OSF

Date : 10-03-2024 **STD 12 Commerce Elements of Account** Total Marks : 40

12th Account Practice Sheet Day 12 (Part 2 - Ch.5)

Section A

*** Choose The Right Answer From The Given Options.** **[5]**

1. In which terms ratios are presented ?

   (A) Proportion (B) Percentage (C) Time (D) All of the given

   Ans. : (D) All of the given

2. The cost of goods sold of a company is ₹ 10,00,000 Operating expenses are ₹ 2,00,000 Non-operating expenses are ₹ 3,00,000. Financial expenses are ₹ 1,00,000 If total sales is ₹ 20,00,000, determine operating profit ratio.

   (A) 20 (B) 40 (C) 30 (D) 28

   Ans. : (B) 40%

3. Liquidity ratio is ....

   (A) measurement of solvency

   (B) measurement of short-term profitability

   (C) measurement of profitability

   (D) measurement of liquidity

   Ans. : (D) measurement of liquidity

4. Working capital means ....

   (A) difference between current assets and non-current assets

   (B) difference between current liabilities and non-current assets

   (C) difference between current assets and non-current liabilities

   (D) difference between current assets and current liabilities

   Ans. : (D) difference between current assets and current liabilities

5. Which asset is to be subtracted from current asset to get liquid assets?

   (A) Prepaid expense (B) Cash and bank balance (C) Debtors (D) Bills receivables

   Ans. : (B) Cash and bank balance

Section B

*** Answer The Following Questions In One Sentence.** **[4]**

6. In order to arrive at trade receivables is bad debt reserve deducted from debtors?

   Ans. : No, in order to arrive at trade receivable bad debts reserve will not be deducted from debtors.

7. By which ratios efficiency is measured?

Ans. : With the help of following ratios, efficiency is measured.

- (1) Stock Turnover
- (2) working capital turnover
- (3) Debtors turnover
- (4) Creditors turnover.

8. What are operating expenses ?

Ans. : Coming soon ...

9. Relationship between which variables is disclosed by gross profit ratio.

Ans. : Coming soon ...

Section C

*** Answer The Following Questions. [15]**

10. Explain three objectives of ratio analysis.

Ans. : Following are the objectives of ratio analysis.
1. To know profitability status of the entity: In accounting, the profitability of the business can be measured by applying the ratio analysis in different forms.

2. For financial statement analysis: Ratio analysis works as indicator to the users of financial statements. Different stakeholders undertake analysis of profit and loss statements and balance sheet. I make this analysis meaningful and useful ratio analysis is used.

3. To know the liquidity status of the entity: The liquidity ratio explains the capacity to meet short term liabilities of the entity. From the liquidity, short term solvency of the business can be measured.

4. To know operating efficiency of business entity: Different types of assets are acquired by the business entity, for measurement of effective and efficient use of assets, ratio analysis is useful. For this turnover ratio is used.

5. For forecasting: The trend of respective items can be seen by ratio analysis. This trend can be useful to the company to undertake planning and forecast.

6. The information about weak aspects: There may be overall good results of the business entity. Out of different aspects like profitability, liquidity, solvency or efficiency, there may be weak performance of anyone aspects and good performance of other aspects. By ratio analysis, each aspect is evaluated personally. So the information for weak aspects can be obtained and necessary remedies can be undertaken.

11. Describe three limitations of ratio analysis.

Ans. : Main three limitations of ratio analysis can be as under :
1. Absence of standard ratios: Any individual ratio does not provide any analysis or interpretation. The use of ratios can be established only when the standard ratios

are available for comparison. If standard ratios are not determined, the computed ratios become useless.

2. Influence of price changes: The base for ratio analysis is financial statement. Financial statements are prepared with historical information and in historical information the effect inflation is not considered which is also a limitation.

3. Difficulty in comparison: When two same category, business entities, follow different accounting policies, then information obtained by ratio analysis becomes useless, e.g. method of depreciation, method of stock valuation etc.

4. Limited Utility: The utility of ratios calculated on the basis of only one year is limited For the comparison the figures of the previous year and those of the current year is not much useful. If possible the figures of the firm ought to be compared with those of a firm similar business.

5. Factors Neglected: It is obvious that a business is affected by external and internal factors, competition and total economic condition of the country. But these factors are not included in the calculation of ratios. Since they are calculated on the past figures, they have limited utility.

12. When are the computed ratios useful?

Ans. : Individual ratio does not indicate any type of favourable or unfavourable situation. For making analysis of financial statements more useful and meaningful comparison of ratio analysis is included in it. Individual ratio present only result but when computed ratio copmpared with any standards or with certified ratio then it is useful, i.e. current ratio of net profit is 25%, which gives only result, but in last year it was 20% and in current year it is 25% then we can compare it and get conclusion from it.

13. Explain the traditional classification of ratios.

Ans. : In traditional classification, the computation of accounting ratio is done on the basis of financial statements. In this statement trading account, profit and loss account and balance sheet are included.
Traditional Classification

- For computation of ratios of Trading A/c and profit-loss A/c values at numerator and denominator are taken from these accounts only. Similarly for balance sheet ratio, computation. values of numerator and denominator are taken from balance sheet only.
- For computation of composite ratios, one component is taken from Trading A/c or Profit and Loss A/c and other is taken from Balance Sheet

14. Explain the approaches of proprietary funds.

Ans. : There are two approaches used to determine the owner’s funds. Under both the approaches owners’ funds remain identical.
1. Liabilities Based Approach: As per this approach ;

Owners’ funds = Equity share capital + Preference share capital + Reserves and surplus – Debt balance of P & L A/c (if any).

2. Assets Based Approach: As per this approach ;
Owners’ funds = Non-current Assets + Current Assets – Non-current liabilities – Current liabilities.

Section D

*** Answer The Following Questions With Necessary Calculations.** **[16]**

15. Calculate stock turnover ratio from the following information of ‘Y’ Company Limited:

Particulars	(Rs.)	Particulars	(Rs.)
Opening stock	2,00,000	Closing stock	1,50,000
Sales	40,00,000	Purchases	22,00,000
Purchase expenses	10,00,000	Wages	2,50,000

Ans. :

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

$= \frac{2,00,000+1,50,000}{2}$

= Rs.1,75,000

Cost of goods sold = Opening stock + Purchase + Purchase expense + Wages Closing stock
= 2,00,000 + 22,00,000 + 1,00,000 + 2,50,000 - 1,50,000
= Rs.26,00,000

Stock turnover $= \frac{\text{Cost of goods sold}}{\text{Average stock}}$

$= \frac{26,00,000}{1,75,000}$

= 14.85 Times

16. From the following information of ‘N' Company Limited, calculate debt-equity ratio :

Particulars	(Rs.)	Particulars	(Rs.)
Creditors	1,60,000	Non-current assets.	12,00,000
Bills payables	1,40,000	Current assets	10,00,000
Outstanding expenses	1,00,00	Total liabilities	10,00,000

Ans. :

Debt: Non-current liabilities		
Total liabilities		10,00,000
Less: Current liabilities		
Creditors	1,60,000	

Bills payables	1,40,000	
Outstanding expenses	1,00,000	4,00,000
Debt:		6,00,000

Equity: Total assets - Total debt.

Noncurrent assets	12,00,000
Current assets	10,00,000
	22,00,000
Less: Total liabilities	10,00,000
Equity:	12,00,000

Debt – equity Ratio $= \frac{\text{Debt(Non} - \text{Current liabilities)}}{\text{Equity(Shareholder's Funds)}}$

$= \frac{6,00,000}{12,50,000}$

= 0.5:1

17. From the following information of 'M' Limited, calculate debt-equity ratio:

Particulars	(Rs.)	Particulars	(Rs.)
Current liabilities	4,50,000	Long-term liabilities	8,00,000
Long-term provisions	6,00,000	Total assets	30,00,000

Ans. :

Non-current debt :		
Long-term liabilities		8,00,000
Long-term provisions		6,00,000
		14,00,000
Equity (Shareholder's funds):		
Total assets		30,00,000
Less: Long-term liabilities	8,00,000	
Long-term provisions	6,00,000	
Current liabilities	4,50,000	18,50,000
		11,50,000

Debt – equity Ratio $= \frac{\text{Debt(Non} - \text{Current liabilities)}}{\text{Equity(Shareholder's Funds)}}$

$= \frac{14,00,000}{11,50,000}$

= 1.22:1

18. Explain any one ratio of solvency.

Ans. :

Solvency ratio is used to measure how far the business entity is competent enough to pay long term liabilities.

- Following are the solvency ratio.
- (1) Debt to equity ratio (2) Total assets to debt ratio
- (3) Proprietary ratio (4) Interest coverage ratio
- Explanation of Debt-equity ratio:

$$\text{Formula} = \frac{\text{Debt}(\text{Non}\frac{\text{Current}}{\text{Long}}\text{Term liabilities})}{\text{Equity}(\text{Shareholder's Funds})}$$

- The objective of this ratio is to know the proportion of owner's capital and borrowed funds which are acquired by the business as a long term source of finance.
- Here long term liabilities means long term borrowings deferred tax liabilities, other long term liability and long term provisions etc.
- Shareholder's funds = Equity share Capital + Preference share capital + Reserves and surplus - Debit balance of profit-loss A/c
- If debt to equity ratio is higher, it indicates that the business unit is more dependent on the borrowed funds and it is risky from the lenders point of view.
- If debt to equity ratio is low, it means business unit is less dependent on the borrowed funds and it is not risky from the lenders point of view.

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