Principles of Accounting-II
Class 12

COMPANY FORMATION

1) Differentiate between the public and private limited company

The difference between public company and private company can be explained on the following basis:

Numbers of members: In a public company, the minimum number of member is 7 whereas the maximum number is not specified. On the other hand, private company can be established by a single person and maximum member is specified.

Transfer of share: The shareholder of a public company can freely transfer their shares. Butshareholder of private company cannot transfer their shares without consent of other shareholders.

Issue of Shares: Public company's share can be issued openly for all people whereas shares are not openly distributed to public in private company.

Use of word 'limited': A public limited company has compulsory to use the word 'limited' toat the end of its name. For example, Nepal Bank Limited. In case of private companies, it is for them to attach 'private limited' as the last word in its name.

2) Mention any three features of the company

The main three features of a company are as follows:

a) **Limited liabilities:** The shareholder liability is limited to the face value of the shares that theyhave purchased.
b) **Artificial Legal Person:** A company is identified as an artificial person recognized by law. It can hold and deal with any type of property of which it is the owner in any way it likes, can enter into contracts, open bank account in its own name.
c) **Transfer of shares:** The shareholders of the public limited company can transfer their shares freely without of the consent of the company and others shareholders. But for the transfer ofthe shares of a private company, permission has been taken from other shareholders.

3) Define Public Limited Company.

A public limited company is one which requires at least 7 members for its incorporation. There is no restriction on issue or transfer of its shares and this type of company can invite the public to purchase its shares and debentures.

4) Memorandum of Association (MOA)

Memorandum of Association (MOA) is the main document of a company. It is the legal document that has to be filed with the registrar of companies at the time of incorporation of the company. It is often called as a memorandum and is comprised of fundamental conditions on the basis of which a company operates. The memorandum of association shall include the following matters

- The name of the company,

- The registered address of the company,
- The objectives of the company,
- The figure of the authorized capital of the company and the figure of the share capital to be issued by the company for time being and the figure of undertaken to be paid by the promoter of the company,
- Types of shares of the company, the rights, and powers inherent in such shares, the value of each share and number of shares of different types.
- Number of shares which the promoters have undertaken to subscribe for the time being,
- Terms of payments of share amounts,
- Statements that the liability of shareholders shall be limited,
- The maximum number of shareholders in case of a private company etc.

5) Article of Association (AOA)

Article of Association (AOA) is the document containing all the rules and regulations to run a company. It defines the overall company's purpose. It the document which tells what is the procedure for appointing the board of directors, recording the financial transaction, conducting a general meeting, issuing shares and so on. It is comprised of rules and regulations that govern the company's internal affairs. It includes:

- Share capital, call of share, forfeiture of share, conversion of share into stock, transfer of shares, share warrant, the surrender of shares, etc.
- Directors, their qualifications, appointment, remuneration, powers, and proceedings of the board of directors meetings.
- Voting rights of shareholders, by poll or proxies and proceeding of shareholders general meetings.
- Dividends and reserves, accounts and audits, borrowing powers and winding up.

6) Prospectus

A company's prospectus is a formal legal document designed to provide information and full details about an investment offering for sale to the public. A public company shall publish its prospectus prior to issuing its securities publicly. It contents:

- The details of introduction, objectives and management of the company.
- Capital Structure of the company
- Estimated income of the company for at least three years.
- Condition of issue of share i.e. par, premium or discount and mode and terms of payment. Etc.

7) Define Registered Company.

These are those companies, which are formed by registration under the Company Act. The provision of Company Act, Memorandum of Association and Articles of Association represent the activities of such companies. Private company and public company are the examples of Registered company.

SHARE AND SHARE CAPITAL OF A COMPANY

8) Difference between Equity shares and Preference shares

Below are the two differences between equity shares and preferences shares:

a) **Voting Right:** Equity shareholders enjoys voting right, but preference shareholders lacks voting right.

b) **Refund of capital:** Equity share capital is refunded only after of preference share capital in case of liquidation. Preference shareholders have prior right to refund the capital over equity shareholders.

c) **Conversion:** Preference shares can be converted into equity shares whereas equity shares are non-convertible.

9) Define Share capital, issued capital and subscribed capital.

- **Share Capital**: The share capital of a company is usually divided into certain numbers of unit of a fixed amount. These units are called shares. A share refers to a fractional part of the capital. So, the individual unit of capital owned by a shareholder is called a share.
- **Issued capital**: It is that part of authorized capital which offered to the public for subscription. The company issues only those numbers of shares, which are sufficient to meet the present financial requirement of the company.
- **Subscribed capital**: It is the share capital actually subscribed by public. It can never exceed the issued capital. The issued share capital, which has not been subscribed by the public, is called under subscription of capital.

10) Authorized Capital

It is a maximum amount of capital that a company can raise as mentioned in the MOA. It is also known as registered or nominal capital. A company can increase its authorized capital by fulfilling necessary legal provisions.

11) Define Preference shares.

Preference share are risk free and return on investment at certain fixed rate is fixed. Preference share are the shares issued by the company which have the right to received specified rate beforepaid on equity shares. The dividend is pre-determined in case of preference shares.

12) Calls is Arrear and Calls in Advance

Calls in arrears are unpaid amount by shareholders as per call notice of the company till the last date of payment. The company can charge interest in case of Calls in Arrear.

Calls in advance are prepaid amount by shareholders before making call. The company has to pay interest to shareholders as per the provision made in AOA (Article of Association).

13) Re-issue of forfeited share

When a share is forfeited, it is a property of the company. The directors are authorized to re-issue such shares at par, premium or discount. The re-issue amount is debited to bank account and credited to share capital account. The re-issued share at discount should not exceed the forfeited amount.

14) **What do you mean by 'Pro-rata allotment'?**

When shares issued is oversubscribed, applicants may be allotted shares in fixed proportion. This is called pro-rata allotment. The proportion depends upon the shares offered and share applied. For example, if company allots 5,000 shares to the applicant of 8,000 shares. It is pro- rata allotment in the proportion of 5:8.

ACCOUNTING FOR DEBENTURES

15) **Define Debenture.**

Debenture is a medium- to long-term debt instrument used by large companies to borrow money, at a fixed rate of interest. So, a debenture represents a debt. The interest rate is pre-determined. The holders of debenture are called debenture holders. Following are the features of debentures:

Written promises: it contains a promise to repay the principal amount after a certain period. Itis a written document of loans issued by a company to its holders. It also contains a promise ofperiodic payment of interest at a fixed rate.

Certificate: it is issued by a company and is usually in the form of a certificate which is an acknowledgement of a debt.

16) Difference between Shares and Debentures

SHARES	DIFFERENCES	DEBENTURES
The shares are owned by the funds of the company	Meaning	The debentures are the borrowed funds of the company
Represent the capital of the company	What is it?	Represent the debt of the company
Known as shareholder	Holder	Known as debenture holder
Owners	Status of holder	Creditors
Get the dividend	Form of return	Get the interest
No	Security of payment	Yes

17) **Convertible and Non-Convertible Debentures**

Debentures can be classified as Convertible and Non-Convertible Debentures, on the basis of conversion.

Convertible debentures are a type of debentures that can be converted into equity shares of the company.

Non-convertible debentures are defined as the type of debentures that cannot be converted into equity shares of the company.

FINAL ACCOUNT OF A COMPANY

18) What is Balance Sheet?

A balance sheet is a financial statement that reports a company's assets, liabilities and shareholders' equity at a specific point in time.

FINANCIAL STATEMENT ANALYSIS

19) Define Financial Statement

Financial Statements are formal records of the financial activities and position of a business, person, or other entity. Relevant financial information is presented in a structured manner and in a form which is easy to understand. It mainly includes: a) profit and loss a/c b) balance sheet c) cash flow statement.

20) Objectives of financial statements.

Financial statement analysis (or financial analysis) is the process of reviewing and analyzing a company's financial statements to make better economic decisions to earn income in future. These statements include the income statement, balance sheet, cash flow statement and so on.

The three objectives of financial statement are as follows:

- To predict solvency position: Financial statement facilities to establish the capacity of a business to repay its loan and interest with its own resources.
- To know profitability and business growth: the financial statement clearly shows the Business activities whether it is running at a profit or not.
- To provide liquidity position: the financial statement must represent its financial soundness in the short-term. It can establish whether a business has sufficient current assets to meet its current liabilities or not.

21) Limitation of financial statement

The limitations of financial statement are as follows:

- Historical in nature: It is based on historical figures only. They disclose the past result and the position of the entity of the past. So, they fail to provide present position and future prospects of the business.
- Only interim reports: These statements have been prepared on the basis of accounting period concept. So, result and position disclosed by financial statement is interim in nature.
- Record only monetary facts: Financial statement discloses only monetary facts. It does not represent qualitative information like public relation, quality of management etc. which cannot be measured in monetary terms.
- Wrongful Analysis: Sometimes, financial statement analysis can perform wrongful analysis because of biasness and misleading information.

22) Importance of financial statement.

Following are the importance of financial statement:

- It accesses the past and current position of the company.
- If offers valuable information for decision making to top-level management.

- They offer information related to profitability and operation cost.
- They are useful for financial institutions to make loan decision.

23) Objectives of financial statement analysis.

Following are the main objectives of analysis of financial statement:

- To know the profitability/ business growth of the business organization.
- To compare financial and operating efficiency of the organization.
- To know the solvency position of the business organization.

24) Limitation of financial statement analysis.

Following are the main limitation of financial statement analysis:

- **Short coming of tools of analysis**: There are many tools of analysis available to the analyst, which tools are to be used in a particular situation depends on the expertise of the analyst. If awrong tool is used, it may give misleading result.
- **Ignores the qualitative elements**: They provide information relating to past only. They fail to reflect the qualitative elements like efficiency of management. So, the outcome of analysis cannot be taken as final judgments.
- **Difficulties in Adjusting Price level changes**: The quick changes in the value of money inthe present day economy also reduce the validity of analysis. It is only a record of historical facts. So, it cannot represent the current value of the business.

25) Parties interested in Financial Statement of the company.

The parties interested in financial statement of the company are:

- Shareholders
- Management
- Lenders
- Creditors/ Suppliers
- Government
- Employees

RATIO ANALYSIS

26) Ratio Analysis

In Mathematics, a ratio indicates how many times one number contains another. In Accounts, Ratio analysis is used as technique to quantity the relationship between two or more sets of financial data taken from financial statements like income statement and balance sheet. It provides the information relating to strengthen and weakness of a financial data in relation to other.

27) Two Objectives of Ratio Analysis

The two objectives of Ratio analysis are:

- Judge the operating efficiency of the firm.

- Measure the short-term and long-term financial position of the firm.

28) Limitations of ratio analysis.

The limitations of ratio analysis are as follows:

- Ignores the Qualitative factors
- Difficulties in adjusting Price level changes
- Based on past facts
- Limitation of accounting period

29) Current Assets

Current assets: Those assets, which are held for their conversion into cash normally within year or immediately or already in cash. For example, cash, bank balance, inventory, debtors, etc.

30) Fixed Assets

Fixed assets are those assets which are purchased for long-term use and are not likely to be converted quickly into cash. For example, land, buildings, and equipment.

31) Current Liabilities.

Current liabilities: Those liabilities which to be paid normally within year or immediately. For example, creditors, account payable, etc.

32) Long Term Liabilities

Long Term liabilities are those accounts which can be repaid after the period of one year. It affects the long-term financial position of the firm. Long term loans, debentures, bonds, etc. are the examples of long-term liabilities.

33) Write about gross profit margin and net profit margin.

Goss profit margin: This ratio measures the relationship between gross profit and net sales. Computing this ratio determine the efficiency which production and or purchase operation and selling operation carried on.

Gross Profit Margin = Gross Profit/ Net Sales x100%

Net profit margin: This ratio shows the relationship between net profit and net sales. Computing this ratio determine the overall profitability due to various factors such as operational efficiency.

Net Profit Margin = Net Profit/ Net Sales x100%

34) Average Collection Period

It refers to the period in which the debtors are collected on an average basis. It is also named as receivable collection period. It shows the period within which debts are collected.

Average Collection Period = Days in a year/ Debtor turnover ratio

FUND FLOE STATEMENT

35) Define Fund Flow Statement

The funds flow statement is a statement that presents the movement of funds and is a report of financial operation of the business undertaking. It is prepared to know the sources and application of the funds during an accounting period. It is prepared by comparing two years' balance sheet figures and additional information.

For knowing the financial activities of a company is known as funds flow statement.

36) Fund from Operation

It is fund generated in a business as a result of carrying out the operations during the normal course of business. It is calculated through the difference between operating revenue and operating expenses. It is different from Net Profit which is calculated considering both operating and non-operating activities.

COST ACCOUNTING

37) Cost Accounting

- Cost accounting is a form of managerial accounting that aims to capture a company's total cost of production by assessing the variable costs of each step of production as well as fixed costs, such as a rent expense.
- Cost accounting is used internally by management in order to make fully informed business decisions.
- This helps the organization in cost controlling and making strategic planning.

38) Difference between Cost and Financial Accounting

Cost Accounting

Cost Accounting	Financial Accounting
It is an accounting system through which an organization keeps the track of various costs incurred in production.	It is an accounting system that captures the record of financial information about the business to show the correct financial position of the company.
Both historical and pre-determined cost are used.	Only historical cost are used.
It is mostly used by manufacturing concern.	It is maintained in almost all types of business concern.
Its objective is to determine the cost of production and facilitate you cost control and decision-making.	Its objective is to determine the profit / loss and financial position of the firm.

39) Importance/ Advantage/Need of Cost Accounting

- Classification of Costs (prime cost, direct cost, factory cost, selling cost etc.)
- Price Determination
- Control Cost

40) Four Objectives of Cost Accounting

- Determine cost of production and per unit cost
- Determine the selling price per unit (SPPU).
- To help control the cost
- To evaluate efficiency of the firm

41) Three Functions of Cost Accounting

- To ascertain the cost of product
- Determine SPPU of the product
- To analyze and control the cost

COST CLASSIFICATION

42) What do you mean by cost?

Cost is the amount of expenditure incurred while manufacturing any products or rendering any services. It represents the resources that have been sacrificed while producing products or services. It can also be defined as the monetary value sacrificed for obtaining goods or services or converting raw material into finished goods.

43) Direct cost and Indirect cost

Direct cost: A direct cost is a price that can be directly tied to the production of specific goods or services. A direct cost can be traced to the cost object, which can be a service, product, or department. For example, direct labour, direct material, etc.

Indirect cost: Indirect costs are expenses that apply to more than one business activity. Unlike direct costs, you cannot assign indirect expenses to specific cost objects. For example, indirect material, indirect labour, etc.

44) Functional classification of cost

On the basis of function, the cost can be classified into production cost, administration cost, selling and distribution cost.

Production cost is inclusive of all direct material, direct labor, direct expenses and manufacturing expenses.

Administrative cost is incurred for carrying the administrative function of the organization.

Selling cost refers to the cost of selling function.

45) Variable cost and Semi-variable cost.

Variable cost: The variable cost is a cost that tends to vary in accordance with level of activity within the relevant range and within a given period. Direct materials, direct labor and direct expenses tend to vary in direct proportion to the level of activity.

Semi-variable cost: Semi-variable costs are those costs, which are partly fixed and partly variable. Both fixed and variable costs are included in these cost. It is also known as semi-fixed cost. These costs remain constant up to certain level of production and increase beyond that level of production. Telephone charges, electricity charges, insurance charges are the examples of semi- variable costs.

46) Controllable cost and uncontrollable cost

Controllable cost: A cost which can be influenced by the action of a specified number of an undertaking is known as controllable cost. For examples, direct material, direct labor.

Uncontrollable cost: A cost which cannot be influenced by the action of specified number of an undertaking is known as uncontrollable cost. For examples, Rent, rates, taxes.

47) Fixed Cost

Fixed cost means that cost tends to be unaffected with the volume of output. It is also known as period cost. It is called fixed because the total cost remains constant in spite of any changes in output. Rent, Permanent staff salaries are the examples of fixed costs.

48) Variable Cost

Variable costs are costs that change as the quantity of the good or service that a business produces changes. For example, cost of direct materials.

ACCOUNTING FOR MATERIALS

49) Material Control

Material refers to the commodities required to the manufacturing industry to manufacture the finished product or render service. Materials control is a system which ensures that right quality of material is available in the rightquantity at the right time and right place with the right amount of investment.

50) Objectives of Material Control

- Reduce the cost of material
- Minimize wastage
- Ensure smooth flow of production
- Reduce under and over stocking of material

51) Duties of a storekeeper

- To periodically check bin card balance with physical balance.
- To maintain stores in a tidy manner.
- To accept materials after proper verification of documents.

52) What is bin card?

Bin card is the statement of all the receipts and issue of the stock from the store department. It is also called stock card or bin tag. It is the responsibility of the store keeper to write every in and out of stock from the store. The physical stock count and the stock quantity reported according to the bin card should be equal; otherwise internal audit department will have the right to investigate the matter with management.

53) Specimen of a bin card.

ABC Company

Specimen Bin Card Format

Bin card #: Code #: Material name: Location: Stores ledger folio:	Maximum stock level: Minimum stock level: Recorder level: In charge:

Date	Receipts		Issues		Balance	Checked & Verified By		
	G.R.N	Qty	Requisition #	Qty	Qty	Date	Name	Initial

54) What do you mean by classification and codification of materials?

Classification is the process of grouping of each material either on the basis of their nature or on the basis of their usages.

Codification is the process for assigning symbol for each item in accordance with a proper arrangement. So, except its name, an item of material is also known by the symbol allotted in it.

55) Material Purchase Process

The purchase department follows the following procedures to control at the time of purchase:

- Request for materials from the department requiring the material.
- Locating source of material and supplies
- Receiving of material.

56) Sketch a specimen of purchase requisition form?

Purchase Requisition Form is prepared by the storekeeper for regular store. A formal request made by the department concerned to the purchasing department to order goods in written form is known as purchase requisition form.

ABC Concern

Purchase Requisition Form

S.No. .... Date: ....

Department: ....

The Manager

Purchase Department

Please purchase the following items which are required latest by ....

Serial No.	Items code No.	Quantity	Description	Remarks

Requested by .... Approved by ....

For use in purchase Department

Date	Purchase order no.	Name of supplier	Date of delivery	Remarks

57) Perpetual Inventory System

A perpetual inventory system is an inventory management method that records when stock is sold or received in real-time through the use of an inventory management system that automates the process. A perpetual inventory system will record changes in inventory at the time of the transaction.

58) Decentralized Purchasing

Decentralized purchasing refers to purchasing materials by all departments and branches independently to fulfill their needs. Decentralized purchasing helps to purchase the materials immediately in case of an urgent situation.

Advantages

- Materials can be purchased by each department locally as and when required.
- Materials are purchased in right quantity of right quality for each department easily.
- No heavy investment is required initially.
- Purchase orders can be placed quickly.
- The replacement of defective materials takes little time.

Disadvantages

- Organization losses the benefit of a bulk purchase.
- Specialized knowledge may be lacking in purchasing staff.
- There is a chance of over and under-purchasing of materials.
- Fewer chances of effective control of materials.
- Lack of proper co-operation and co-ordination among various departments.

59) Centralized Purchasing

In this system, the other entire department should send purchase requisition to the centralized purchasing department to make timely and suitable purchases.

ACCOUNTING FOR LABOUR

60) Difference between Time Rate and Piece Rate Wage system

Based of differences	Time rate	Piece rate
1. Basis of wages	Wages is calculated on the basis of time spent by the worker on the jobs.	Wages is calculated on the basis of output or production.
2. Idle time	There is a possible of excessive idle time in this system.	There is a less chance of idle time in this system.
3. Quality of work	The quality of work is good as there is no pressure to produce more goods.	The quality of work may not be good because of pressure to produce more goods.
4. incentive	There is a lack of incentive for the efficient and honest workers.	It encourages motivated workers to produce more and earn more.
5. Control and supervision	Control and supervision are needed as the workers may not work properly.	It encourages motivate workers to produce more and earn more.
6. suitability	If the quality is more concerned than quantity, this method is suitable.	If the quantity is more concerned than quality, this method is appropriate.
7. equality	All the workers get equal wages under this method irrespective of the output.	The works with high output get higher wages and vice versa.

61) Advantages and Disadvantages of Piece Rate Wage System

Advantages

- Simplicity
- No payment for Idle time
- Easy to calculate amount of wage
- More suitable to the beginners.

Disadvantages

- Less attention to quality
- No guarantee of minimum wages
- Adverse effect on worker's health

62) Advantages and Disadvantages of Time Rate Wage System

Advantages

- Ensures Quality
- Unity among workers
- Avoids over speeding and damages of equipment

Disadvantages

- No incentive to the efficient workers
- Dissatisfaction among the efficient workers
- Go-slow policy
- Payment for idle time

ACCOUNTING FOR OVERHEAD

63) What do you mean by overheads?

In simple words, all the expenses except direct material, direct labour and other direct expenses are called overhead. The overheads are the aggregate of all indirect costs such as indirect materials, indirect wages and other indirect expenses.

64) Classification of overheads

According to its function

Overheads can be classified according to various basis. According to functions, overheads can be classified as:

- Production overhead (factory rent, insurance, depreciation on machinery, etc.)
- Office and Administrative overhead (office rent, tax, staff's salary, depreciation of office assets, etc.)
- Selling and Distribution overhead (advertisement, salesman commission, showroom expenses, etc.)

According to control

Controllable overhead (idle time wages, consumable materials, etc.)
Uncontrollable overhead (depreciation of assets and other fixed costs)

According to Behaviour

Fixed overhead: Fixed Overheads are the costs that remain unchanged with the change in the level of output. That is, such expenses are incurred even if there is no output produced during the specific period. (rent of building, interest on loan, etc.)
Variable overhead: Variable Overheads are the costs that change with a change in the level of output.

That is, such expenses increase with increasing production and decrease with decreasing production. (indirect material, indirect labour, etc.)

Semi-variable overhead: As the name suggests, the semi-variable costs are the expenses that are partially fixed and partially variable. That is, these expenses remain fixed only up to a certain level of output. In other words, such expenses would increase if the output goes beyond such a level. (Electricity charges, landline bill, etc.)

65) Difference between Allocation and Apportionment of overhead with suitable examples.

Basis For Difference	**Overheads Allocation**	**Apportionment**
Introduction	Allotment of total overheads to the certain cost center	Distributing the overhead costs to the different cost centers
Represents	Entire overhead costs	Part of overhead costs
Assigned	On direct basis	On proportional basis
Applicable	When total overhead cost is related to a single unit	When total overhead cost belongs to different units
Examples	Salary of sales manager	Salary of General manager