	- 10,000	
2,00,000	30,000	10,000	?	1,20,000	

Unit 2 Accounts of not-for-profit organisation

At the end of the accounting period, the following final accounts are prepared by not-for-profit organisations:

- (i) Receipts and payments account,
- (ii) Income and expenditure account and
- (iii) Balance sheet

Receipts and Payments Account

Receipts and Payments account is a summary of cash and bank transactions of not-for-profit organisations prepared at the end of each financial year.

Non-cash items such as depreciation, outstanding expenses and accrued income are not shown in receipts and payments account.

Format of Receipts and Payment Account

Dr. Receipts and Payments Account of for the year ending Cr.

Receipts		Payments	
To Balance b/d		By Balance b/d	
Cash in hand	xxx	Bank overdraft	xxx
Cash at bank		xxx	xxx
Revenue receipts:		Revenue payments:	
To Subscription	xxx	By Salaries	xxx
To Entrance fees	xxx	By Rent paid	xxx
To General donations	xxx	By Electricity charges	xxx
To Grant-in-aid	xxx	By Postage	xxx
To Sale of old newspapers	xxx	By Rent and taxes	xxx
To Interest on investment	xxx	By Insurance	xxx
To Dividend	xxx	By Advertisement	xxx
To Locker rent received	xxx	By Telephone charges	xxx
To Rent received	xxx	By Entertainment expenses	xxx
To Sundry receipts	xxx	By Audit fees	xxx
By Repairs			xxx
Capital receipts:		By Upkeep of ground	xxx
To Life membership fees	xxx	By Conveyance charges	xxx
To Donation for specific purpose	xxx	By Newspapers and periodicals	xxx
To Legacies	xxx	By Office expenses	xxx
To Endowment fund	xxx	By Gardening expenses	xxx
To Sale of fixed assets	xxx	By Sundry expenses	xxx
To Sale of investments			xxx
To Receipt for specific purpose or fund	xxx	Capital Payments:	
To Interest on specific fund investments	xxx	By Fixed assets	xxx
To Balance c/d	xxx	By Investments	xxx
(Bank overdraft)		By Repayment of loan	xxx
		By Balance c/d	xxx
	Cash in hand		xxx

Cash at bank	xxx	xxx
	xxx	xxx

Revenue receipts	Capital receipts	Revenue or capital receipt
Subscription	Life membership fees	Admission fee or Entrance fee
Interest on investment	Legacies	Donations
Interest on fixed deposit	Specific donations	Special fees
Sale of (old) sports materials	Sale of fixed assets	Grants from government and other organisations
Sale of (old) newspapers	Special funds	
Collection or receipts relating to	Tournament fund	
a) Tournament	Prize fund	
b) Sports		
c) Matches		
d) Entertainments		
e) Dinner		

Capital expenditure	Revenue expenditure
Purchase of sports equipment	Honorarium
Purchase of books for library	Charity
Audit fees	
Purchase of sports materials	
Printing and stationery	
Postage and courier charges	
Expenses relating to	
a) Tournament, b) Sports, c) Matches, d) Entertainments, e) Dinner	

Income and Expenditure Account

Income and expenditure account is a summary of income and expenditure of a not-for-profit organisation prepared at the end of an accounting year. It is prepared to find out the surplus or deficit pertaining to a particular year.

Format of Income and Expenditure Account

Name of the club / Institution

Dr. Income and Expenditure Account for the year ended..... Cr.

Expenditure		Income	
To Salaries	xxx	By Subscription	xxx
To Charities	xxx	By Donation received	xxx
To Rent	xxx	By Admission fee received	xxx
To Donation paid	xxx	By Grant received	xxx

To Stationery	xxx	By Rent received	xxx
To Loss on sale of asset	xxx	By Interest received	xxx
To Depreciation	xxx	By Profit on sale of asset	xxx
To Surplus* (Excess of income over expenditure)	xxx	By Deficit* (Excess of expenditure over income)	xxx
	xxx		xxx

Income and Expenditure Account for the year ended... Cr.

Expenditure	Income	
By Subscription		xxx
Less: Subscription for the previous year		xxx
		xxx
Less: Subscription for the subsequent year		xxx
		xxx
Add: Outstanding subscription for the current year		xxx
		xxx
Add: Received in advance during the previous year for the current year	xxx	xxx

Balance sheet as on ...

Liabilities	Assets	
Subscription received in advance for the subsequent year	xxx	Outstanding subscription for the: current year previous year
		xxx
		xxx

Balance Sheet

A Balance sheet is a statement showing the financial position of an organisation. The preparation of balance sheet of a not-for-profit organisation is more or less similar to that of a trading concern. Assets and liabilities, as on the last date of the accounting period are taken to the balance sheet (liabilities are taken on the left side and assets on the right side of the balance sheet).

Not-for-profit entities exist to provide services to the members or to the society at large.

The three principal accounting statements of a not-for-profit organisation include Receipts and Payments Account, Income and Expenditure Account and Balance Sheet.

The Receipts and Payments Account is a summarised cash book which records all cash receipts and cash payments effected during an accounting year irrespective of the nature as to capital or revenue, irrespective of the period to which it belongs, that is, whether it relates to the previous or current year or subsequent year.

Income and Expenditure Account is prepared to ascertain the excess of revenue income over revenue expenditure (surplus) or excess of revenue expenditure over revenue income (deficit) for a particular accounting year, which is the result of the entity's over all activities for the accounting year.

Unit 3 Accounts of partnership firms-fundamentals

a) Fixed capital method

Format of partners' capital account under fixed capital method

Dr. Partners' capital account Cr.

Date	Particulars	A	B	Date	Particulars	A	B
To	Cash/Bank A/c	xxx	xxx	By	Balance b/d	xxx	xxx
(permanent withdrawal of capital)							
To	Balance c/d	xxx	xxx				
				By	Cash/Bank A/c	xxx	xxx
					(additional capital introduced)	xxx	xxx

(b) Partners' current account

Format of partners' current account under fixed capital method

Dr. Partners' current account Cr.

Date	Particulars	A	B	Date	Particulars	A	B
To	Balance b/d*	xxx	xxx	By	Balance b/d*	xxx	xxx

To Drawings A/c	xxx	xxx	By Interest on capital A/c	xxx	xxx
To Interest on drawings A/c	xxx	xxx	By Salary A/c	xxx	xxx
To Profit and loss appropriation A/c (share of loss)	xxx	xxx	By Commission A/c	xxx	xxx
		By Profit and loss appropriation A/c		xxx	xxx
To Balance c/d**		xxx		xxx	(share of profit)
By Balance c/d**			xxx		xxx
	xxx	xxx		xxx	xxx

Fluctuating capital method

Format of capital account under fluctuating capital method

Dr. Partners' capital account Cr.

Date	Particulars	A	B	Date	Particulars	A	B
	To Cash / Bank A/c (capital withdrawn)	xxx	xxx		By Balance b/d	xxx	xxx
	To Drawings A/c		xxx			xxx	xxx
						(additional introduced)	capital
	To Interest on drawings A/c	xxx	xxx		By Interest on capital A/c	xxx	xxx
	To Profit and loss appropriation A/c (share of loss)	xxx	xxx		By Salary A/c	xxx	xxx
	To Balance c/d		xxx		By Profit and loss appropriation A/c	xxx	xxx
	(share of profit)	xxx	xxx			xxx	xxx

Interest on capital and interest on drawings of partners

Interest on capital

(a) For providing interest on capital

Date	Particulars	L.F.	Debit	Credit
	Interest on capital A/c Dr.			xxx

To Partner's capital / current A/c xxx

(b) For closing interest on capital account

Date	Particulars	L.F.	Debit	Credit
	Profit and loss appropriation A/c Dr.			xxx
	To Interest on capital A/c			xxx

Calculation of interest on capital

Interest on capital = Amount of capital x Rate of interest per annum x Period of interest

Particulars		
Capital at the end		xxx
Add: Drawings during the year (if fluctuating capital)		xxx
Capital withdrawn during the year	xxx	xxx
		xxx
Less: Profit credited during the year (if fluctuating capital)		xxx
Additional capital introduced during the year	xxx	xxx
Capital at the beginning		xxx

Interest on drawings

(a) For charging interest on drawings

Date	Particulars	L.F.	Debit	Credit
	Partner's capital/ current A/c Dr.			xxx
	To Interest on drawings A/c			xxx

(b) For closing interest on drawings account

Date	Particulars	L.F.	Debit	Credit
	Interest on drawings A/c Dr.			xxx
	To Profit and loss appropriation A/c			xxx

Calculation of interest on drawings

(i) Direct method

Interest is calculated on drawings for the period from the date of drawings to the date of closing date of the accounting year. The following formula is used to compute the interest on drawings:

$$\text{Interest on drawings} = \text{Amount of drawings} \times \text{Rate of interest} \times \text{Period of interest}$$

(ii) Product method

Product method is based on the principle that interest on the amount for a number of days/months is the same as interest for one day/month on the sum of the products of amount withdrawn and the period of interest.

The procedure for calculating interest on drawings under product method is as follows:

- (i) Multiply each amount withdrawn by the relevant period (in months) to find out the individual product.
- (ii) Find out the sum of all the individual products.
- (iii) Calculate interest at the prescribed rate for one month by using the following formula.

$$\text{Interest on drawings} = \text{Sum of products} \times \text{Rate of interest p.a.} \times \frac{1}{12}$$

Tutorial note

If the period of interest is taken in days, each amount withdrawn is to be multiplied by the relevant period (in days) to find out the individual product and the following formula is to be used to find out the interest on drawings.

$$\text{Interest on drawings} = \text{Sum of products} \times \text{Rate of interest p.a.} \times \frac{1}{365}$$

Total amount of drawings made during the year

Rate of interest per annum

Number of months from the date of first withdrawal to the end of the year +

Number of months from the date of last withdrawal to the end of the year

(iii) Average period method

If the partners withdraw fixed amount at fixed time interval, interest on drawings may be calculated on the basis of the average period. Fixed time interval refers to withdrawal made monthly, quarterly, half-yearly, once in 2 months and once in 4 months. The following formula may be used to calculate interest on drawings:

$$\text{Interest on drawings} = \times \times$$

Average period =

Average period is computed as follows:

The following table shows the average period in months for withdrawal made at the beginning, in the middle and at the end of every month, quarter and half-year of the year.

Frequency of withdrawal	Average period (in months)		
	Time of withdrawal		
	At the beginning	In the middle	At the end
Monthly	$\frac{(12+1)}{2} = 6.5$	$\frac{(11.5+0.5)}{2} = 6$	$\frac{(11+0)}{2} = 5.5$
Quarterly	$\frac{(12+3)}{2} = 7.5$	$\frac{(10.5+1.5)}{2} = 6$	$\frac{(9+0)}{2} = 4.5$
Half-yearly	$\frac{(12+6)}{2} = 9$	$\frac{(9+3)}{2} = 6$	$\frac{(6+0)}{2} = 3$

(i) If drawings are made at the beginning of every month:

Average period

Interest on drawings = Total amount of drawings × Rate of interest × Average Period

(ii) If drawings are made in the middle of every month:

Interest on drawings = Total amount of drawings × Rate of interest × Average Period / 12

(iii) If drawings are made at the end of every month:

Interest on drawings = Total amount of drawings × Rate of interest × Average Period / 12

Salary and commission to partners

(a) For partners' salary and commission due

Date	Particulars	L.F.	Debit	Credit
	Partner's salary A/c Dr.			xxx
	Partner's commission A/c Dr.			xxx
	To Partner's capital / current A/c			xxx

(b) For closing partners' salary and commission account at the end of the accounting year

Date	Particulars	L.F.	Debit	Credit
	Profit and loss appropriation A/c Dr.			xxx
	To Partner's salary A/c			xxx
	To Partner's commission A/c			xxx

Tutorial note: Partners are entitled to remuneration only if there is a profit in the firm. Hence, Profit and loss appropriation account is debited. As the remuneration is due to the partners, capital/current account of partners is credited.

Commission to partners may be allowed as a percentage of net profit before charging such commission or as a percentage of net profit after charging such commission. In such cases, commission is calculated as below:

(i) Commission as a percentage of net profit before charging such commission

Net profit before commission \times % of commission / 100

(ii) Commission as a percentage of net profit after charging such commission

Net profit before commission \times % of commission \times / 100 + % of commission

Interest on loan from partners

(a) For providing interest on partner's loan

Date	Particulars	L.F.	Debit	Credit
	Interest on partner's loan A/c Dr.			xxx
	To Partner's loan A/c			xxx

Note: Interest on partner's loan being an expense to the firm is debited in firm's books. Interest on loan is due to the partner and it is generally added to the loan amount due and hence partner's loan account is credited.

(b) For closing interest on partner's loan account

Date	Particulars	L.F.	Debit	Credit
	Profit and loss A/c Dr.			xxx
	To Interest on partner's loan A/c			xxx

Tutorial note: Interest on partners' loan is a charge against profit, that is, whether there is profit or loss for the firm, this interest is to be provided. Hence, interest on partners' loan is transferred to profit and loss account.

Division of profits among partners

Date	Particulars	L.F.	Debit	Credit
	Profit and loss appropriation A/c Dr.			xxx
	To Partner's capital/current A/c			xxx

Note: If there is a loss, the reverse entry is made.

Profit and loss appropriation account

Format of Profit and loss appropriation account

The following is the format of profit and loss appropriation account:

Dr. Profit and loss appropriation account Cr.

Particulars		Particulars	
To Interest on partners' capital A/c	xxx	By Profit and loss A/c *	xxx
To Partners' salary A/c	xxx	By Interest on partners' drawings A/c	xxx
To Partners' commission A/c	xxx		
To Partners' capital/current A/c (Profit)	xxx		xxx
	xxx		xxx

*Amount of profit transferred from profit and loss account.

Calculation of commission:

Commission =
 Net profit before commission * Rate of commission / (100 + Rate of commission)

Unit 4 Goodwill in partnership accounts

Methods of valuation of goodwill

Average profit method

(a) Simple average profit method

Goodwill = Average profit × Number of years of purchase

Average profit = Total profit / Number of years

(b) Weighted average profit method

Goodwill = Weighted average profit × Number of years of purchase

Weighted average profit = Total of weighted profits / Total of weights

Super profit methods

Super profit = Average profit – Normal profit

Average profit is calculated by dividing the total of adjusted actual profits of certain number of years by the total number of such years. Normal profit is the profit earned by the similar business firms under normal conditions.

Normal profit = Capital employed × Normal rate of return

Capital employed = Fixed assets + Current assets – Current liabilities

Normal rate of return = It is the rate at which profit is earned by similar business entities in the industry under normal circumstances.

(a) Purchase of super profit method

Under this method, goodwill is calculated by multiplying the super profit by a certain number of years of purchase.

Goodwill = Super profit × Number of years of purchase

Normal profit = Capital employed × Normal rate of return

Super profit = Average profit – Normal profit

Goodwill = Super profit × Number of years of purchase

(c) Annuity method

Goodwill = Super profit × Present value annuity factor

Capitalisation method

Goodwill = Total capitalised value of the business – Actual capital employed

Capitalised value of the business = Average profit/ Normal rate of return x 100

Actual capital employed = Fixed assets (excluding goodwill) + Current assets – Current liabilities

Goodwill is the good name or reputation of the business which brings benefit to the business.

Unit 5 Admission of a partner

Adjustments required at the time of admission of a partner

On admission, the new partner may bring capital in cash or in kind or both. The following journal entry is passed to record the capital brought in.

Journal entry

Date	Particulars	L.F.	Debit	Credit
	Cash or Bank A/c Dr.			xxx
	Assets A/c Dr.			xxx
	To Partner's capital A/c			xxx

Distribution of accumulated profits, reserves and losses

(a) For transferring accumulated profit and reserves

Journal entry

Date	Particulars	L.F.	Debit	Credit
------	-------------	------	-------	--------

Profit and loss appropriation A/c Dr.	XXX
General reserve A/c Dr.	XXX
Reserve fund A/c Dr.	XXX
Workmen compensation fund A/c Dr.	XXX
Investment fluctuation fund A/c Dr.	XXX
To Old partners' capital / current A/c (in the old ratio)	XXX

(b) For transferring accumulated loss

Journal entry

Date	Particulars	L.F.	Debit	Credit
	Old partner's capital / current A/c Dr.			XXX
	To Profit and loss A/c (in old ratio)			XXX

Revaluation of assets and liabilities

Following are the journal entries to be passed to record the revaluation of assets and liabilities:

Date	Particulars	L.F.	Debit	Credit
1. For increase in the value of asset				
	Concerned asset A/c Dr.			XXX
	To Revaluation A/c			XXX
2. For decrease in the value of asset				
	Revaluation A/c Dr.			XXX
	To Concerned asset A/c			XXX
3. For increase in the amount of liabilities				
	Revaluation A/c Dr.			XXX
	To Concerned liability A/c			XXX
4. For decrease in the amount of liability				
	Concerned liability A/c Dr.			XXX
	To Revaluation A/c			XXX
5. For recording an unrecorded asset				
	Concerned asset A/c Dr.			XXX
	To Revaluation A/c			XXX
6. For recording an unrecorded liability				
	Revaluation A/c Dr.			XXX
	To Concerned liability A/c			XXX
7. For transferring the balance in revaluation A/c				
(a) If there is profit on revaluation				
	Revaluation A/c Dr.			XXX
	To Old partners' capital A/c (individually in old ratio)			XXX

(b) If there is loss on revaluation

Old partners' capital A/c (individually in old ratio) Dr.		xxx
To Revaluation A/c		xxx

Format of Revaluation Account:

Dr. Revaluation Account Cr.

Particulars		Particulars	
To Concerned asset A/c (net decrease)	xxx	By Concerned asset A/c (net increase)	xxx
To Concerned liability A/c (net increase)	xxx	By Concerned liability A/c (net decrease)	xxx
To Old partners' capital A/c (profit on revaluation shared in old ratio)*	xxx	By Old partners' capital A/c (loss on revaluation shared in old ratio)*	xxx
	xxx		xxx

*There will be either profit or loss on revaluation.

New profit sharing ratio and sacrificing ratio 5.5.1 **New profit sharing ratio** It is necessary to determine the new profit sharing ratio at the time of admission of a partner because the new partner is entitled to share the future profits of the firm. New profit sharing ratio is the agreed proportion in which future profit will be distributed to all the partners including the new partner. If the new profit sharing ratio is not agreed, the partners will share the profits and losses equally.

Sacrificing ratio The old partners may sacrifice a portion of the share of profit to the new partner. The sacrifice may be made by all the partners or some of the partners. Sacrificing ratio is the proportion of the profit which is sacrificed or foregone by the old partners in favour of the new partner. The purpose of finding the sacrificing ratio is to share the goodwill brought in by the new partner. The share sacrificed is calculated by deducting the new share from the old share.

Share sacrificed = Old share - New share

Sacrificing ratio = Ratio of share sacrificed by the old partners

Share of the new partner is the sum of shares sacrificed by the old partners.

Tutorial note: When the new profit sharing ratio is not given in the problem, it is to be calculated based on the information given in the problem.

Calculation of sacrificing ratio and new profit sharing ratio under different situations

1. When new profit sharing ratio is given

When new profit sharing ratio is given, sacrificing ratio has to be calculated as follows:

Sacrificing ratio = Ratio of share sacrificed by the old partners

Share sacrificed = Old share - New share

2. When new profit sharing ratio is not given

(a) When share sacrificed is given

When new profit sharing ratio is not given, but the share sacrificed by the old partner(s) is given, new profit sharing ratio is calculated as follows:

New share of old partner = Old share - Share sacrificed

Share of new partner = Sum of shares sacrificed by old partners

Computation of sacrificing ratio and new profit sharing ratio

New share of old partner = Old share - Share sacrificed

(b) When proportion of share sacrificed is given

(i) When share sacrificed is given as a proportion on old partners' share

When new profit sharing ratio is not given, but the share sacrificed is given as a proportion on old partners' share, new profit sharing ratio is calculated as follows:

Share sacrificed by old partner = Old share x Proportion of share sacrificed

New share of old partner = Old share - Share sacrificed

Share of new partner = Sum of shares sacrificed by old partners

Computation of sacrificing ratio and new profit sharing ratio

Share sacrificed = Old share x Proportion of share sacrificed

New share = Old share - Share sacrificed

Computation of sacrificing ratio and new profit sharing ratio

Share sacrificed = Old share × Proportion of share sacrificed

New share = Old share - Share sacrificed

(ii) When proportion of share sacrificed on new partner's share is given

When new profit sharing ratio is not given, but the proportion of share sacrificed on new partner's share is given, new profit sharing ratio is calculated as follows:

New share of old partner = Old share - Share sacrificed

Share sacrificed = New partner's share × Proportion of share sacrificed

Computation of sacrificing ratio and new profit sharing ratio

Share sacrificed = New partner's share × Proportion of share sacrificed

New share of old partner = Old share - Share sacrificed

(c) When share sacrificed and proportion of share sacrificed is not given

When new profit sharing ratio, share sacrificed and the proportion of share sacrificed is not given, but only the share of new partner is given, new profit sharing ratio is calculated by assuming that the share sacrificed is the proportion of old share. New profit sharing ratio is calculated as follows:

Share sacrificed = New partner's share × Old share

New share of old partner = Old share - Share sacrificed

New share of old partners = Remaining share × Old share

Adjustment for goodwill

Accounting treatment for goodwill

1. When new partner brings cash towards goodwill

(i) For the goodwill brought in cash credited to old partners' capital account

Date	Particulars	L.F.	Debit	Credit
	Cash / Bank A/c Dr.			xxx
	To Old partners' capital / current A/c (in sacrificing ratio)			xxx

(ii) For the goodwill brought in kind (in the form of assets) credited to old partners' capital account

Date	Particulars	L.F.	Debit	Credit
	Respective Asset A/c Dr.			xxx
	To Old partners' capital / current A/c (in sacrificing ratio)			xxx

(iii) For withdrawal of cash received for goodwill by the old partners

Date	Particulars	L.F.	Debit	Credit
	Old partners' capital / current A/c Dr.			xxx
	To Cash / Bank A/c			xxx

2. When the new partner does not bring goodwill in cash or in kind

Date	Particulars	L.F.	Debit	Credit
	New partners' capital A/c Dr.			xxx
	To Old partners' capital / current A/c (in sacrificing ratio)			xxx

Calculation of sacrificing ratio

Sacrificing ratio = Old share – New share

3. Existing goodwill

4. Journal entry

Date	Particulars	L.F.	Debit	Credit
	Old partners' capital / current A/c (in old ratio) Dr.			xxx
	To Goodwill A/c (Existing goodwill written off)			xxx

Sacrificing ratio is the proportion of the profit which is sacrificed or foregone by the old partners in favour of the new partner.

Student activity

Read and analyse the following transactions. Fill in the following table by writing asset or liability and put a • in the appropriate column. The first two transactions

are done as examples.

- (1) The value of inventory should be revalued from ` 2,500 to ` 3,000.
- (2) Building revalued from ` 2,00,000 to ` 1,60,000
- (3) Creditors revalued from ` 2,000 to ` 1,800, as discount can be availed from creditors.
- (4) The value of furniture decreased by ` 2,000
- (5) A provision for outstanding wages would be created for ` 1,000
- (6) Vehicle revalued to ` 20,000 from ` 28,000
- (7) Outstanding salary would be created for ` 10,000
- (8) Provision for doubtful debts is to be created for ` 1,000
- (9) Land revalued from ` 2,00,000 to ` 2,50,000
- (10) Fixtures revalued from ` 20,000 to ` 22,000

Transaction number	Asset/liability	Increase	Decrease	Debit revaluation account	Credit revaluation account
1	Asset		•	•	
2	Asset		•	•	
3					
4					
5					
6					
7					
8					
9					
10					

What do you conclude from the above activity? Show your understanding by filling in the table below. Write increase or decrease in the appropriate box. One box is filled in as an example.

Revaluation account	Debit	Credit
Asset	Decrease	?
Liability	?	?

Unit 6 Retirement and death of a partner

Distribution of accumulated profits, reserves and losses

(a) For transferring accumulated profits and reserves

Date	Particulars	L.F.	Debit	Credit
	Profit and loss Appropriation A/c	Dr.		xxx
	General reserve A/c	Dr.		xxx
	Reserve fund A/c	Dr.		xxx
	Workmen compensation fund A/c	Dr.		xxx
	Investment fluctuation fund A/c	Dr.		xxx
	To All partners' capital / current A/c (in the old ratio)			xxx

(b) For transferring accumulated loss

Date	Particulars	L.F.	Debit	Credit
	All partners' capital / current A/c	Dr.		xxx
	To Profit and loss A/c (in old ratio)			xxx

Revaluation of assets and liabilities

(a) When revised value of assets and liabilities are shown in the books:

(b)(b)

(c) Following are the journal entries to be passed to record the revaluation of assets and liabilities:

Date	Particulars	L.F.	Debit	Credit
1. For increase in the value of asset				
	Concerned asset A/c	Dr.		xxx
	To Revaluation A/c		xxx	
2. For decrease in the value of asset				
	Revaluation A/c	Dr.		xxx
	To Concerned asset A/c		xxx	
3. For increase in the amount of liabilities				
	Revaluation A/c	Dr.		xxx
	To Concerned liability A/c		xxx	
4. For decrease in the amount of liability				
	Concerned liability A/c	Dr.		xxx
	To Revaluation A/c		xxx	
5. For recording an unrecorded asset				
	Concerned asset A/c	Dr.		xxx
	To Revaluation A/c		xxx	

6. For recording an unrecorded liability

Revaluation A/c	Dr.		xxx
To Concerned liability A/c		xxx	

7. For transferring the balance in revaluation A/c**(a) For profit on revaluation**

Revaluation A/c	Dr.		xxx
To All partners' capital A/c (individually in old profit sharing ratio)		xxx	

(b) For loss on revaluation

All partner's capital A/c (individually in old profit sharing ratio)	Dr.		xxx
To Revaluation A/c		xxx	

Format of revaluation account is as follows:

Dr. Revaluation Account Cr.

Particulars		Particulars	
To Concerned asset A/c (net decrease)	xxx	By Concerned asset A/c (net increase)	xxx
To Concerned liability A/c (net increase)	xxx	By Concerned liability A/c (net decrease)	xxx
To All partners' capital A/c (profit on revaluation shared in old ratio) *	xxx	By All partners' capital A/c (loss on revaluation shared in old ratio)*	xxx
	xxx		xxx

*There will be either profit or loss on revaluation.

(b) When revised values of assets and liabilities are not shown in the books:**Determination of new profit sharing ratio and gaining ratio****New profit sharing ratio****Gaining ratio**

Share gained = New share – Old share

Gaining ratio = Ratio of share gained by the continuing partners

Tutorial note: When the new profit sharing ratio is not given in the problem, it is to be calculated based on the information given in the problem.

Calculation of gaining ratio and new profit sharing ratio under different situations

1. When new profit sharing ratio is given

When new profit sharing ratio is given, only gaining ratio has to be calculated as follows:

Gaining ratio = Ratio of share gained by the continuing partners

Share gained = New share – Old share

2. When new profit sharing ratio is not given

(a) Only one partner gains the retiring partner's share

When new profit sharing ratio is not given and only one continuing partner gains the entire share of the retiring partner, new profit sharing ratio is calculated as follows:

New share of continuing partner = Old share + Share gained

b) More than one partner gains the retiring partner's share

(i) Proportion of share gained on retiring partner's share is given

When new profit sharing ratio is not given, but the proportion of share gained on retiring partner's share is given, new profit sharing ratio is calculated as follows:

New share of continuing partners = Old share + Share gained

Share gained = Retiring partner's share × Proportion of share gained

(i) Proportion of share gained is not given

When new profit sharing ratio, share gained and the proportion of share gained is not given, the new share is calculated by assuming that share gained is the proportion of the old share. Therefore, the new profit sharing ratio and the gaining ratio among the continuing partners is their old profit sharing ratio between them.

Adjustment for goodwill

Date	Particulars	L.F.	Debit	Credit
	Continuing partners' capital / current A/c (in gaining ratio)		Dr.	xxx
	To Retiring partner's capital / current A/c			xxx

Existing goodwill

Journal entry

Date	Particulars	L.F.	Debit	Credit
	All partners' capital / current A/c (in old ratio)		Dr.	xxx
	To Goodwill A/c			xxx

Adjustment for current year's profit or loss upto the date of retirement

Date	Particulars	L.F.	Debit	Credit
	Profit and loss Suspense A/c		Dr.	xxx
	To Retiring partner's capital / current A/c (Retiring partner's current year share of profit credited to his capital account)			xxx

Profit and loss suspense account is a temporary account opened to transfer the share of retiring or deceased partner's share in current year's profit or loss upto the date of retirement or death.

Note: If there is loss the reverse entry is passed.

Profit and loss suspense account is closed by transferring to the profit and loss account at the end the accounting period.

Settlement of the amount due to the retiring partner

(a) When the amount due is paid in cash immediately

Date	Particulars	L.F.	Debit	Credit
	Retiring partner's capital A/c		Dr.	xxx
	To Cash / Bank A/c			xxx

(b) When the amount due is not paid immediately in cash

Date	Particulars	L.F.	Debit	Credit
	Retiring partner's capital A/c		Dr.	xxx
	To Retiring partner's loan A/c			xxx

(c) When the amount due is partly paid in cash immediately

Date	Particulars	L.F.	Debit	Credit
------	-------------	------	-------	--------

Retiring partner's capital	Dr.	xxx
A/c		
To Cash / Bank A/c (amount paid)		xxx
To Retiring partner's loan A/c		xxx

Retiring partner's loan account will appear on the liabilities side of the balance sheet prepared after retirement till it is completely settled.

DEATH OF A PARTNER

Adjustments required on the death of a partner

(i) To transfer the amount due to the deceased partner to the executor or legal representative of the deceased partner.

Date	Particulars	L.F.	Debit	Credit
	Deceased partner's capital	Dr.		xxx
	A/c			
	To Deceased partner's executor	A/c	xxx	

(ii) For payment made

(a) When the amount due is paid in cash immediately

Date	Particulars	L.F.	Debit	Credit
	Deceased partner's executor	Dr.		xxx
	A/c			

To Cash / Bank A/c xxx

(b) When the amount due is not paid immediately in cash

Date	Particulars	L.F.	Debit	Credit
	Deceased partner's executor Dr. A/c			xxx
	To Deceased partner's executor loan A/c			xxx

(c) When the amount due is partly paid in cash immediately

Date	Particulars	L.F.	Debit	Credit
	Deceased partner's executor Dr. A/c			xxx
	To Cash / Bank A/c (amount paid)			xxx
	To Deceased partner's executor loan A/c			xxx

Unit 7 Company accounts

Process of issue of equity shares

(i) Inviting subscription: A public company has to issue a prospectus and invite the general public to subscribe for its shares.

(ii) Receipt of application: On the basis of the prospectus, applications are deposited in a scheduled bank by the applicants along with application money within the time specified. Application money must be at least 5 per cent of the nominal value of the shares.

(iii) Allotment of shares: When the minimum subscription stated in the prospectus has been subscribed for by the public, a company can allot shares. For those to whom shares could not be allotted, their application money will be refunded. If the minimum subscription is not received, all the application money received has to be refunded to the applicants.

Issue of shares for cash in instalments

The share capital may be received through instalments as below:

- First instalment called application money
- Second instalment called allotment money
- Third instalment called first call money
- The last instalment called final call money

(i) When shares are issued for cash at par:

Following are the journal entries to be passed:

Date	Particulars	L.F.	Debit	Credit
1. On receipt of application money				
	Bank A/c		Dr.	xxx
	To Equity share application A/c			xxx
2. On allotment of shares, to transfer share application money				
	Share application A/c		Dr.	xxx
	To Equity share capital A/c			xxx

3. On refund of application money for rejected applications

Equity share application A/c	Dr.	xxx
To Bank A/c		xxx

4. For allotment money due

Equity share allotment A/c	Dr.	xxx
To Equity share capital A/c		xxx

5. On receipt of allotment money

Bank A/c	Dr.	xxx
To Equity share allotment A/c		xxx

6. On making call for the call money due

Equity share call A/c	Dr.	xxx
To Equity share capital A/c		xxx

7. On receipt of call money

Bank A/c	Dr.	xxx
To Equity share call A/c		xxx

Under subscription

Over subscription

Calls in advance

Following are the journal entries to be passed:

Date	Particulars	L.F.	Debit`	Credit`
(a) For money received in advance on allotment and call				
	Bank A/c		Dr.	xxx
	To Call in advance A/c			xxx
(b) For adjusting towards call(s)				
	Calls in advance A/c		Dr.	xxx
	To Share call A/c			xxx

Calls in arrear

Forfeiture of shares

The following journal entry is to be passed in the books of the company:

Date	Particulars	L.F.	Debit`	Credit`
	Equity share capital A/c (called up amount)		Dr.	xxx
	To Equity share allotment A/c (amount unpaid)			xxx
	To Equity share call A/c (amount unpaid)			xxx
	To Forfeited shares A/c (amount so far paid) (Forfeiture of shares for non payment of allotment and call)			xxx

Re-issue of forfeited shares

Date	Particulars	L.F.	Debit`	Credit`
(i) When reissue is made at par				
	Bank A/c		Dr.	xxx
	To Equity share capital A/c			xxx
(ii) When reissue is made at premium				
	Bank A/c		Dr.	xxx
	To Equity share capital A/c			xxx
	To Securities premium A/c			xxx
(iii) When reissue is made at loss				
	Bank A/c		Dr.	xxx
	Forfeited shares A/c (loss on reissue)		Dr.	xxx
	To Equity share capital A/c			xxx

If the reissue price is more than the amount unpaid on forfeited shares, it results in profit on reissue which is treated as capital profit and is transferred to capital reserve account. The following journal entry is passed:

Date	Particulars	L.F.	Debit`	Credit`
	Forfeited shares A/c		Dr.	xxx
	To Capital reserve A/c			xxx

When only a part of the forfeited shares are reissued, the proportionate amount of profit on the shares reissued should be transferred to capital reserve account. Proportionate amount of profit is computed as follows:

$$\frac{\text{Total amount forfeited}}{\text{Total number of shares forfeited}} \times \text{Number of shares reissued}$$

Gain or loss = Amount forfeited – loss on reissue

Shares issued at premium

Following are the journal entries for recording securities premium:

Date	Particulars	L.F.	Debit`	Credit`
(i) If premium is collected with application money				
(a) For receiving application money (application money + premium)				
	Bank A/c		Dr.	xxx
	To Equity share application A/c			xxx
(b) For transfer of application money				
	Equity share application A/c		Dr.	xxx
	To Equity share capital A/c			xxx
	To Securities premium A/c			xxx
(ii) If premium is collected with allotment money/call money				
(a) For allotment/ call money due (allotment/call money + premium)				
	Equity share allotment/call A/c		Dr.	xxx
	To Equity share capital A/c			xxx
	To Securities premium A/c			xxx
(b) For receiving allotment/call money				
	Bank A/c		Dr.	xxx
	To Equity share allotment/call A/c			xxx

(iii) When shares are forfeited (for which premium is not received)

Equity share capital A/c	Dr.	xxx
Securities premium A/c	Dr.	xxx
To Equity share allotment A/c		xxx
To Equity share call A/c		xxx
To Forfeited shares A/c		xxx

Tutorial note While forfeiting shares for which premium had already been received, securities premium account should not be debited.

Issue of shares for cash in lumpsum

When shares issued either at par or at premium are payable in single payment, the shares are said to be issued against lumpsum payment.

The following journal entries are passed:

Date	Particulars	L.F.	Debit`	Credit`
(i) For receipt of application money				
	Bank A/c		Dr.	xxx
	To Equity share application A/c			xxx
(ii) For transfer of application money				
	Equity share application A/c		Dr.	xxx
	To Equity share capital A/c			xxx
	To Securities premium A/c (if issued at premium)			

Issue of shares for consideration other than cash

A company may issue shares for consideration other than cash when the company acquires fixed assets such as land and buildings, machinery, etc. Under such situation, the following journal entries are to be passed.

Date	Particulars	L.F.	Debit`	Credit`
(i) For purchase of asset				
	Respective asset A/c		Dr.	xxx
	To Vendor A/c			xxx
(ii) For issue of shares				

Vendor A/c	Dr.	xxx
To Equity share capital A/c		xxx
To Securities premium A/c (if issued at premium)		xxx

A company may also issue shares as consideration for the purchase of business, to promoters for their services and to brokers and underwriters for their commission.

Student activity

Complete the following journal entries by filling the missing information.

Date	Particulars	L.F.	Dr.`	Cr.`
1.	_____ Dr.			2,00,000
	To Share application A/c	_____		
	(Application money received @ 2 per share)			
2.	Share application A/c Dr.		_____	
	To Share capital A/c			2,00,000
	(Share application money for _____ shares transferred to _____)			

Unit 8 Financial Statement Analysis

Financial statements of companies

Note: Statement of profit and loss (Part II of Schedule III) and Balance Sheet (Part I of Schedule III) have been given only for understanding purpose and not for examination.

Schedule III of the Companies Act, 2013

PART II – STATEMENT OF PROFIT AND LOSS

Name of the Company

Profit and loss statement for the year ended

(Rupees in.....)

	Particulars	Note No.	Figures for the current reporting period 3	Figures for the previous reporting period 4
	1	2		
I	Revenue from operations		xxx	xxx
II	Other income		xxx	xxx
III	Total Revenue (I+II)		xxx	xxx
IV		Expenses:		
	Cost of materials consumed		xxx	xxx
	Purchase of Stock-in-Trade		xxx	xxx
	Changes in inventories of finished goods		xxx	xxx
	Work-in-progress and Stock-in-trade		xxx	xxx
	Employee benefits expenses		xxx	xxx
	Finance costs		xxx	xxx
	Depreciation and amortisation expenses		xxx	xxx
	Other expenses		xxx	xxx
	Total expenses		xxx	xxx
	Profit before exceptional and extraordinary items and tax (III-IV)		xxx	xxx
VI	Exceptional items		xxx	xxx
VII	Profit before extraordinary items and tax (V-VI)		xxx	xxx
VIII	Extraordinary items		xxx	xxx
IX	Profit before tax (VII-VIII)		xxx	xxx
X		Tax expense:		
	(1) Current tax		xxx	xxx

(2) Deferred tax		xxx	xxx
XI	Profit (Loss) for the period from continuing operations (VII-VIII)	xxx	xxx
XII	Profit (Loss) from discontinuing operations	xxx	xxx
XIII	Tax expense of discontinuing operations	xxx	xxx
XIV	Profit (Loss) from discontinuing operations (after tax) (XII-XIII)	xxx	xxx
XV	Profit (Loss) for the period (XI+XIV)	xxx	xxx
XVI		Earnings per equity share:	
(1) Basic		xxx	xxx
(2) Diluted		xxx	xxx

PART I – BALANCE SHEET

Name of the Company

Balance Sheet as at

(Rupees in))

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
1	2	3	4
I. EQUITY AND LIABILITIES			
1. Shareholders' funds			
a) Share capital			
b) Reserves and Surplus			
c) Money received against share warrants			
2. Share application money pending allotment			
3. Non-current liabilities			

- a) Long-term borrowings
- b) Deferred tax liabilities (Net)
- c) Other long term liabilities
- d) Long-term provisions

4. Current liabilities

- a) Short-term borrowings
- b) Trade payables
- c) Other current liabilities
- d) Short-term provisions

Total

II. ASSETS

1. Non-current assets

- a) Fixed assets
 - i) Tangible assets
 - ii) Intangible assets
 - iii) Capital Work-in-progress
 - iv) Intangible assets under development
- b) Non-current investments
- c) Deferred tax assets (Net)
- d) Long-term loans and advances
- e) Other non-current assets

2. Current assets

- a) Current investments
- b) Inventories
- c) Trade receivables
- d) Cash and cash equivalents
- e) Short-term loans and advances
- f) Other current assets

Total

Financial statement analysis

Tools of financial statement analysis

(i) Comparative statement

A statement giving comparison of net increase or decrease in the individual items of financial statements of two or more years of a business concern is called comparative statement. It shows the actual figures at different periods of time, the increase or decrease in these figures in absolute terms and the percentages of such increase or decrease. The two basic comparative statements prepared are comparative income statement and comparative balance sheet.

(ii) Common-size statements

The common-size statements show the relationship of various items with some common base, expressed as percentage of the common base. The common bases are total of assets or total of equity and liabilities or revenue from operations (net sales). The common size statements include common-size income statement and common-size balance sheet.

In the common-size income statement, revenue from operations is taken as 100 and various expenses and incomes are expressed as a percentage to the revenue from operations. In the common-size balance sheet, the total of balance sheet, that is, the total of assets or total of equity and liabilities is taken as 100 and various assets and liabilities are expressed as a percentage of the total of assets or total of equity and liabilities.

The common-size statements can be compared with those of previous years. They can also be compared with those of other similar businesses with similar accounting policies.

(iii) Trend analysis

Trend refers to the tendency of movement. Trend analysis refers to the study of movement of figures over a period. The trend may be increasing trend or decreasing trend or irregular. When data for more than two years are to be analysed, it may be difficult to use comparative statement. For this purpose, trend analysis may be used. One year, generally, the first year is taken as the base year. The figures of the base year are taken as 100. The figures for the other years are expressed as a percentage to the base year and the trend is determined.

(iv) Funds flow analysis

The term 'fund' refers to working capital. Working capital refers to the excess of current assets over current liabilities. The term 'flow' means movement and includes both 'inflow' and 'outflow'. Funds flow analysis is concerned with

preparation of funds flow statement which shows the inflow (sources) and outflow (applications) of funds in a given period of time. Funds flow analysis is useful in judging the credit worthiness, financial planning and preparation of budgets.

(v) Cash flow analysis

Cash flow analysis is concerned with preparation of cash flow statement which shows the inflow and outflow of cash and cash equivalents in a given period of time. Cash includes cash in hand and demand deposits with banks. Cash equivalents denote short term investments which can be realised easily within a short period of time, without much loss in value. Cash flow analysis helps in assessing the liquidity and solvency of a business concern.

Preparation of comparative statements

Preparation of common-size statements

Format of common-size statement

Particulars	Absolute amount	Percentage
-------------	-----------------	------------

Unit 9 Ratio Analysis

Meaning of accounting ratios

Ratio is a mathematical expression of relationship between two related or interdependent items. It is the numerical or quantitative relationship between two items. It is calculated by dividing one item by the other related item. When ratios are calculated on the basis of accounting information, these are called 'accounting ratios'.

Accounting ratios can be expressed in any of the following forms:

- (i) **Pure:** It is expressed as a quotient. Example: 2 or 2:1.
- (ii) **Percentage:** It is expressed in percentage. Example: 25%.
- (iii) **Times:** It is expressed as certain number of times of a particular figure. Example: 4 times.

Meaning and definition of ratio analysis

Ratio analysis is a tool which involves analysing the financial statements by calculating various ratios. It is a tool of financial statement analysis, in which, inferences are drawn based on the computation and analysis of different ratios.

According to Myers, "Ratio analysis is a study of relationship among various financial factors in a business".

Objectives of ratio analysis

Following are the objectives of ratio analysis:

- (i) To simplify accounting figures
- (ii) To facilitate analysis of financial statements
- (iii) To analyse the operational efficiency of a business
- (iv) To help in budgeting and forecasting
- (v) To facilitate intra firm and inter firm comparison of performance

Classification of ratios

Ratios may be classified in the following two ways:

- (i) Traditional classification
- (ii) Functional classification

Traditional classification

Traditional classification of ratios is done on the basis of the financial statements from which the ratios are calculated. Under the traditional classification, the

ratios are classified as: (i) Balance sheet ratios, (ii) Income statement ratios and (iii) Inter-statement ratios.

(i) Balance sheet ratio

If both items in a ratio are from balance sheet, it is classified as balance sheet ratio.

(ii) Income statement ratio

If the two items in a ratio are from income statement, it is classified as income statement ratio.

(iii) Inter-statement ratio

If a ratio is computed with one item from income statement and another item from balance sheet, it is called inter-statement ratio.

Functional classification

Functional classification of ratios is based on the purpose for which ratios are computed and it is the most commonly used classification. Under the functional classification, the ratios are classified as follows:

- (i) Liquidity ratios
- (ii) Long term solvency ratios
- (iii) Turnover ratios
- (iv) Profitability ratios**

Computation of ratios

Liquidity ratios

Liquidity ratios include: (i) Current ratio and (ii) Quick ratio.

i) Current ratio

Current ratio gives the proportion of current assets to current liabilities of a business concern. It is computed by dividing current assets by current liabilities.

Current ratio = Current assets / Current liabilities

Current assets

Current assets are those assets that are either in the form of cash or cash equivalents or can be converted into cash or cash equivalents in a short time, that is, within a year or within the period of an operating cycle.

Current liabilities

Current liabilities are those liabilities which are repayable in short time, that is, within a year or within the period of an operating cycle.

Current assets include

- (i) Current investments
- (ii) Inventories (stock)
- (iii) Trade receivables (Bills receivable and sundry debtors less provision for doubtful debts)
- (iv) Cash and cash equivalents (Cash in hand, cash at bank, etc.)
- (v) Short-term loans and advances given
- (vi) Other current assets (Prepaid expenses, accrued income, etc)

Current liabilities include

- (i) Short-term borrowings
- (ii) Trade payables (Bills payable and sundry creditors)
- (iii) Other current liabilities (Expenses payable, income received in advance, etc.)
- (iv) Short-term provisions

Current assets = Current investments + Inventories + Trade receivables + Cash and cash equivalents + Prepaid expenses

Current liabilities = Trade creditors + Bills payable + Expenses payable

ii) Quick ratio

Quick ratio gives the proportion of quick assets to current liabilities. It indicates whether the business concern is in a position to pay its current liabilities as and when they become due, out of its quick assets. Quick assets are current assets excluding inventories and prepaid expenses. It is otherwise called liquid ratio or acid test ratio. It is calculated as follows:

Quick ratio = Quick assets / Current liabilities

Quick assets = Current assets – Inventories – Prepaid expenses

Long term solvency ratios

- (i) Debt equity ratio
- (ii) Proprietary ratio
- (ii) Capital gearing ratio

(i) Debt equity ratio

Debt equity ratio is calculated to assess the long term solvency position of a business concern. Debt equity ratio expresses the relationship between long term debt and shareholders' funds. It is computed as follows:

Debt equity ratio = Long term debt / Shareholders' funds

Long term debt

Long term debt includes debentures, bonds, long term loans and other long term borrowings.

Shareholders' funds

Shareholders' funds = Equity share capital + Preference share capital + Reserves and surplus

Shareholders' funds = Equity share capital + Reserves and surplus

(ii) Proprietary ratio

Proprietary ratio gives the proportion of shareholders' funds to total assets. Proprietary ratio shows the extent to which the total assets have been financed by the shareholders' funds. It is calculated as follows:

Proprietary ratio = Shareholders' funds / Total assets

Shareholders' funds = Equity share capital + Preference share capital + Reserves and surplus

(iii) Capital gearing ratio

Capital gearing ratio is the proportion of fixed income bearing funds to equity shareholders' funds. Fixed income bearing funds include fixed interest and fixed dividend bearing funds. It is calculated as follows:

Capital gearing ratio =

Funds bearing fixed interest and fixed dividend / Equity Shareholders' funds

Funds bearing fixed interest or fixed dividend

Preference share capital

Debentures

Bonds

Long term borrowings carrying fixed interest

Equity shareholders' funds

Equity shareholders' funds

= Equity share capital + Reserves and surplus

Capital gearing ratio is a measure of long term solvency as well as capital structure. When the capital gearing ratio is greater than one, the firm is said to be high geared.

Equity shareholder's funds = Equity share capital + General reserve + Surplus

Turnover ratios

Turnover ratios show how efficiently assets or other items have been used to generate revenue from operations. They are also called as activity ratios or efficiency ratios. They show the speed of movement of various items. They are expressed as number of times in relation to the item compared.

The important turnover ratios are:

- (i) Inventory turnover ratio
- (ii) Trade receivables turnover ratio
- (iii) Trade payables turnover ratio
- (iv) Fixed assets turnover ratio

(i) Inventory turnover ratio

It indicates the number of times inventory is turned over to make revenue from operations (sales) during a particular accounting period. It is a comparison of cost of revenue from operations (cost of goods sold) with average amount of inventory during a given period. It is calculated as under:

Inventory turnover ratio = Cost of revenue from operations / Average inventory

Cost of revenue from operations = Purchases of stock in trade + Changes in inventories of finished goods + Direct expenses

(or)

= Revenue from operations – Gross profit

Tutorial note

Revenue from operations is the net sales.

Changes in inventory = Opening inventory – Closing inventory

Direct expenses = Wages + Carriage inwards + Freight inwards + Dock charges +

Octroi + Import duty + Coal, gas, fuel and power + Other direct expenses

Average inventory = Opening inventory + Closing inventory / 2

Inventory conversion period

Inventory conversion period is the time taken to sell the inventory. A shorter inventory conversion period indicates more efficiency in the management of inventory. It is computed as follows:

Inventory conversion period

(in days) = Number of days in a year / Inventory turnover ratio

Inventory conversion period

(in months) = Number of months in a year / Inventory turnover ratio

(ii) Trade receivables turnover ratio

Trade receivables turnover ratio is the comparison of credit revenue from operations with average trade receivables during an accounting period. It gives the velocity of collection of cash from trade receivables. It is calculated as follows:

Trade receivables turnover ratio = Credit revenue from operations / average trade receivables

Average trade receivables =

Opening trade receivables + Closing trade receivables / 2

Trade receivables Trade debtors + Bills receivable

Credit revenue from operations (net credit sales) is taken for trade receivables turnover ratio as trade receivables arise only from credit sales. Greater the trade receivables turnover ratio, greater is the efficiency of management in collection of receivables.

Tutorial note

In the absence of opening trade receivables, closing trade receivables can be taken instead of average trade receivables to calculate the ratio.

Debt collection period

Debt collection period is the average time taken to collect the amount due from trade receivables. Lesser the debt collection period, greater is the efficiency of management in collection of cash from trade receivables. It is calculated as follows:

Debt collection period
(in days) = Number of days in a year / Trade receivables turnover ratio

Debt collection period
(in months) = Number of months in a year / Trade receivables turnover ratio

(iii) Trade payables turnover ratio

Trade payables turnover ratio is the comparison of net credit purchases with average trade payables during an accounting period. It gives the velocity of payment of cash towards trade payables. It is calculated as follows:

Trade payables turnover ratio = Net credit purchases / Average trade payables

Net credit purchases = Total credit purchases – Purchases returns

Average trade payables = $\frac{\text{Opening trade payables} + \text{Closing trade payables}}{2}$
 Trade payables = Trade creditors + Bills payable

Greater the trade payable turnover ratio, better is the efficiency of the management in managing trade payable as it indicates that amount due to suppliers are settled quicker.

Tutorial note

In the absence of opening trade payables, closing trade payables can be taken instead of average trade payables.

Credit payment period

It is the average time taken by the business for payment of accounts payable. Lesser the credit payment period, greater is the efficiency of the management in managing accounts payable as it indicates quicker settlement of trade payables. It is calculated as follows:

Credit payment period (in days)
 = $\frac{\text{Number of days in a year}}{\text{Trade payables turnover ratio}}$

Credit payment period (in months)
 = $\frac{\text{Number of months in a year}}{\text{Trade payables turnover ratio}}$

(iv) Fixed assets turnover ratio

Fixed assets turnover ratio gives the number of times the fixed assets are turned over during the year in relation to the revenue from operations. This ratio indicates the efficiency of utilisation of fixed assets.

Fixed assets turnover ratio = $\frac{\text{Revenue from operations}}{\text{Average fixed assets}}$

Average fixed assets = $\frac{\text{Opening fixed assets} + \text{Closing fixed assets}}{2}$

Profitability ratios

Profitability ratios help to assess the profitability of a business concern. These ratios also help to analyse the earning capacity of the business in terms of utilisation of resources employed in the business. Generally these ratios are expressed as a percentage.

The profitability ratios commonly used are

- (i) Gross profit ratio
- (ii) Operating cost ratio

- (iii) Operating profit ratio
- (iv) Net profit ratio
- (v) Return on investment

(i) Gross profit ratio

Gross profit ratio is the proportion of gross profit to net revenue from operations. Gross profit ratio shows the margin of profit available out of revenue from operations. It is computed as below:

$$\text{Gross profit ratio} = \text{Gross profit} / \text{Revenue from operations} \times 100$$

Gross profit = Revenue from operations – Cost of revenue from operations
A higher gross profit ratio indicates high profitability. It should be sufficiently high to provide for indirect expenses to be paid by a business.

(ii) Operating cost ratio

Operating cost ratio is the proportion of operating cost to revenue from operations. This ratio is a test of the operational efficiency of the business. It is calculated as under.

$$\text{Operating cost ratio} = \text{Operating cost} / \text{Revenue from operations} \times 100$$

Operating cost is the cost which is associated with the operating activities of the business.

$$\text{Operating cost} = \text{Cost of revenue from operations} + \text{Operating expenses}$$

$$\text{Operating expenses} = \text{Employee benefit expenses} + \text{Depreciation} + \text{Other expenses related to office and administration, selling and distribution}$$

A lower operating ratio indicates better profitability. Lesser the operating cost ratio, higher is the margin available for payment of non operating expenses such as interest on loans, loss on sale of fixed assets, etc.

Tutorial Note

Loss on sale of fixed assets is a non-operating item, hence it is ignored.

(iii) Operating profit ratio

Operating profit ratio gives the proportion of operating profit to revenue from operations. Operating profit ratio is an indicator of operational efficiency of an organisation. It may be computed as follows:

$$\text{Operating profit ratio} = \text{Operating profit} / \text{Revenue from operations} * 100$$

Alternatively, it is calculated as under.

Operating profit ratio = 100 – Operating cost ratio

Operating profit = Revenue from operations – Operating cost

A higher ratio indicates better profitability. Greater the operating ratio, higher is the margin available for paying non-operating expenses.

Tutorial note

Operating cost ratio + Operating profit ratio = 100%

Unit 10 Computerised Accounting system-Tally

Designing the accounting reports

Routine accounting reports include

- (a) Day books / Journal
- (b) Ledger
- (c) Trial balance
- (d) Income statement
- (e) Balance sheet
- (f) Cash flow statement

1. Starting Tally

Tally can be started in either of the ways as given below:

Click on Start > All Programs > Tally.ERP 9 > Tally.ERP 9 icon

(or)

Click on Tally.ERP 9 icon (shortcut) on the desktop

2. Creation of a company

It is essential to enter the particulars of the company for which accounts are to be maintained in Tally.

In order to create a company, the following steps are to be followed:

Company Info > Create Company

Tally asks for name, address, books and financial year details, security control, base currency information, etc. Now, provide all particulars of the company as required in Tally. After completing all entries, choose 'Yes' to accept data and create company.

3. Gateway of Tally

Tally screen appears as in figure 10.4 given below, after creation of a company and whenever Tally is started. This screen is called Gateway of Tally. It shows the company selected under List of Selected Companies on the left pane.

Gateway of Tally is shown on the right pane which contains menu options such as Transactions and Reports. The shortcut key for each menu option is a letter from the option's name, which will be highlighted in red.

Vertical button bar is placed on the extreme right of the screen which contains buttons such as F1 and F2 for quick interaction with Tally.ERP 9.

Bottom horizontal information panel displays details of product, version, licence, configuration and calculator.

4. Closing Tally

The following are the two ways for closing Tally:

Press Esc Key > Press Enter or Y or Click on Yes

(or)

Press Ctrl + Q

5. Select a company

If multiple companies are created, to choose a particular company, after opening Tally, click F1 (Select Cmp) on the vertical button bar. Tally.ERP 9 displays the Select Company screen, with a list of companies that are already created. Select the company for which accounting has to be done.

6. Company features

After creation of a company, it is necessary to set up Tally.ERP 9's features. The features in Tally.ERP 9 are set of capabilities, provided as options, that enable maintenance of financial records as per the requirements of the users. Click F11:Features, on the vertical button bar to go to Company Features menu. It contains Accounting Features, Inventory Features, etc.

7. Accounting Features

The General Accounting Features include 'Maintain accounts only', 'Integrate accounts and inventory' and use Income and Expenses A/c instead of Profit and Loss A/c. The other Accounting Features include Invoicing, Banking Features, etc. For practice purpose, only the accounting aspects are considered and inventory features are not considered.

Select Accounting Features from the Company Features menu. Under General Accounting Features, set 'Yes' to 'Maintain accounts only' option. Leave all other features to default values and accept 'Yes'.

The Accounting Features screen will appear as shown in figure 10.6. (see the next page)

8. Statutory and Taxation features

Statutory and Taxation features include Goods and Services Tax (GST), Value Added Tax (VAT) and Tax Deducted at Source (TDS). To enable Goods and

Services Tax, set 'Yes' to 'Enable Goods and Services Tax' option. For practice purpose set to default value of 'No'.

9. Creating Accounting Groups

In Tally, a Group is a collection of ledgers of the same nature. There are predefined groups of accounts which are widely used in accounts of many organisations. These predefined groups comply with the basic accounting principles of classifying various account heads into Assets, Liabilities, Income and Expense as shown below:

To view predefined groups,

Gateway of Tally > Masters > Accounts Info > Groups > Single Group > Display

If any additional group is required, it can be created as follows:

Gateway of Tally > Masters > Accounts Info > Groups > Single Group > Create

10. Ledger Accounts

In Tally, to record transactions, the transactions are to be identified with the related ledger accounts. Tally has two predefined ledgers, Cash and Profit & Loss A/c. The user has to create various other ledgers based on their requirements.

To create ledger:

Gateway of Tally > Masters > Accounts Info > Ledgers > Single Ledger > Create

After selection, Tally screen will appear as in Figure 10.8.

While creating a ledger, name and the Group under which the ledger account is to be classified should be provided. Leave all other features to default values and accept 'Yes'.

11. Modification of group and ledger

Alteration or deletion of group and ledger is possible. While details of user-defined group/ledger can be fully altered, only name can be altered for predefined group/ledger. Predefined group/ledger cannot be deleted. However, user-defined group/ledger can be deleted.

To delete a ledger: Gateway of Tally > Masters > Accounts Info > Ledgers > Single Ledger > Alter > Select the Ledger to be deleted > Alt D > Yes

12. Vouchers

Voucher is a document which contains details of transactions. Transactions are to be recorded through voucher entries. Tally has a set of predefined vouchers such as Purchase, Sales, Payment, Receipt and Contra.

To view the list of voucher types:

Gateway of Tally > Masters > Accounts Info > Voucher Types > Display
As per the requirements of users, additional voucher type can be created.

Following are some of the major accounting vouchers used in an organisation:

- i) Receipt Voucher
- ii) Payment Voucher
- iii) Contra Voucher
- iv) Purchase Voucher
- v) Sales Voucher
- vi) Journal Voucher

(i) Receipt Voucher

All transactions related to receipt either in cash or through bank are recorded using receipt voucher. In this voucher, cash or bank account is debited and other ledger account is credited.

To record receipt:

Gateway of Tally > Transactions > Accounting Vouchers > F6:Receipt

(ii) Payment Voucher

All transactions related to payments either in cash or through bank are recorded using payment voucher. In this voucher, cash or bank account is credited and other ledger account is debited.

To record payment:

Gateway of Tally > Transactions > Accounting Vouchers > F5:Payment

(iii) Contra Voucher

A transaction involving both cash account and bank account is recorded using contra voucher. The transaction may be for deposit of cash into bank account or withdrawal of cash from bank account.

To record contra:

Gateway of Tally > Transactions > Accounting Vouchers > F4:Contra

(iv) Purchase Voucher

Purchase vouchers are used for recording both cash and credit purchases of goods.

To record purchases:

Gateway of Tally > Transactions > Accounting Vouchers > F9:Purchase

(v) Sales Voucher

Sales vouchers are used for recording both cash and credit sales of goods.

To record sales:

Gateway of Tally > Transactions > Accounting Vouchers > F8:Sales

(vi) Journal Voucher

Journal vouchers are used for recording transactions involving other than cash, bank, purchases and sales such as depreciation, provision for bad debts.

To record journal:

Gateway of Tally > Transactions > Accounting Vouchers > F7:Journal
To record transactions using voucher, Accounting Voucher Creation has to be used. Accounting Voucher Creation contains Name and Number of the voucher, Date of voucher, Particulars, Debit and Credit and Narration.

5. To view reports**(i) To view Trial Balance**

Gateway of Tally > Reports > Display > Trial Balance > AltF1 (detailed)

(ii) To view Profit and Loss Account

F10: A/c Reports > Profit & Loss A/c > AltF1 (detailed)

(or)

Gateway of Tally > Reports > Profit & Loss A/c > AltF1 (detailed)

(iii) To view Balance Sheet

F10: A/c Reports > Balance Sheet > AltF1 (detailed)

(or)

Gateway of Tally > Reports > Balance Sheet > AltF1 (detailed)

(iv) To view Ratio Analysis

F10: A/c Reports > Ratio Analysis

(or)

Gateway of Tally > Reports > Ratio Analysis

(v) To view Day Book

F10: A/c Reports > Day Book > AltF1 (detailed)

(or)

Gateway of Tally > Reports > Display > Day Book > AltF1 (detailed)

Following steps are to be followed to enter the transactions in Tally.ERP 9

1. To create company

Company Info > Create Company

Type the Name as Bright and keep all other fields as they are and choose 'Yes' to accept.

2. To maintain accounts only

Gateway of Tally > F11 Accounting Features > General > Maintain accounts only: Yes > Accept Yes

3. To create ledger accounts with opening balances

Gateway of Tally > Masters > Accounts Info > Ledgers > Single Ledger > Create

Note

Cash account need not be created as it is a default ledger. Only the opening balance has to be recorded by altering the cash account.

To record the opening balance of cash:

Gateway of Tally > Masters > Accounts Info > Ledgers > Single Ledger > Alter

To delete or alter a transaction:

Gateway of Tally > Reports > Display > Day Book > (Choose the voucher to be deleted or altered) Delete or make changes and Accept > Yes

4. To create ledger accounts for transactions

Creation of	Name	Under	Accept
Wages A/c	Wages A/c	Direct Expenses	Yes
Rent A/c	Rent A/c	Indirect Expenses	Yes
Purchases A/c	Purchases A/c	Purchases Accounts	Yes
Senthamarai A/c	Senthamarai A/c	Sundry Creditors	Yes
Sales A/c	Sales A/c	Sales Accounts	Yes
Pushparaj A/c	Pushparaj A/c	Sundry Debtors	Yes
Depreciation A/c	Depreciation A/c	Indirect Expenses	Yes

5. To enter transactions through vouchers

Gateway of Tally > Transactions > Accounting Vouchers

To record closing stock

Since maintain accounts only is set to 'Yes' and integrate accounts and inventory is set to 'No' under accounting features, stock has to be recorded manually. Hence, the closing stock has to be recorded by altering the stock account and while entering the date of closing stock, the date of opening stock has to be entered. The following procedure is to be followed:

Gateway of Tally > Masters > Accounts Info > Ledgers > Single Ledger > Alter > Stock > Closing balance > Date (opening date) > Amount > Accept Yes

6. To view reports

(i) To view Profit and Loss Account

F10: A/c Reports > Profit & Loss A/c > AltF1 (detailed)

(or)

Gateway of Tally > Reports > Profit & Loss A/c > AltF1 (detailed)

Profit and Loss Account

(ii) To view Balance Sheet

F10: A/c Reports > Balance Sheet > AltF1 (detailed)

(or)

Gateway of Tally > Reports > Balance Sheet > AltF1 (detailed)

Reference

Official Guide to Financial Accounting using Tally.ERP 9, Tally Education Private Limited, BPB Publications, Bengaluru

BEST WISHES