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# K V MATRIC. HIGHER SECONDARY SCHOOL

CREATIVITY \* PROSPERITY \* ACHIEVEMENT

546, SATHY MAIN ROAD, KURUMBAPALAYAM, COIMBATORE – 641 107.

HIGHER SECONDARY SECOND YEAR \* ACCOUNTANCY THEORY - QUESTION & ANSWER.

## CHAPTER 07. COMPANY ACCOUNTS

### VERY SHORT ANSWER QUESTIONS

#### 1. What is a share?

- ❖ The capital of a company is divided into small units of fixed amount.
- ❖ These units are called shares.
- ❖ The shares which can be issued by a company are of two types
  - ✓ preference shares and
  - ✓ Equity shares.

#### 2. What is over-subscription?

- ❖ When the number of shares applied for is more than the number of shares offered for subscription, it is said to be over subscription.
- ❖ This situation can be dealt with as per any of the following three alternatives:
  - (a) Some applications are accepted in full and others are totally rejected. Application money is returned to the applicants for rejected applications.
  - (b) All applications are allotted in proportion of shares applied for. This is called pro rata allotment. Excess application money may be returned or may be retained for adjustment towards allotment money and call money.
  - (c) A combination of the above two may be applied.

#### 3. What is meant by calls in arrear?

- ❖ When a shareholder fails to pay the amount due on allotment or on calls, the amount remaining unpaid is known as calls in arrears.
- ❖ In other words, the amount called up but not paid is calls in arrear.
- ❖ As per Table F of the Indian Companies Act, 2013, interest may be charged on calls in arrear if Articles of Association so provide not exceeding 10% per annum.
- ❖ There are two methods of accounting of calls in arrear.
  - (i) By not opening calls in arrear account
  - (ii) By opening calls in arrear account

#### 4. Why are the shares forfeited?

- ❖ When a shareholder defaults in making payment of allotment and/or call money, the shares may be forfeited.
- ❖ On forfeiture, the share allotment is cancelled and to that extent, share capital is reduced.
- ❖ The person ceases to be a shareholder of the company after the shares are forfeited.

- ❖ On forfeiture, the amount so far paid by the shareholder is forfeited which is a gain to the company and is credited to forfeited shares account.
- ❖ Forfeited shares account is shown under share capital as a separate head in the Note to Accounts to the balance sheet.

### SHORT ANSWER:

#### 1. State the differences between preference shares and equity shares.

BASIS	PREFERENCE SHARES	EQUITY SHARES
<b>Meaning</b>	Preference shares are the shares which have the two preferential rights over the equity shares	Equity shares are those shares which are not preference shares. These shares do not enjoy any preferential rights
<b>Rights about dividend</b>	Preference towards the payment of dividend at a fixed rate during the life time of the company	Rate of dividend is not fixed on equity shares and it depends upon the profits earned by the company
<b>Return on share capital</b>	Preference towards the repayment of capital on winding up of the company	In case of winding up of a company equity shareholders are paid after the payments are made to preference shareholders.
<b>Types of shares</b>	Preference share have many types	Equity shares are also known as ordinary shares.

#### 2. Write a brief note on calls in advance.

- ❖ The excess amount paid over the called up value of a share is known as calls in advance.
- ❖ It is the excess money paid on application or allotment or calls.
- ❖ Such excess amount can be returned or adjusted towards future payment.
- ❖ If the company decides to adjust such amount towards future payment, the excess amount may also be transferred to a separate account called calls in advance account.
- ❖ Calls in advance does not form part of the company's share capital and no dividend is payable on such amount.
- ❖ In the balance sheet, it should be shown under current liabilities.
- ❖ As per Section 50 of the Indian Companies Act, 2013, the company can accept calls in advance only if it is authorised by its Articles of Association.
- ❖ As per Table F of the Indian Companies Act, 2013, interest may be paid on calls in advance if Articles of Association so provide not exceeding 12% per annum.

### 3. What is reissue of forfeited shares?.

- ❖ Shares forfeited can be reissued by the company.
- ❖ The shares can be reissued at any price.
- ❖ But, the reissue price cannot be less than the amount unpaid on forfeited shares. Example: If a share of Rs.10 on which Rs.4 has already been paid as application money is forfeited and reissued as fully paid up, then a minimum of Rs.6 must be fixed as the new price ( $10 - 4 = 6$ ).
- ❖ When forfeited shares are reissued at a loss, such loss is to be debited to forfeited shares account.
- ❖ When forfeited shares are reissued at a premium, the amount of such premium will be credited to securities premium account.

### 4. Write a short note on (a) Authorised capital (b) Reserve capital.

#### ❖ AUTHORISED CAPITAL :

- ✓ It means such capital as is authorised by the memorandum of association.
- ✓ It is the maximum amount which can be raised as capital.
- ✓ It is also known as registered capital or nominal capital.

#### ❖ RESERVE CAPITAL :

- ✓ The company can reserve a part of its subscribed capital to be called up only at the time of winding up.
- ✓ It is called reserve capital.

### 5. What is meant by issue of shares for consideration other than cash?

- ❖ 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

## LESSON INSIDE QUESTION:

### 1) Explain the Divisions of share capital ?

The share capital of a company is divided into the following categories:

#### ❖ Authorised capital :

- ✓ It means such capital as is authorised by the memorandum of association.
- ✓ It is the maximum amount which can be raised as capital.
- ✓ It is also known as registered capital or nominal capital.

#### ❖ Issued capital :

This represents that part of authorised capital which is offered for subscription.

#### ❖ Subscribed capital:

- ✓ It refers to that part of issued capital which has been applied for and also allotted by the company.

#### ❖ Called up capital:

- ✓ It refers to that part of subscribed capital which has been called up by the company for payment.
- ❖ **Paid up capital :**
  - ✓ It is that part of called up capital which has been actually paid by the shareholders.
- ❖ **Reserve capital :**
  - ✓ The company can reserve a part of its subscribed capital to be called up only at the time of winding up.
  - ✓ It is called reserve capital.

## 2) How do raise the capital of the public company?

A public company may raise capital by issue of equity shares through the following ways

- ❖ Public issue
- ❖ Private placement
- ❖ Rights issue
- ❖ Bonus issue
- ❖ **Public issue :**
  - ✓ Issue of equity shares to the public through prospectus by a public company is called public issue.
  - ✓ It includes initial public offer and further public offer.
- ❖ **Private placement :**
  - ✓ Private placement means any offer of equity shares or invitation to subscribe equity shares to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in Section 42 of the Indian Companies Act, 2013.
- ❖ **Rights issue:**
  - ✓ Issue of equity shares to the existing shareholders of the company through a letter of offer is known as rights issue.
- ❖ **Bonus issue:**
  - ✓ Issue of equity shares to the existing shareholders of the company at free of cost out of accumulated profit is known as bonus issue.

## 3) Explain the Process of issue of equity shares.

The Process of issue of equity shares A company can issue shares as per the provisions of the Indian Companies Act and as per the guidelines issued by Securities and Exchange Board of India (SEBI).

- ❖ **Inviting subscription:**
  - ✓ A public company has to issue a prospectus and invite the general public to subscribe for its shares.
- ❖ **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.

❖ 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.

4) Explain the Shares issued at premium :

- ❖ When a company issues shares at a price more than the face value (nominal value), the shares are said to be issued at premium.
- ❖ The excess is called as premium amount and is transferred to securities premium account.
- ❖ The amount of securities premium may be included in application money or allotment money or in a call.
- ❖ Securities premium account is shown under reserves and surplus as a separate head in the Note to Accounts to the balance sheet.

\*\*\*\*\* ALL THE BEST \*\*\*\*\*

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HIGHER SECONDARY SECOND YEAR \* ACCOUNTANCY THEORY - QUESTION & ANSWER.

## CHAPTER 08. FINANCIAL STATEMENT ANALYSIS

### VERY SHORT ANSWER QUESTIONS

1. What are financial statements?

- ❖ Financial statements are the statements prepared by the business concerns at the end of the accounting period to ascertain the operating results and the financial position.
- ❖ The basic financial statements prepared by business concerns are income statement and balance sheet.

2. List the tools of financial statement analysis.

Tools of financial statement analysis:

- ✓ Comparative statement
- ✓ Common-size statements
- ✓ Trend analysis
- ✓ Funds Flow analysis
- ✓ Cash Flow analysis

3. What is working capital?

- ❖ The term 'fund' refers to working capital.
- ❖ Working capital refers to the excess of current assets over current liabilities.

4. When is trend analysis preferred to other tools?

- ❖ 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.
- ❖ 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.

### SHORT ANSWER:

1. 'Financial statements are prepared based on the past data'. Explain how this is a limitation.

- ❖ Record of historical data:
  - ✓ Financial statements are prepared based on historical data.
  - ✓ They may not reflect the current position.

## 2. Write a short note on 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.

## 3. Briefly explain any three limitations of financial statements.

### LIMITATIONS OF FINANCIAL STATEMENT ANALYSIS.

Following are the limitations of financial statement analysis:

- ❖ All the limitations of financial statements such as ignoring non-monetary information, ignoring price level changes, etc., are applicable to financial statement analysis also.
- ❖ Financial statement analysis is only the means and not an end, that is, it is only a tool in the hands of management and other shareholders. Interpretation of the results has to be done only by the financial analysts with due regard to the internal and external environmental factors.
- ❖ Expert knowledge is required in analysing the financial statements.
- ❖ Interpretation of the analysed data involves personal judgement as different experts may give different views.

## 4. Explain the steps involved in preparing comparative statement.

Preparation of comparative statements A comparative statement has five columns.

Following are the steps to be followed in preparation of the comparative statement:

- ✓ Column 1: In this column, particulars of items of income statement or balance sheet are written.
- ✓ (ii) Column 2: Enter absolute amount of year 1.
- ✓ (iii) Column 3: Enter absolute amount of year 2.
- ✓ (iv) Column 4: Show the difference in amounts between year 1 and year 2. If there is an increase in year 2, put plus sign and if there is decrease put minus sign.
- ✓ (v) Column 5: Show percentage increase or decrease of the difference amount shown in column 4 by dividing the amount shown in column 4 (absolute amount of increase or decrease) by column 2 (year 1 amount). That is,
- ✓ Percentage increase or decrease =  $\frac{\text{Absolute amount of increase or decrease} \times 100}{\text{Year 1 amount}}$

## 5. Explain the procedure for preparing common-size statement.

Preparation of common-size statements Common-size statement can be prepared with three columns.

Following are the steps to be followed in preparation of common-size statement:



- ✓ Column 1: In this column, particulars of items of income statement or balance sheet are written.
- ✓ Column 2: Enter absolute amount.
- ✓ Column 3: Choose a common base as 100. For example, revenue from operations can be taken as the base for income statement and total of balance sheet can be taken as the base for balance sheet. Work out the percentage for all the items of column 2 in terms of the common base and enter them in column 3.
- ✓ Format of common-size statement.

Particulars	Absolute amount	Percentage
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### LESSON INSIDE QUESTION:

#### 1) What are the Features of financial statements?

Following are the features of financial statements:

- ❖ Financial statements are generally prepared at the end of an accounting period based on transactions recorded in the books of accounts.
- ❖ These statements are prepared for the organisation as a whole.
- ❖ Information is presented in a meaningful way by grouping items of similar nature such as fixed assets and current assets.
- ❖ Financial statements are prepared based on historical cost.
- ❖ Financial statements are prepared based on accounting principles and Accounting Standards, which make financial statements comparable and realistic.
- ❖ Financial statements involve personal judgement in certain cases.
- ❖ For example, selection of method of depreciation, percentage of reserve, etc

#### 2) What are Significance of financial statements?

3) Financial statements reveal the operating results and financial position of the business concern. The significance of financial statements to various stakeholders is as follows:

##### ❖ To management:

- ✓ Financial statements provide information to the management to take decision and to have control over business activities, in various areas.

##### ❖ To shareholders:

- ✓ Financial statements help the shareholders to know whether the business has potential for growth and to decide to continue their shareholding.

##### ❖ To potential investors:

- ✓ Financial statements help to value the securities and compare it with those of other business concerns before making their investment decisions.

❖ To creditors:

- ✓ Creditors can get information about the ability of the business to repay the debts from financial statements.

❖ To bankers:

- ✓ Information given in the financial statements is significant to the bankers to assess whether there is adequate security to cover the amount of the loan or overdraft.

❖ To government:

- ✓ Financial statements are significant to government to assess the tax liability of business concerns and to frame and amend industrial policies.

❖ To employees:

- ✓ Through the financial statements, the employees can assess the ability of the business to pay salaries and whether they have future growth in the concern

4) What are the Objectives of financial statement analysis ?

Financial statement analysis may be done with any of the following objectives:

- ❖ To analyse the profitability and earning capacity
- ❖ To study the long term and short term solvency of the business
- ❖ To determine the efficiency in operations and use of assets
- ❖ To determine the efficiency of the management and employees
- ❖ To determine the trend in sales, production, etc.
- ❖ To forecast for future and prepare budgets
- ❖ To make inter-firm and intra-firm comparisons

5) What is mean by Horizontal analysis ?

- ❖ When figures relating to several years are considered for the purpose of analysis, the analysis is called horizontal analysis.
- ❖ Generally, one year is taken as the base year and the figures relating to the other years are compared with that of the base year.
- ❖ Comparative statements and trend percentages are examples of horizontal analysis.

6) What is mean by Vertical analysis ?

- ❖ When figures relating to one accounting year alone are considered for the purpose of analysis, the analysis is called vertical analysis.
- ❖ Here, relationship is established among items from various financial statements relating to the same accounting period.

- ❖ Preparation of common size statements and computation of ratios are examples of vertical analysis.

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HIGHER SECONDARY SECOND YEAR \* ACCOUNTANCY THEORY - QUESTION & ANSWER.

## CHAPTER 09. RATIO ANALYSIS

### VERY SHORT ANSWER QUESTIONS

1. What is meant by 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'.

2. What is 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:

$$\text{Quick ratio} = \frac{\text{Current Assets}}{\text{current liabilities}}$$

- ❖ Quick assets = Current assets - Inventories - Prepaid expenses Higher the quick ratio, better is the short-term financial position of an enterprise.

3. What is meant by debt equity ratio?

- ❖ 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:

$$\text{Debt equity ratio} = \frac{\text{Long term debt}}{\text{Shareholders' funds.}}$$

4. What does return on investment ratio indicate?

- ❖ Return on Investment (RO I) Return on investment shows the proportion of net profit before interest and tax to capital employed (shareholders' funds and long term debts).
- ❖ This ratio measures how efficiently the capital employed is used in the business.
- ❖ It is an overall measure of profitability of a business concern.
- ❖ It is computed as below:

$$\text{Return on Investment (ROI)} = \frac{\text{Net profit before interest and tax} \times 100}{\text{Capital employed}}$$

Capital employed = Shareholders' funds + Non-current liabilities Greater the return on investment better is the profitability of a business and vice versa.

### 5. State any two limitations of ratio analysis.

#### ❖ Change in price level:

Ratio analysis may not reflect price level changes and current values as they are calculated based on historical data given in financial statements.

#### ❖ Measuring financial solvency:

- ✓ Ratio analysis helps to ascertain the liquidity or short term solvency and long term solvency of a business concern.

#### ❖ Facilitating investment decisions:

- ✓ Ratio analysis helps the management in making effective decisions regarding profitable avenues of investment.

#### ❖ Analysing the profitability:

- ✓ Ratio analysis helps to analyse the profitability of a business in terms of sales and investments.

### SHORT ANSWER QUESTIONS

#### 1. Explain the objectives of ratio analysis.

Objectives of ratio analysis Following are the objectives of ratio analysis:

- ✓ To simplify accounting figures
- ✓ To facilitate analysis of financial statements
- ✓ To analyses the operational efficiency of a business
- ✓ To help in budgeting and forecasting
- ✓ To facilitate intra firm and inter firm comparison of performance

#### 2. What is inventory conversion period? How is it calculated?

- ❖ 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:

## ❖ Number of days in a year

- Inventory conversion period =  $\frac{\text{Number of days in a year}}{\text{Inventory turnover ratio}}$   
( in days )
- Inventory conversion period =  $\frac{\text{Number of months in a year}}{\text{Inventory turnover ratio}}$   
( in Months )

## 3. How is operating profit ascertained?

- ❖ 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:

$$\text{Operating profit ratio} = \frac{\text{Operating profit} \times 100}{\text{Revenue from operations}}$$

- ✓ 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

## 4. State the advantages of ratio analysis.

Advantages of ratio analysis Following are the advantages of ratio analysis:

❖ Measuring operational efficiency:

- ✓ Ratio analysis helps to know operational efficiency of a business by finding the relationship between operating cost and revenues and also by comparison of present ratios with those of the past ratios.

❖ Measuring financial solvency:

- ✓ Ratio analysis helps to ascertain the liquidity or short term solvency and long term solvency of a business concern.

❖ Facilitating investment decisions:

- ✓ Ratio analysis helps the management in making effective decisions regarding profitable avenues of investment.

❖ Analysing the profitability:

- ✓ Ratio analysis helps to analyse the profitability of a business in terms of sales and investments.

❖ Intra firm comparison:

- ✓ Comparison of efficiency of different divisions of an organisation is possible by comparing the relevant ratios.



❖ Inter firm comparison:

- ✓ Ratio analysis helps the firm to compare its performance with other firms.

6. State the limitations of ratio analysis.

Limitations of ratio analysis Following are the limitations of ratio analysis:

❖ Ratios are only means:

- ✓ Ratios are not end in themselves but they are only means to achieve a particular purpose.
- ✓ Analysis of related items must be done by the management or experts with the help of ratios.

❖ Accuracy of financial information:

- ✓ The accuracy of a ratio depends on the accuracy of information taken from financial statements.
- ✓ If the statements are inaccurate, ratios computed based on that will also be inaccurate.

❖ Consistency in preparation of financial statements:

- ✓ Inter firm comparisons with the help of ratio analysis will be meaningful only if the firms follow uniform accounting procedures consistently.

❖ Non-availability of standards or norms:

- ✓ Ratios will be meaningful only if they are compared with accepted standards or norms.
- ✓ Only few financial ratios have universally recognized standards.
- ✓ For other ratios, comparison with standards is not possible.

❖ Change in price level:

- ✓ Ratio analysis may not reflect price level changes and current values as they are calculated based on historical data given in financial statements.

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