Unit-5

1. Introduction of financial accounting

Financial accounting:-accounting is defined as the art of recording, classifying, summarizing in terms of money transactions, events of a financial character and interpreting the results.

Function of accounting:-

1. Recording- journal:-it is concerned with the recording of financial transactions in JOURNAL or subsidiary books soon after the transaction take place.

2. Classifying-ledger:-it is concerned with the systematic, analysis of the recorded data and accumulation of similar type of transactions in separate books called LEDGERS.

3. Summarizing- trial balance-final accounts:-it is concerned with the preparation and presentation of the classified data in a manner useful to the users. This function involves the preparation of financial statements such as trial balance, final accounts, balance sheet, statement of cash flows etc.

4. Interpreting:-the accounts interpret the financial statement in a manner useful to users with the help of ratio analysis and other useful tools. so that conclusions can be drawn about the firms strengths and weaknesses.

Advantage or importance of financial accounting:-

1. Replacing memory:-business transactions are innumerable varied and complex, as such it is quite impossible to memorize each and every transaction .accounting records these transactions in writing and thus it is not necessary the business man should memorize all the transactions.

2. Assessing the performance of the business:-accounting keeps proper and systematic records of all business transactions .income statements are prepared with these records and we are able to know the profit earned and the loss suffered by the business. Trading account is prepared to find out gross profit or loss of the enterprise net profit can be known by preparing profit and loss account.

3. Assessing the financial status of the business:-financial position of the business is displayed through position statement i.e. balance sheet of the business .the statement is prepared at the end of the accounting year and reflects the true position of assets and liabilities of the business on a particular data.

4. Documentary evidence:-accounting records can also be used as evidence in the court to substantiate the claim of the business. These records are based on documentary proof every entry is supported by authentic vouchers .this is why, the court accepts these records as evidence.

5. Assisting in realization of debts:-we in accounts prepare personal ledger accounts of all the parties .the personal account shows the exact amount due from the debtors .we can send the debtors their statement of accounts and thus enable them to verify entries and also to make early payment of the amount due the account can also be used to prove the claim of the business the debtors in the court.

6. Facilitating the sale of the business:-the position statement of the business shows the value of assets and liabilities of the business we can calculate the net worth of the business on the basis of these statements. Accounting facilitates in the calculation of the consideration for which the business should be sold.

7. Preventing and detecting frauds:-the proper accounting system and effective arrangement of internal check prevents leakage of goods and cash. in case cheating takes place. Theft or embezzlement is made and fraud is committed, accounting helps in detect in of these losses and also fixes responsibility for it proper accounting prevents employees from committing fraud.

Limitations of accounting

1. Does *not record all events*: Only the transactions of a financial character will be recorded under book keeping. So it does not reveal a complete picture about the quality of human resources, vocational advantages, business contacts etc.

2. Does *not reflect current values*: The data available under book keeping is historical in nature. So they do not reflect current values. For instance we record the values of stock at cost price or market price, whichever is less. In case of building, machinery etc., we adapt historical case as the basis. Infect the current values of Buildings, plant and machinery may be much more than what is recorded in the balance sheet.

3. *Estimates based on personal:*-The estimates used for determining the values of various items may not be correct. For example, debtors are estimated in terms of collectibles, inventories are based on marketability and fixed assets are based on useful working life. These estimates are based on personal judgment and hence sometimes may not be correct.

4. *Inadequate information on costs and profits*: Book keeping only provides information about overall profitability of the business. No information is given about the cost and profitability of different activities of products or divisions

2. Users of accounting information:-

1. Owners:-the owners are proprietors are sole trading concerns and partners in partnership concerns. While in the case of a company, the legal owners are the share holders. They need information to ascertain the operating results and financial position of the company.

2. Management:-management needs information to review the firm's short- term and long-term solvency. Profitability in relation to turnover and investment, and effective utilization of its resources, to decide upon the course of action to be taken in future.

3. Investors:-investors need information to judge prospects of their investment in the enterprise to decide whether to have shares or not.

4. Creditors:-creditors are those parties who provide resources to the enterprise. They need information to determine whether the enterprise can settle its obligation in time.

5. Employees:-employees need information to determine whether the firm is able to pay higher wages and bonus.

6. Government:-the government needs information to collect taxes and duties from the business

7. Researchers:-researchers are interested in interpreting the financial statements of the concern for a given objective.

3. Double-entry book-keeping system

In financial accounting .there are two systems of book-keeping.

1. Single – entry book-keeping system

2. Double-entry book-keeping system.

1. Single – entry book-keeping system: Single- entry system is an unscientific way of maintaining accounts. Small business units in the unorganized sector maintain their books of accounts under single-entry system of book –keeping.

2. Double-entry book-keeping system: Double –entry book-keeping is a scientific way of recording transactions based on the fact that for every debit, there is a corresponding credit. Under double –entry system both debit and credit aspects of the transaction are being recorded.

Advantages of double–entry book-keeping:-

1. **Information about every account**:-under double- entry system both aspects of a transaction are being recorded in the books of accounts .hence information about every account is available in the books of account as all accounts are to be found in the ledgers under double-entry system. Under single –entry system .only a few accounts such as cash account, debtor's accounts and creditors accounts are maintained.

2. **Helps to know the receivable and payables**:-it helps to know how is owed to the creditors and how much is due from the debtors. Also it focuses on the bills payable and receivable.

3. **Arithmetical accuracy**:-the arithmetical accuracy can be ascertained by preparing a statement of debits and credits called trial balance and this is possible because both debit aspects and credit aspects of every transaction are recorded.

5. Help to locate errors:-trail balance can reveal the errors that creep in accounts while recording the business information.

6. Help to ascertain profit/loss:-the profit and loss statement can be prepared without much difficulty under double- entry system unlike in single-entry system.

7. Help to know the financial position:- double –entry system help to prepare balance sheet that reveals the financial position of the business as on a particular date.

4. Types of accounts and rules governing each account:-

1. Personal account

2. Real account

3. Nominal account.

1. Personal account:-These are accounts opened in the name of persons or firms. Persons may be natural person. Ex:-Ramu account (A/C), artificial persons Ex:-bank account, companys.The rules governing personal accounts are debit the receiver, and credit the giver.

2. Real account:-these are account opened in the name of assets such as land and buildings, plant and machinery, good will etc. The rule governing real account is debit what comes in and credit what goes out.

3. Nominal account:-these accounts relate to the expenses losses, incomes and gains. ex:-salaries, rent and interest accouts.etc. The rule governing nominal account is debit all expenses and losses, credit all incomes and gains.

3. Journal

Journal:-The word journal is derived from the Latin word journ which means a day .Therefore; journal means a day book where in day-to- day business transactions are recorded in order of dates. It is called journal. The process of recording a transaction in the journal is called journalizing. The entries enter in the book are called journal entries.

Types of account and rules of debit and credit

1. Personal a/c:-persons – receiver & giver – receiver name is debit – giver name is credit.

2. Real a/c: - assets – what come in debit – what goes out credit.

3. Nominal a/c:- Expenses, losses and income and gains – Expenses and losses debited - income and gains credited.

Important steps for entering entries in the journal:-

Every transaction has two aspects 1.debit and 2.credit.

Ex: - 1 January 2020 purchase of machinery for cash Rs.10,000

First have to identify above two aspects and two accounts.

1. Machinery (real a/c) 2.cash (real a/c)

After have to follow debit and credit principles.

Machinery a/c - debit

Cash a/c - credit

Format of journal

Journal entries in the books of --------

Date	Particulars	L.F	Debit	Credit

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
1jan2020	Machinery a/c Dr To cash a/c (being purchase of machinery for cash)		10000	 10000

1. Date column: - under this column, the date on which the transaction is entered.

2. Particulars column:-under this column have entered three lines.

First line has to enter the debit account name and Dr.

Second line have to enter credit account name (second line start with TO)

Third line entered the narration of transaction.

3. Ledger folio column:-under this column, the ledge page number containing the relevant account is entered at the time of posting.

4. Debit column:-under this column, the amount to be debited is entered.

5. Credit column: - under this column, the amount to be credited is entered.

KEY WORDS IN BOOK-KEEPING

Goods:-items purchased for resale is called goods. . 1. The purchase of goods on cash or credit:-it is entering in journal debited the name of purchase account.

Ex: - 2 January 2020 purchase of goods from Ramu Rs.12,000

Purchase a/c (real a/c) - debit

Ramu a/c (personal a/c-giver) – credit.

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
2jan 2020	purchase a/c Dr To Ramu a/c (being purchase of goods from Ramu)		12000	 12000

2.) The sale of goods on cash or credit it is entering in journal credited the name of sale account.

Ex: -3 January 2020 sold goods to RaJu Rs.14,000

Raju a/c (personal a/c-receiver) – debit

Sale a/c (real a/c) - credit

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
3jan 2020	Raju a/c Dr To Sale a/c (being sold goods to Raju)		14000	 14000

3) The returning the goods purchased:-is entering in the journal credited the name of purchase return account.

Ex: - 4 January 2020 purchase return of goods to Ramu Rs. 2,000

Ramu a/c (personal a/c-receiver) – debit

Purchase return a/c (real a/c) - credit

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
4jan 2020	Ramu a/c Dr To Purchase return a/c (being purchase retun of goods to Ramu)		2000	 2000

4) The returning the goods sales:-is entering in the journal debited the name of sales return account.

Ex: -5 January 2020 return sale goods from Raju Rs.4,000

Sale return a/c (real a/c) - debit

Raju a/c (personal a/c-giver) – credit

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
5jan 2020	Sale return a/c Dr To Raju a/c (being return of sale goods from Raju)		4000	 4000

Capital:-Entrepreneur is taking the some amount for starting the business. it is called capital. Is enter in the journal credited the name of capital account.

5. January 2020. Commenced business with cash Rs.40, 000

Cash a/c (real a/c) – debit

Capital a/c (personal a/c) – credit

Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
5jan 2020	cash a/c Dr To capital a/c (being commenced business with cash)		40000	 40000

6. **Drawings**:-owner of business used cash or goods for personal .is enter in the journal debited the name of drawing account.

15 January, 2020 proprietor for personal use Rs10, 000

Drawing a/c (personal a/c) – debit

Cash a/c (real a/c) – credit

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
15jan 2020	Drawing a/c Dr To cash a/c (being proprietor for personal use)		10000	 10000

7. **Cash. Transaction**:-

1) Any transaction has cash. That Transaction is cash transaction.

Ex: - 10. January 2020. Purchase furniture for cash Rs.40 00

2) Any transaction has cash and person name it is also cash transaction

Ex: - 10. January 2020. Purchase furniture for cash from Ramu Rs.40 00 .

3) Any transaction has not cash and person name .it is also cash transaction.

Ex: - 10. January 2020. Purchase of Furniture Rs.4000.

It is enter in the journal the name of cash account.

Furniture a/c (real a/c) – debit

Cash a/c (real a/c) – credit

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
10jan 2020	Furniture a/c Dr To cash a/c (being purchase furniture for cash)		4000	 4000

Credit transaction:-any transaction have person name or specially mention on credit. It is credit transaction is entering in the journal the name of person.

Ex:-11. January 2020. Purchase of Machinery from siva Rs.40000

Machinery a/c (real a/c) – debit

Siva a/c (personal a/c -giver) – credit

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
11jan 2020	Machinery a/c Dr To Siva a/c (being purchase of Machinery from siva)		40000	 40000

<u>Cheques</u>:-any transaction has cheques received or issue. It is enter in the journal the name of bank account.

Ex:-20. January 2020. Paid to Mohan by cheque Rs.5000

Mohan a/c (personal a/c- receiver) – debit

Bank a/c (real a/c) – credit

Ex:-Journal entries in the books of Ramesh

Date	Particulars	L.F	Debit	Credit
20jan 2020	Mohan a/c Dr To Bank a/c (being paid to Mohan by cheque)		5000	 5000

<u>Problems in journal</u>

<u>Problem-1</u>.journalise the following transactions in the books of Ganesh.

1jan.2016 Ganesh started his business with cash Rs 1, 00,000

2jan.2016 borrowed from Mahesh Rs 50,000

5jan. 2016 purchased furniture Rs 30,000

8 Jan. 2016 purchased furniture from Mohan on credit Rs 25,000

10 Jan. 2016 purchased goods for cash Rs 5,000

15 Jan. 2016 purchased goods from Ram on credit Rs 8,000

16 Jan. 2016 sold goods for cash Rs 10,000

17 Jan.2016 Sold goods to shyam on credit Rs 2,000

20 Jan.2016 Received cash from Shyam Rs 1,000

22 Jan.2016 Paid cash to Ram Rs 8,000

25 jan.2016 paid salary Rs 5,000

28 jan.2016 received interest Rs 2,000

Solution:-

Journal entries in the books of Ganesh

Date	Particulars	L.F	Debit	Credit
1.jan 2016	cash a/c Dr		100000	
	To capital a/c			100000
	(being commenced business with cash)			
2.jan 2016	cash a/c Dr		50000	
	To Mahesh a/c			50000
	(being borrowed from Mahesh)			
5.jan 2016	Furniture a/c Dr		30000	
	To Cash a/c			30000
	(being purchase furniture for cash)			
8.jan 2016	Furniture a/c Dr		25000	
	To Mohan a/c			25000
	(being purchase furniture from Mohan)			
10.jan 2016	purchase a/c Dr		5000	
	To cash a/c			5000
	(being purchase goods for cash)			
15.jan 2016	purchase a/c Dr		8000	
	To Ram a/c			8000
	(being purchase goods from Ram)			

16. jan 2016	cash a/c Dr To sales a/c (being goods sold for cash)		10000	10000
17. jan 2016	shyam a/c Dr To sales a/c (being goods sold to shyam)		2000	2000
20.jan 2016	cash a/c Dr To shyam a/c (being cash received from shyam)		1000	1000
22.jan 2016	Ram a/c Dr To cash a/c (being paid cash to Ram) -------------------------------------		8000	8000
25.jan 2016	Salary a/c Dr To cash a/c (being paid cash to salary) -------------------------------------		5000	5000
28.jan 2016	cash a/c Dr To interest a/c (being interest receive		2000	2000

<u>Problem-2</u> .journalize the following transactions.

January, 1 Raju commenced business Rs1,00,000

January, 4sold goods to chandu Rs10, 000

January, 6 brought for cash Rs20, 000

January, 10 received interest Rs10, 000

January, 12 paid to bank Rs15, 000

January, 15 withdraw cash from bank Rs 2, 000

January, 18 sold goods to venkat Rs40, 000

January, 26 sold goods for cash Rs40, 000

January, 28 paid for rent Rs30, 000

January, 31 proprietor for personal use Rs10, 000

- (Dec/Jan 2014)

Solution:-

Journal entries in the books of Raju

Date	Particulars	L.F	Debit	Credit
1.jan	cash a/c Dr To capital a/c (being Raju commenced business)		100000	100000
4.jan	Sandu a/c Dr To Sale a/c (being sold goods to chandu)		10000	10000
6.jan	purchage a/c Dr To Cash a/c (being brought for cash)		20000	20000
10.jan	cash a/c Dr To interest a/c (being received interest)		10000	10000
12.jan	Bank a/c Dr To cash a/c (being paid to bank)		15000	15000
15.jan	Cash a/c Dr To bank a/c (being withdraw cash from bank)		2000	2000
18.jan	Venkat a/c Dr To sales a/c (being goods sold to venkat)		40000	40000

26.jan	cash a/c Dr To sales a/c (being goods sold to cash)		40000	40000
28.jan	Rent a/c Dr To cash a/c (being paid cash to rent) ----------------------------------- ---------------------		30000	30000
31.jan	Drawing a/c Dr To cash a/c (being proprietor for personal use ---		10000	10000

<u>Problem 3</u>.journalise the following transactions in the books of Madhava Rao

2007, January 1. He started business with a capital of Rs60, 000

2007, January4. Bought furniture from RajuRs.2000

2007, January12. Sold goods to Mahindra Singh Rs2, 000

2007, January 15.cash sales Rs75, 000

2007, January 26.paid salaries by cheque Rs1, 000

2007, January 31.proprietor personal uses Rs500

- (Dec/Jan (supply) 2014)

Solution:-

Journal entries in the books of Madhava Rao

1.jan 2007	cash a/c Dr To capital a/c (being started business with a capital)		60000	60000
4.jan 2007	Furniture a/c Dr To Raju a/c (being Bought furniture from Raju)		2000	2000
12.jan 2007	Mahendra sigh a/c Dr To sales a/c (being Sold goods to Mahindra Singh)		2000	2000
15.jan 2007	cash a/c Dr To sales a/c (being cash sales)		75000	75000
26.jan	salarys a/c Dr To bank a/c (being paid salaries by cheque)		1000	1000
31.jan 2007	Drawing a/c Dr To cash a/c (being proprietor personal uses) ---		500	500

<u>Problem:-4</u> journalize the following transaction in books of Madhu.

1. January 2010. Commenced business with cash Rs.40, 000
2. January 2010. Purchased goods on credit from shyam Rs.30, 000
3. January 2010.Received cash from Murthy Rs.40, 000
4. January 2010. Paid wages Rs.500
5. January 2010. Goods returned to shyamRs.200
6. January 2010. Goods sold to kamal Rs.10, 000
7. January 2010. Paid into bankRs.500
8. January 2010. Goods sold for Rs.700
9. January 2010. Bought goods for cashRs.1, 000

- (November 2011)

<u>Solution:-</u>

Journal entries in the books of Madhu

1.jan 2010	cash a/c Dr		40000	
	To capital a/c			40000
	(being Commenced business with cash)			
2.jan 2010	purchage a/c Dr		30000	
	To shyam a/c			30000
	(being Purchased goods on credit from shyam)			
3.jan 2010	cash a/c Dr		40000	
	To Murthy /c			40000
	(being Received cash from Murthy)			
4.jan 2010	wages a/c Dr		500	
	To cash a/c			500
	(being Paid wages)			

5.jan 2010	shyam a/c Dr To goods returned a/c (being Goods returned to shyam)		200	200
6.jan 2010	Kamal a/c Dr To sales a/c (being Goods sold to kamal) ---		10000	10000
7.jan 2010	Bank a/c Dr To cash a/c (being Paid into bank) --		500	500
8.jan 2010	Cash a/c Dr To sales a/c (being Goods sold)		700	700
9.jan 2010	purchase a/c Dr To cash a/c (being Bought goods for cash)		1000	1000

Final accounts

Final accounts have three stages as:-

1. Trading a/c

2. Profit and loss a/c and

3. Balance sheet

1. Trading account:-the first sage in the presentation of final accounts .it is the preparation of the main purpose of twofold.

1. To ascertain gross profit and gross loss as a result of buying and selling of goods and

2. To enable management to make a comparison of gross profit or gross loss of the current year with that of previous year.

Proforma (format) of trading account

Dr Trading a/c of ---- for the year ended ---- Cr

To opening stock		xxxx	By sales	xxx	
To purchases	xxx		Less:-returns	xx	xxxx
Less:-returns	xx	xxx	By closing stock		xxx
To import duty		xxx			
To wage		xxx			
To coal,gas&water		xxx			
To manufacturing Ex.		Xxx			
To carriage		xxx			
To fright		xxx			
To gross profit (transferred to Profit &loss a/c)		xxx			
		xxxxx			Xxxx

2. Profit and loss account:-the businessman is always interested in knowing his income or net profit.net profit represents the excess of gross profit plus other revenue incomes over sales including sales costs and other expenses. The debit side of profit &loss a/c shows the expenses and credit side the incomes. If the total of the credit side is more .if will be net profit and it the debit side happens to be more it would be net loss.

The proforma (format) of profit &loss a/c is given.

Dr Profit & loss a/c ----- for the year ended------ Cr

	Rs.		Rs.
To rent	xxx	By gross profit	xxx
To salaries	xxx	By interest received	xxx
To printing &stationary	xxx	By discount received	xxx
To postage	xxx	By commission received	xxx
To legal charge	xxx		
To audit fee	xxx		
To insurance	xxx		
To general expenses	xxx		
To trading expenses	xxx		
To advertisements	xxx		
To sales men's salaries	xxx		
To sales men's commission	xxx		
To bad debts	xxx		
To carriage out wards	xxx		
To depreciation	xxx		
To repairs and maintains	xxx		
To interest on capital	xxx		
To interest on loan	xxx		
To discount allowed	xxx		

To net profit xxx (to transferred to capital) --------- . Xxxx	-------- Xxxx

3. **Balance sheet**:-A balance sheet may, therefore, be define as a statement which sets out the assets and liabilities of a business firm and which serves to ascertain the financial position of the same on any particular date. On the left-hand side of this statement the liabilities and the capital are shown on the right-hand side all the assets. Always be equal. Otherwise there is an error somewhere.

Proforma (format) of balance sheet

Balance sheet of ----- as on -------

Liabilities			Assets	
		Rs.		Rs.
Sundry creditors		xxx	Cash in hand	xxx
Creditors		xxx	Cash at bank	xxx
Bills payables		xxx	Bills receivable	xxx
Bank overdraft		xxx	Sundry debtors	xxx
Loan		xxx	Debtors	xxx
Reserves		xxx	Prepaid expenses	xxx
Capital	xxx		Accrued income	xxx
Add:-net profit	xxx		Closing stock	xxx
	Xxx		Investments	xxx
Less:- drawings	xxx	xxx	Furniture	xxx
			Plant &machinery	xxx
			Land &building	xxx
			Good will	xxx

------- xxxx	------- Xxxx

Note:- any adjustment in problem have to enter two time one time trading a/c (or)profit and loss a/c and second time enter in the balance sheet liabilities side (or) asset side.

Remaining all have to enter one time in trading a/c (or)profit and loss a/c (or) balance sheet in liabilities side (or)asset side.

Problems in final accounts.

Problem:-1.from the following trial balance of Ram as 31-3-2007, prepare trading and profit and loss account and balance sheet for the year ended 31-3-2007.

Particulars	Debit Rs.	Credit Rs.
Opening stock	45000	
Plant &machinery	75000	
Purchases	225000	
Trade expenses	10000	
Carriage inwards	2500	
Capital		75000
Carriage outward	1500	
Factory rent	1500	
Discount allowed	350	
Sales		420750
Bills payable		2000
Insurance	700	
Sundry debtors	60000	
Office rent	3000	
Printing and stationery	600	

Sales men salaries	2800	
Advertising	15000	
Sundry creditors		15000
Bills receivables	6000	
Bad debts provision		200
Drawings	6000	
Salaries	15000	
Wages	20000	
Furniture	7500	
Coal and gas	1000	
Cash in hand	2000	
Cash at bank	12500	
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Total	512950	512950

Adjustments:-1.closing stock Rs.35000.

(December 2015)

Solution:-

Dr Trading a/c of Ram for the year ended 31-3-2007 Cr

	Rs.		Rs
To opening stock	45000	By sales	420750
To purchases	225000	By closing stock	35000
To wage	20000		
To coal,gas&water	1000		
To carriage inwards	2500		
To factory rent	1500		
To gross profit (transferred to Profit &loss a/c)	160750		
	----------		-------------
	455750		455750

Dr profit & loss a/c of Ram for the year ended 31-3-2007 Cr

	Rs		Rs.
To office rent	3000	By gross profit	160750
To salaries	15000		
To printing &stationary	600		
To insurance	700		
To trading expenses	10000		
To advertisements	15000		
To sales men's salaries	2800		
To carriage out wards	1500		

To discount allowed 350	
To net profit 111800	
(To transferred to capital)	
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160750	160750

Balance sheet of Ram as on 31-3-2007

Liabilities			Assets	
		Rs		Rs
Sundry creditors		15000	Cash in hand	2000
Bills payables		2000	Cash at bank	12500
bad debt provision		200	Bills receivable	6000
capital	75000		Sundry debtors	60000
Add:-net profit	111800		Closing stock	35000
	186800		Furniture	7500
Less:- drawings	6000	180800	Plant &machinery	75000
		-------------		------------
		198000		198000

Problem:-2 prepare trading and profit and loss account and balance sheet as on 31-3-2004 from the under mentioned trail balance of M/s Sahani

Closing stock was valued at Rs 9000.

Particulars	Debit Rs.	Credit Rs.
Opening stock	10000	
Purchases and sales	20000	40000
Returns	2000	1000
Discounts	1000	2000
Capital and drawings	5000	65000
Cash and bank overdraft	7000	12000
Debtors and creditors	19000	12000
Carriage and cartage	3000	
Freight	4000	
Salaries	6000	
Stationery	4000	
Land and building	35000	
Plant and machinery	15000	
Furniture	5000	
Bills receivable and payable	6000	4000
General reserve		6000
	--------------------	------------
Total	142000	142000

-(December 2016)

Solution:-

Dr Trading a/c of shahini for the year ended 31/3/2004 Cr

		Rs			Rs.
To opening stock		10000	By sales	40000	
To purchases	20000		Less:-returns	2000	38000
Less:-returns	1000	19000	By closing stock		9000
To carriage		3000			
To fright		4000			
To gross profit (transferred to Profit &loss a/c)		11000			
		----------			----------
		47000			47000

Dr profit & loss a/c of shahini for the year ended 31/3/2004 Cr

	Rs.		Rs
To salaries	6000	By gross profit	11000
To stationary	4000	By discount received	2000
To discount	1000		
To net profit (to transferred to capital)	3000		
	---------		--------
	13000		13000

Balance sheet of shahini as on 31/3/2004

Liabilities			Assets	
		Rs		Rs
Creditors		12000	Cash in hand	7000
Bills payables		4000	Bills receivable	6000
Bank overdraft		12000	Debtors	19000
Reserves		6000	Closing stock	9000
Capital	65000		Furniture	5000
Add:-net profit	3000		Plant &machinery	15000
	68000		Land &building	35000
Less:- drawings	6000	62000		
		---------		---------
		96000		96000

Problem:-3.from the following trial balance of M/s Ram, prepare trading and profit and loss account for the year ending on 31-3 -2012and the balance sheet on that date.

Particulars	Debit Rs.	Credit Rs.
Opening stock	5000	
Purchases	16750	
Discount allowed	1300	
Wages	6500	
Sales		30000
Salaries	2000	
Travelling expenses	400	
Commission	425	
Carriage inward	275	

Administration expenses	105	
Trade expenses	600	
Interest	250	
Building	5000	
Furniture	200	
Debtors	4250	
Creditors		2100
Capital		13000
Cash	2045	
	--------------	--------------
Total	45100	45100

Stock as on 31-3- 2002was Rs.6000. - (December 2017)iv

Solution:-

Dr Trading a/c of Ram for the year ended 31/3/2012 Cr

	Rs		Rs
To opening stock	5000	By sales	30000
To purchases	16750	By closing stock	6000
To wage	6500		
To carriage inword	275		
To gross profit (transferred to Profit &loss a/c)	7475		
	----------		--------
	36000		36000

Dr profit & loss a/c Ram for the year ended 31/3/2012 Cr

	Rs		Rs
To salaries	2000	By gross profit	7475
To traveling expenses	400		
To administration expenses	105		
To trading expenses	600		
To commission	425		
To interest	250		
To discount allowed	1300		
To net profit	2395		
(to transferred to capital)			
	------------		--------
	7475		7475

Balance sheet of Ram as on 31/3/2012

Liabilities			Assets	
Sundry creditors	xxx	Rs		Rs
Creditors		2100	Cash	2045
Capital	13000		Debtors	4250
Add:-net profit	2395	15395	Closing stock	6000
			Furniture	200
			building	5000
		-------		---------
		17495		17495

Problem:-4 the following balances extracted from the books of Mohan prepare a trading and profit and loss account and balance sheet on 31-12-2016.

	Amount
Stock on 1st January	11000
Bills receivable	4500
Purchases	39000
Wages	2800
Insurance	700
Sundry debtors	30000
Carriage inwards	800
Commission (dr.)	800
Interest on capital	700
Stationary	450
Returns inwards	1300
Returns outwards	500
Trade expenses	200
Furniture	1000
Cash in hand	500
Cash at bank	4750
Rent	1100
Carriage outwards	1450
Sales	60000
Bills payable	3000
Creditors	19650
Capital.	17900

The stock on 31st December 2016 was valued at Rs 25000. - (December 2017) III

Solution:-

Dr Trading a/c of Mohan for the year ended 31/12/2016 Cr

		Rs			Rs.
To opening stock		11000	By sales	60000	
To purchases	39000		Less:-returns	1300	58700
Less:-returns	500	38500	By closing stock		25000
To wage		2800			
To carriage inward		800			
To gross profit (transferred to Profit &loss a/c)		30600			
		----------			-------------
		83700			83700

Dr profit & loss a/c Mohan for the year ended 31/3/2016 Cr

	Rs.		Rs
To rent	1100	By gross profit	30600
To stationary	450		
To insurance	700		
To trading expenses	200		
To commission	800		

To carriage out wards	1450		
To interest on capital	700		
To net profit	25200		
(to transferred to capital)			
	------------		-----------
	30600		30600

Balance sheet of Mohan as on 31/3/2016

Liabilities			Assets	
		Rs		Rs
Sundry creditors	xxx		Cash in hand	500
Creditors		19650	Cash at bank	4750
Bills payables		3000	Debtors	30000
Bank overdraft			Bills receivables	4500
			Furniture	1000
Capital	17900		Closing stock	25000
Add:-net profit	25200	43100		
		-------------		---------
		65750		65750

Ratios Analysis

Ratio analysis is a very important tool of financial analysis. It is the process of establishing a significant relationship between the items of financial statements. To provide a meaningful understanding of the performance and financial position of a firm.

Ratio: - the term ratio means the numerical or an arithmetical relationship between two figures or variables. Ratio is expressed in percentage, rate and proportion.

Advantages of ratio analysis:-

1. Understand:-ratio analysis simplifies the understanding of financial statements.

2. Inter relationship:-ratio bring out the interrelationship among various financial figures and bring to light their financial significance and it is a device to analyze and interpret the financial health of the enterprise.

3. Planning and fore casting:-ratios contribute significantly towards effective planning and forecasting.

4. Comparisons:-ratios facilitate inter firm and intra firm comparisons

5. Control tools:-ratios serve as effective control tool

6. Specific information:-ratios cater to the particular information need of a particular person

Limitations of ratio analysis

1. False result: - ratios are based upon the financial statements. In case financial statements are incorrect or the data upon which ratios are based in incorrect, ratios calculated will be false and defective.

2. Limited comparability: - the ratio of the one firm cannot always be compared with the performance of other firm, if uniform accounting policies are not adopted by the. Difference in the methods of calculation of stock or the methods used to record the depreciation on assets will not provide identical data. So they cannot be compared.

3. Price level changes affect ratios: - the comparability of ratios suffers. If the price of the commodities in two different years as not the same change in price affects the cost of production. Sales and also the value of assets. It means that the ratio will be meaningful for comparison if the prices do not change.

4. Ignoring qualitative factors: - analysis is the quantitative measurement of the performance of the business. It ignores the qualitative aspect of the enterprise. How so ever important it may be .it shows that ratio is only one sided approach to measure the efficiency of the business.

5. Historical data: - ratio is based on past data and hence cannot be reliable guide to future performance.

Types of ratios:-

1. Liquidity ratios

2. Capital structure or coverage ratios.

3. Activity or turnover ratios

4. Profitability ratios.

1. Liquidity ratios:-these ratios show the short-term financial solvency of the business .usually the following two ratios are calculated for this purpose.

1. Current ratio

2. Quick ratio.

1. Current ratio:-this ratio establishes a relationship between Current assets and current liabilities. This ratio is computed by dividing the current assets by current liabilities.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

2. Quick ratio:-this ratio establishes a relationship between quick assets and current liabilities. Quick assets are meaning those current assets which can be converted into cash immediately. This ratio is computed by dividing the quick assets by current liabilities.

$$\text{Quick ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

2. Capital structure or coverage ratio: - capital structure ratios are also referred as leverage ratios. These ratios show the long-term financial position of the business .usually the following two ratios are calculated for this purpose.

1. Debt equity ratio

2. Interest coverage ratio.

1. Debt equity ratio**:-**this ratio establishes a relationship between long-term debts and share holds funds. This ratio is computed by dividing the Debt by Equity (or) long term loans by share holder’s funds.

$$\text{1. Debt equity ratio} = \frac{\text{Debt}}{\text{Equity}} \quad \text{(or)} \quad \frac{\text{long term loans}}{\text{share holder's funds}}$$

2. Interest coverage ratio**:** - this ratio establishes a relationship between profit before interest, tax and interest. This ratio is calculated as.

$$\text{Interest coverage ration} = \frac{\text{Net profit before interest and tax}}{\text{Interest}}$$

3. **Activity or turnover ratios**:-this ratio is also referred as asset management ratio. The activity ratio measures how effectively an organization manages its assets. Activity ratio is classified as.

1. Inventory turnover ratio: - this ratio establishes a relationship between costs of goods sold and average inventory. This ratio is calculated as.

$$\text{Inventory turnover ratio} = \frac{\text{Costs of goods sold}}{\text{Average inventory}}$$

2. Debtor's turnover ratio: - this ratio establishes a relationship between net credit sales andaverage debtors. This ratio is calculated as.

$$\text{Debtors turnover ratio} = \frac{\text{Net credit sales}}{\text{Average debtors}}$$

4. Profitability ratios:-profitability refers to the ability of the business to earn profit. It shows the efficiency of business. These ratios measure the profit earning capacity of the company. The profitability of the business can be measured with the following ratio.

1. Gross profit ratio
2. Net profit ratio
3. Operating ratio
4. Earnings per share

5. Price/ Earnings ratio.

1. Gross profit ratio:-this ratios measure the relationship between gross profit and net sales. The main objective of computing this ratio is to determine the efficiency with which production or purchase operation are carried on .this ratio calculated as

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

2. Net profit ratio:-this ratio measures the relationship between net profit and net sales. The main objective of computing this ratio is to determine the overall profitability due to various factors such as operations efficiency .trading on equity etc. this ratio calculated as

$$\text{Net profit ratio} = \frac{\text{Net profit}}{\text{Net sales}} \times 100$$

3. Operating ratio:-this ratio measures the relationship between operating cost and net sales. The main objective of computing this ratio is to determine the operational efficiency. This ratio calculated as

$$\text{Operating ratio} = \frac{\text{Operating cost}}{\text{Net sales}} \times 100$$

4. Earnings per share: - this ratio measures the earnings available to an equity shareholder on a per share basis .the objective of computing this ratio is to measure the profitability of the firm on per equity share basis. This ratio is calculated as

$$\text{Earnings per share ratio} = \frac{\text{Net profit after interest, tax and preference dividend}}{\text{Net sales}}$$

5. Price/ Earnings ratio: - this ratio establishes the relationship between amount price of equity share and the earning per share. This ratio is calculate as

$$\text{Price/ Earnings ratio} = \frac{\text{Market price of equity}}{\text{Earnings per share}}$$

Problems in ratio analysis

1. Liquidity ratios

1. Current ratio:-this ratio establishes a relationship between Current assets and current liabilities. This ratio is computed by dividing the current assets by current liabilities.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

2. Quick ratio:-this ratio establishes a relationship between quick assets and current liabilities. Quick assets are meaning those current assets which can be converted into cash immediately. This ratio is computed by dividing the quick assets by current liabilities.

$$\text{Quick ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

Current assets and current liabilities

Current liabilities	Current assets
Creditors or sundry creditors	Cash or cash at hand
Bills payables	Cash at bank
Bank overdraft	Debtors or sundry debtors
Outstanding expenses	Stock or inventory
Income received in advance	Bills receivables
Short term loans	Short term or trade investments
Income tax payable	Prepaid expenses.

Quick assets = current assets – (stock +prepaid expenses)

Problem:-1.calculate 1) current ratio 2) liquid or quick ratio the following information.

Cash	10,000	bills receivables	5,000
Cash at bank	5,000	Stock	3,000
Debtors	20,000	prepaid expenses	2,000
Creditors	16,000	outstanding expenses	2 000
Bills payable	4,000.		

Solution:-

$$1.\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Current assets		current liabilities	
Cash	10000	creditors	16000
Cash at bank	5000	bills payable	4000
Debtors	20000	outstanding expenses	2000
Bills receivable	5000	Total liabilities	22000
Stock	3000		
Prepaid expenses	2000		
Total current assets	48000		

$$\text{Current ratio} = \frac{48000}{22000} = 2.18$$

$$2.\text{Quick ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

Quick assets = current assets – (stock +prepaid expenses)

= 48000 – (3000+2000)

= 48000- 5000 =43000

$$\text{Quick ratio} = \frac{43000}{22000} = 1.95$$

Problem:-2.calculate current and liquid (quick) ratio from the following information.

Balance sheet as on 31-12-2015.

Liabilities		Assets	
Share capital	100000	Fixed assets	150000
Debenture	115000	Cash	20000
Creditors	40000	Cash at bank	30000
Bills payables	10000	Debtors	60000
Bank over draft	15000	Bills receivable	30000
Income tax payable	20000	Stock	5000
		Prepaid expenses	5000
	-----------		-----------
.	300000		300000

Solution:-

$$1.\ \text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Current assets		current liabilities	
Cash	20000	creditors	40000
Cash at bank	30000	bills payable	10000
Debtors	60000	Bank overdraft	15000
Bills receivable	30000	income tax payable	20000
Stock	5000	Total liabilities	85000
Prepaid expenses	5000		
Total current assets	150000		

$$\text{Current ratio} = \frac{150000}{85000} = 1.76$$

$$2.\text{Quick ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

Quick assets = current assets – (stock +prepaid expenses)

= 150000 – (5000+5000)

= 150000- 10000 =140000

$$\text{Quick ratio} = \frac{140000}{85000}$$

= 1.64

2) Capital structure ratios:-

2. Capital structure or coverage ratio: - capital structure ratios are also referred as leverage ratios. These ratios show the long-term financial position of the business .usually the following two ratios are calculated for this purpose.

1. Debt equity ratio
2. Interest coverage ratio.

1. Debt equity ratio:-this ratio establishes a relationship between long-term debts and share holds funds. This ratio is computed by dividing the Debt by Equity (or) long term loans by share holder's funds.

$$1.\ \text{Debt equity ratio} = \frac{\text{Debt}}{\text{Equity}} \quad \text{(or)} \quad \frac{\text{long term loans}}{\text{share holder's funds}}$$

2. Interest coverage ratio: - this ratio establishes a relationship between profit before interest, tax and interest. This ratio is calculated as.

$$\text{Interest coverage ration} = \frac{\text{Net profit before interest and tax}}{\text{Interest}}$$

Debts and Equity

Debt (or) long-term loans	Equity (or) share holders funds
Debentures Loans from specialized financial institutions Public deposits Loan and mortgage Term loans Secured loans.	Equity share capital Preference share capital Reserves Surplus (previous profits) General reserve Capital reserve.

Problems:-1from the following data calculate the debt-equity ratio.

10000 equity shares of Rs 10 each	1, 00,000
General reserves	45 000
Accumulative profit	30,000
Debentures	75,000
Sundry trade creditors	40,000
Outstanding expenses	10,000

Solution:-

1. Debt equity ratio = $\dfrac{\text{Debt}}{\text{Equity}}$ (or) $\dfrac{\text{long term loans}}{\text{share holder's funds}}$

Debt (or) long term loans		Equity (or) share holders funds.	
Debentures	75000	equity shares	100000
		General reserves	45000
		Accumulated profit	30000
			175000

Debt equity ratio = $\dfrac{75000}{175000}$ =0.42 times.

2. Interest coverage ratio: - this ratio establishes a relationship between profit before interest, tax and interest. This ratio is calculated as.

Interest coverage ration = $\dfrac{\text{Net profit before interest and tax}}{\text{Interest}}$

Problem 1: The operation profit of Rajan Ltd. after charging interest on debentures and tax is a sum of Rs 4, 00,000. The amount of interest is Rs 30,000 and the provision for tax has been made of Rs 70,000.calculate the interest charges cover ratio.

Solution:

$$\text{Interest coverage ration} = \frac{\text{Net profit before interest and tax}}{\text{Interest}}$$

<u>Net profit before interest and tax</u>

Profit after charging interest on debentures & tax	4, 00,000
Interest on debentures	30,000
Provision for tax	<u>70,000</u>
Net profit before interest and tax	<u>5, 00,000</u>

Interest on dentures 30,000

$$\text{Interest coverage ration} = \frac{5,00,000}{30,000} = 16.67 \text{ times}$$

3. <u>Activity or turnover ratios:</u>

-this ratio is also referred as asset management ratio. The activity ratio measures how effectively an organization manages its assets. Activity ratio is classified as.

1. **Inventory (stock) turnover ratio: -** this ratio establishes a relationship between costs of goodssold and average inventory. This ratio is calculated as.

$$\text{Inventory turnover ratio} = \frac{\text{Costs of goods sold}}{\text{Average inventory}}$$

Cost of goods sold =opening stock +purchases +direct expenses – closing stock.

(Or)

Cost of goods sold = Net sales –gross profit

Net sales = sales – sales returns

$$\text{Average inventory} = \frac{\text{opening stock + closing stock}}{2}$$

(Or)

$$\text{Average inventory} = \frac{\text{inventory}}{2}$$

Problem 1. Calculate stock turnover ratio in the following cases.

a) Cost of goods sold	2 00000
Average stock	40000
b) Sales	2 20000
Average stock	40000
Sales return	20000
Gross profit	20% on sales.
c) Opening stock	21000
Closing stock	29000
Purchases	1 00000
Wages	10000

Solution:

a) Inventory turnover ratio = $\frac{\text{Costs of goods sold}}{\text{Average inventory}}$

Inventory turnover ratio= $\frac{200000}{40000}$ = 5 times.

b) Inventory turnover ratio = $\frac{\text{Costs of goods sold}}{\text{Average inventory}}$

Cost of goods sold = Net sales –gross profit

Net sales = sales – sales returns

Net sales = 2, 20,000 - 20,000 =2, 00,000

Gross profit 20% on sales = net sales x 20%

2, 00,000x 20% =40,000

Cost of goods sold = 2, 00,000- 40,000= 1, 60,000

Inventory turnover ratio= $\frac{1,60,000}{40000}$ = 4 times.

c) Inventory turnover ratio = $\frac{\text{Costs of goods sold}}{\text{Average inventory}}$

Cost of goods sold =opening stock +purchases +direct expenses – closing stock

Cost of goods sold =21000 +100000 +10000 – 29000

=131000 – 29000

=102000

Average inventory = $\frac{\text{opening stock + closing stock}}{2}$

Average inventory = $\frac{21000+ 29000}{2}$

$$= \frac{50000}{2}$$

$$= 25000$$

$$\text{Inventory turnover ratio} = \frac{10\,2000}{25000} = 4.08 \text{ times.}$$

2. **Debtor's turnover ratio: -** this ratio establishes a relationship between net credit sales andaverage debtors. This ratio is calculated as.

$$\text{Debtors turnover ratio} = \frac{\text{Net credit sales}}{\text{Average debtors}}$$

Net credit sales= total sales – cash sales

$$\text{Average debtors} = \frac{\text{Opening debtors + closing debtors}}{2}$$

2. Problem:-calculate the debtors turnover ratio .if total sales is Rs 250000, cash sales Rs 70000 debtors is the opening is Rs 16000,and closing Rs 24000.

Solution:-

$$\text{Debtors turnover ratio} = \frac{\text{Net credit sales}}{\text{Average debtors}}$$

Net credit sales= total sales – cash sales

= 250000– 70000

=180000

$$\text{Average debtors} = \frac{\text{Opening debtors + closing debtors}}{2}$$

$$= \frac{16000 + 24000}{2}$$

$$= \frac{40000}{2} = 20000$$

$$\text{Debtors turnover ratio} = \frac{180000}{20000} = 9 \text{ times}$$

4. Profitability ratios:-profitability refers to the ability of the business to earn profit. It shows the efficiency of business. These ratios measure the profit earning capacity of the company. The profitability of the business can be measured with the following ratio.

1. Gross profit ratio
2. Net profit ratio
3. Operating ratio

1. Gross profit ratio:-this ratios measure the relationship between gross profit and net sales. The main objective of computing this ratio is to determine the efficiency with which production or purchase operation are carried on .this ratio calculated as

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

Net sales = sales – sales returns

2. Net profit ratio:-this ratio measures the relationship between net profit and net sales. The main objective of computing this ratio is to determine the overall profitability due to various factors such as operations efficiency .trading on equity etc. this ratio calculated as

$$\text{Net profit ratio} = \frac{\text{Net profit}}{\text{Net sales}} \times 100$$

3. Operating ratio:-this ratio measures the relationship between operating cost and net sales. The main objective of computing this ratio is to determine the operational efficiency. This ratio calculated as

$$\text{Operating ratio} = \frac{\text{Operating cost}}{\text{Net sales}} \times 100$$

***Problem:-**the following is the profit and loss a/c of Alpha Company the year ending 31-3-2017*

To opening stock	26,000	By sales	1,60,000
To purchases	80,000	By closing stock	38,000
To wages	24,000		
To production expenses	16,000		
To gross profit	52,000		--------
	1,98,000		1,98,000
To selling &distribution	4000	By gross profit	52,000
To administrative expenses	22,800	By compensation for land	
To general expenses	1,200	Acquisition	4,800
To furniture fire loss	800		
To interest on debentures	6,000		
To provision for tax	8,000		
To net profit	14,000		----------
	56,800		56,800

Calculate, gross profit, operating and net profit ratio.

Solution:-

1. Gross profit ratio= $\frac{\text{Gross profit}}{\text{Net sales}} \times 100$

Gross profit ratio= $\frac{52{,}000}{1{,}60{,}000} \times 100$

32.5%

2. Net profit ratio= $\frac{\text{Net profit}}{\text{Net sales}} \times 100$

Net profit ratio= $\frac{14{,}000}{1{,}60{,}000} \times 100$

= 8.75%

$$3.\ \text{Operating ratio} = \frac{\text{Operation cost}}{\text{Net sales}} \times 100$$

Operating cost= cost of goods sold +operating expenses

Cost of goods sold = sales – gross profit

= 1, 60,000 – 52,000 =1, 08,000

Operating expenses = selling distribution expenses +administrative expenses +general expenses

= 4,000+22,800+1,200 =28,000

$$\text{Operating ratio} = \frac{1,08,000 + 28,000}{1,60,000} \times 100$$

$$\text{Operating ratio} = \frac{1,36,000}{1,60,000} \times 100$$

= 85%

Problem 2: Following information is given by a company from its books of accounts as on march 31/2021.

Particulars	Rs.
Inventory	100000
Total current assets	160000
Shareholders' funds	400000
13% Debentures	300000
Current liabilities	100000
Net profit before tax	351000
Cost of revenue from operations (Cost of goods sold)	500000

Calculate: 1) current ratio.2) Liquid ratio 3) Debt equity ratio 4) Interest coverage ratio 5) Inventory turnover ratio. (April 2022)

Solution:

1.) $$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\text{Current ratio} = \frac{160000}{100000}$$

$$= 1.6$$

2.) $$\text{Liquid ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

Quick assets =total current assets – inventory

=160000- 100000

= 60000

$$\text{Quick ratio} = \frac{60000}{100000}$$

$$= 0.6$$

3.) $$\text{Debt equity ratio} = \frac{\text{Long term loans}}{\text{Shareholder funds}}$$

$$\text{Debt equity ratio} = \frac{300000}{400000} = 0.75$$

4.) $$\text{Interest coverage ratio} = \frac{\text{Net profit before interest and tax}}{\text{Interest}}$$

$$\text{Interest coverage ratio} = \frac{351000}{39000} = 9$$

5) $$\text{Inventory turnover ratio} = \frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

$$\text{Average inventory} = \frac{\text{Inventory}}{2}$$

$$= \frac{100000}{2} = 50000$$

$$\text{Inventory turnover ratio} = \frac{500000}{50000} = 10 \text{ times}$$

Problem 3: From the following information calculate:1)Gross profit ratio 2) stock turnover ratio

	Rs.		Rs.
Sales	150000	Cost of goods sold	120000
Opening stock	27000	Closing stock	33000
Debtors	14000	Bills receivables	6000

(May /June 2017- 5M)

Solution:

1) $$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

Gross profit= sales – cost of goods sold

= 150000 – 120000

= 30000

$$\text{Gross profit ratio} = \frac{30000}{150000} \times 100$$

=20%

2) $$\text{Inventory turnover ratio} = \frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

$$\text{Average inventory} = \frac{\text{Opening stock + closing stock}}{2}$$

$$= \frac{27000+33000}{2} = 30000$$

$$\text{Inventory turnover ratio} = \frac{120000}{30000} = 4 \text{ times}$$

Problem 4: calculate current ratio and quick ratio for the following date:

Data	Rs
Cash and bank balance	120000
Debtors and bills receivables	180000
Closing stock	100000
Creditors and bills payables	150000
Bank overdraft	50000

(April 2022-10M)

Solution:

1.) $$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Current Assets		current liabilities	
Cash and bank balance	120000	creditors and bills payables	150000
Debtors and bills receivables	180000	bank overdraft	50000
Closing stock	100000		
Total current assets	400000	Total current liabilities	200000

$$\text{Current ratio} = \frac{400000}{200000}$$

$= 2$

2.) $$\text{Liquid ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

Quick assets =total current assets – stock

=400000 - 100000

= 300000

$$\text{Quick ratio} = \frac{300000}{200000}$$

$= 1.5$

Essay questions

1. Define financial accounting, Explain the importance and limitations of financial accounting.

2. Explain double –entry book keeping and classification or types of accounts

3. Distinguish the advantages and limitations of ratio analysis

4. Define financial ratios. Explain the types of financial ratios.

Short questions

a. Define financial accounting

b. List different types of accounts.

c. Define current ratio and liquid ratio.

d. Define ledger

e. What is double entry system?

f. Write about single entry book-keeping

g. Write examples of current assets

h. What is profitability ratio?

i. Define journal

J. Define ratio analysis