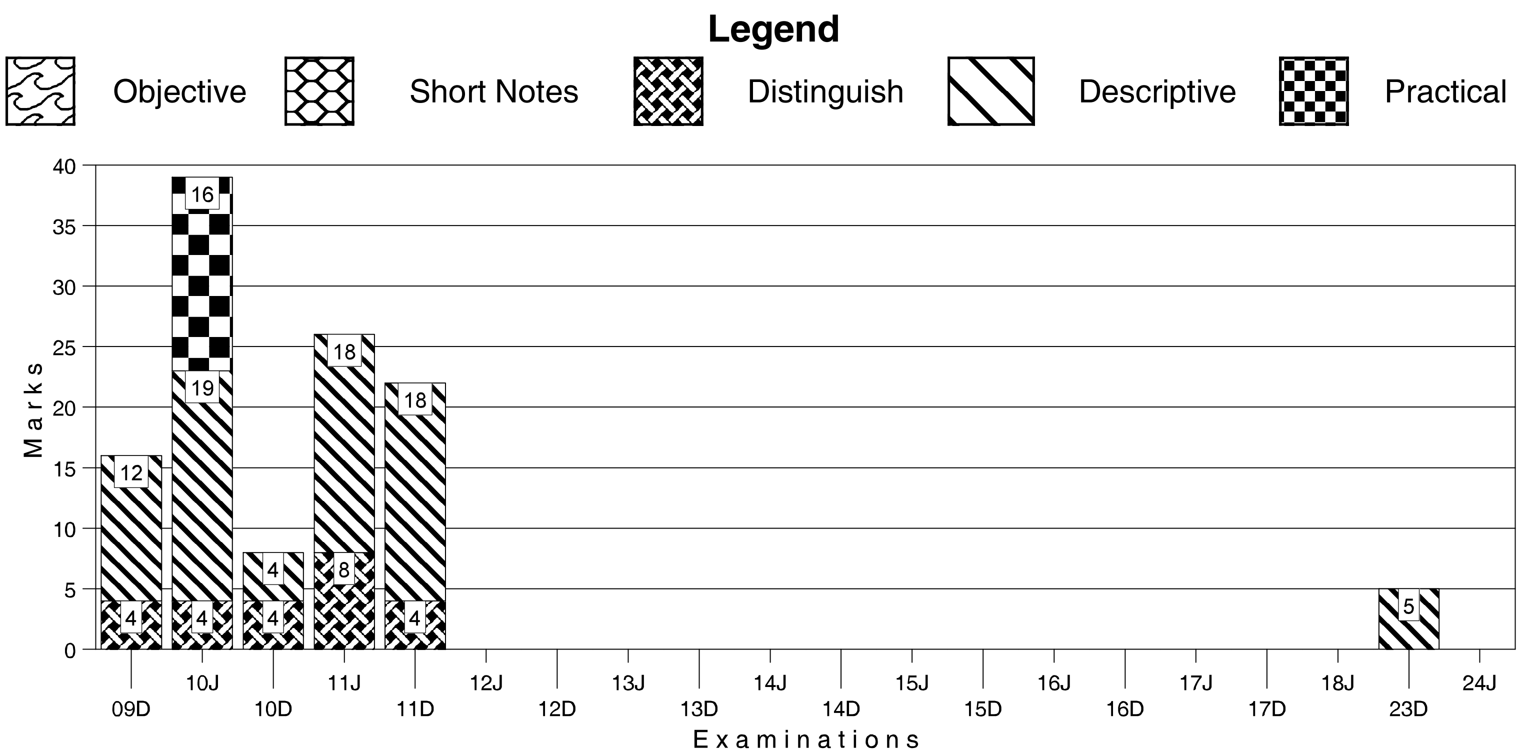
Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



1 INTRODUCTION TO ACCOUNTING

THIS CHAPTER INCLUDES

CHAPTER AT A GLANCE

⇒ A description of proper Accounts is also found in "Arthashastra" written by Kautilya.

⇒ Modern day accounting concept was originated by "Luca Pacioli" in Italy.

⇒ Accounting is the process of collecting, recording, summarizing and communicating financial information.

⇒ This financial information is communicated to the users i.e. proprietor, creditors, investors, government etc.

⇒ As per the definition of American Institute of Certified Public Accountants -
Accounting is "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least, of a financial character and interpreting the results thereof".

Characteristics (attributes) of Accounting

(i) Accounting records transactions and events which are of financial nature.

(ii) Accounting is an art.

A subject is an art, if it helps us in attainment of a given objective. The main aim of accounting is to ascertain financial result and hence it is an art.

(iii) It involves the following activities: recording, classifying and summarizing

Recording: Writing down the transactions and events in the book systematically and chronologically.

Classifying: Process of grouping transactions of similar nature.

Summarizing: Preparation of reports or results from the classified data.

(iv) Accounting helps in determining the financial position of an enterprise by analysing and interpreting the summarized records and communicating them to users.

(v) Accounting information can be manipulated and thus cannot be considered as the true test of performance.

(vi) It records transactions in terms of money.

Objectives of Accounting

(i) Maintaining accounting records

(ii) Ascertaining profit/loss of the enterprise

(iii) Ascertaining the financial position of the enterprise

(iv) Providing accounting information to the users.

Functions of Accounting

(i) Maintaining systematic records

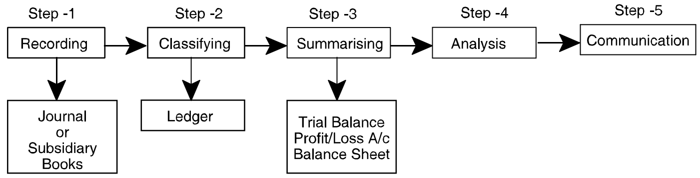
(ii) Protecting and controlling business properties

(iii) Ascertaining the operational profit/loss

(iv) Ascertaining financial position

(v) Facilitating rational decision making.

Process of Accounting/Stages of Accounting



Branches or sub fields of Accounting

(i) **Financial Accounting:** It is concerned with recording of financial data and ascertaining results thereof. It is directed towards preparation of trial balance, P/L A/c and Balance Sheet.

(ii) **Cost Accounting:** Accounting for the cost of the product is known as cost accounting. It helps in cost ascertainment and cost control.

(iii) **Management Accounting:** It helps the management in decision making, increasing efficiency and maximizing profit.

Advantages of Accounting

(i) Provides financial information about the business to interested parties

(ii) Helps in comparison of financial results
- — Comparison of its own results of different years
- — Comparison of financial results with other firms in the industry

(iii) Helps in decision making

(iv) Accounting information can be used as an evidence in legal and taxation matter

(v) Helps in valuation of the business

(vi) Maintenance of business record

(vii) Preparation of financial statements

Disadvantages (Limitations) of Accounting

(i) Accounting ignores non monetary transactions

(ii) Accounting information is sometimes based on estimates which may be unrealistic

(iii) Window Dressing may lead to faulty results.

Note: Window Dressing
The term window dressing means manipulation of accounts in such a way so as to conceal the important facts and show a rosy picture of the financial statements. It is mainly done to attract investors.

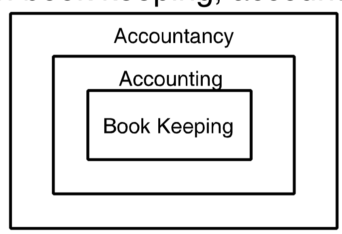
(iv) Accounting ignores the effect of price level changes as the recordings are done at historical costs. Fixed assets are recorded at historical cost. (v) Accounting information can be manipulated and thus can not be considered as the true test of performance. i.e. it. may be biased. Money as measurement unit changes in value. (vi) Accounting information may be biased. Accounting information is not without personal influence or bias of accountant.
Book Keeping
• Book keeping is a branch of knowledge that educates us how the financial records are maintained. Due to being clerical in nature, it is done by junior employees. • It is concerned with recording financial data of the business in a significant and orderly manner. • It is meant to show the effect of all the transactions made during the accounting period on the financial position of the business. • Book keeping is a clerical work which covers procedural aspects of accounting work and includes record keeping function. It is science and art both. • Book keeping is mechanical and repetitive.
Book Keeping and Accounting
(i) Book keeping and accounting are often used interchangeably but they are different from each other (ii) Book keeping is a part of accounting. Accounting requires more skill, experience and imagination. (iii) Book keeping involves only recording of financial data whereas accounting also involves analysing, interpreting and communicating financial information to users. (iv) We can say, book keeping is the first stage of accounting or in simple words “Accounting begins where book keeping ends”.

Basis	Book Keeping	Accounting
1. Scope	Book keeping is concerned with identifying financial transactions, measuring them in money terms, recording and classifying them.	Accounting is concerned with summarising the recorded transactions, interpreting them and communicating the results.
2. Stage	It is a primary stage and constitutes the base for accounting.	It is the secondary stage. It begins where book keeping ends.
3. Performance	Junior staff performs this function.	Senior staff performs this function.
4. Nature of Job	This job is clerical and routine in nature.	This job is analytical and dynamic in nature.
5. Objective	The objective of Book keeping is to maintain systematic records of financial transactions.	The objective of accounting is to ascertain net results of operations and financial position and to comm-unicate information to the interested parties.
6. Structure	Done in accordance with basic accounting concepts and conventions.	Method and procedure for analysis and interpretations may vary from firm to firm.

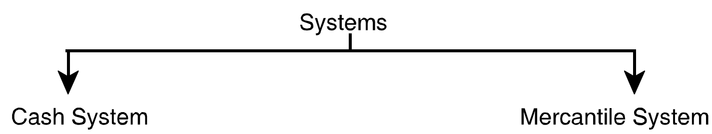
Accountancy

- Accounting include design of accounting system which book-keepers use.
- This work requires more skill, experience and imagination.
- Accountancy refers to the systematic knowledge of accounting.
- Accountancy is an area of knowledge whereas accounting is a process of recording data.
- The application part of accountancy is known as accounting.

- Relationship between book keeping, accounting and accountancy.



Systems of Accounting



Cash System

- Accounting is done not when the transaction takes place but when cash is paid or received.
- No entry is made when a payment or receipt is due.

Example

If the transaction took place in the previous year but the cash is received in the current year, the recording will be done in the current year.
For e.g. In case of professionals i.e. doctor, CA, CS etc. In such the financial statements prepared by them for determination of their income is termed as receipt and expenses A/c.

Merits of Cash System

(i) This method is less complex as the recording is to be done when cash is received or paid. (concepts of accrued or due not used).

(ii) It is most suited where credit transactions are almost negligible and collections are uncertain and where the organisation is small.

Demerits of Cash System

(i) Cash system of accounting violates the matching principle which states that expenses should be matched with their revenues and should be shown in the same year.

(ii) Financial statements prepared under cash system do not show a true and fair view of books of account.

Accrual or Mercantile System of Accounting

- Under this system, transactions are recorded when they occur and not when cash is realised.
- Accrual system of accounting complies with the matching principle which means it relates the revenue earned to the cost incurred during a given period.
- Mercantile system of accounting is widely used and recognized by the business enterprises.
- Costs which are not charged to income are carried forward and are kept under continuous review.

Users of accounting information

Users

Internal Users
⇒ Owners/Shareholders
⇒ Managers
⇒ Employees
⇒ Creditor/Suppliers

External Users
⇒ Government
⇒ Prospective investor
⇒ Regulatory agencies
⇒ Customers
⇒ Researchers
⇒ Bankers

Accountant

Accounting is a clerical work and the person involved in this work is known as an accountant.

Role of Accountant

An accountant performs the following functions:

(i) Maintenance of books of accounts

(ii) Performing audits (conducted by Chartered Accountant)

⇒ Statutory Audit

⇒ Internal Audit

(iii) Performs budgeting

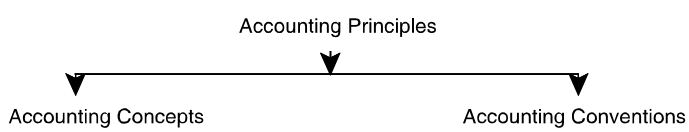
Budgeting means planning of business activities and after the completion of activities comparing the actual results with the planned results to know the variations.

(iv) Handling taxation matters

(v) Carrying out investigations

(vi) Giving advices to the management

(vii) Any other business work.



Accounting Principles, Accounting Concepts and Accounting Conventions

Accounting Principles	**Accounting Concepts**	**Accounting Conventions**
Scientifically laid down guidelines to establish standard for sound accounting practices and procedure. Accounting principles are a body of doctrines commonly associated with the	Accounting concepts define the assumption on the basis of which financial statements of an entity are prepared.	Accounting conventions emerge out of accounting principles which are adopted by the enterprises over a period of time. These are derived by usage and practice.

theory and procedures of accounting, serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternative exists.		⇒ Profit loss and Balance Sheet are prepared according to it.

Accounting Concepts

1. Going Concern Concept

It is on this concept that a clear distinction is made between assets and expenditure.
This concept assumes that business shall continue for an indefinite period. The proprietor has no intention to close it in the near future and would be able to meet its obligations according to plan.
Due to this concept :

(i) Assets are valued at cost and then depreciated every year.
(ii) Expenses and incomes are classified into capital and revenue.

2. Business Entity Concept

- According to this concept, business and its owners are separate entities.
- The owner is treated as the creditor of the company to the extent of capital contributed by him.
- All transactions of the business are recorded in the books of business from the point of view of business.
- This concept keeps the personal affairs of the owner away from the business affairs.
- Income or profit is the property of the business unless distributed among the owners.

3. Money Measurement Concept

- As per this concept, only those transactions which can be expressed in terms of money can be recorded.
- Transactions and events which cannot be expressed in terms of money, even if they affect the business, are not recorded in the books.
- Income or profit is the property of the business unless distributed among the owners.

  Example: Death of the director, disputes within the organisation, strikes, etc. may affect the working and profits of the business, but are not recorded in books of accounts.
- Measuring unit for money is the currency of the ruling country.

  Note:

  Entity and money measurement are considered as the basic concepts on which other procedural concepts depend.

4. Cost Concept

- According to this concept, the value at which the various assets shall be recorded in the books shall be the historical cost or acquisition cost.
- This concept says that the assets shall be recorded at cost at the time of its purchase and its value shall be reduced systematically by charging depreciation.
- This concept helps to keep the statements free from personal bias or judgements.
- This concept is not beneficial for new investors as they are more interested in knowing the present worth of the business rather than its historical cost.

5. Dual Aspect Concept

- According to this concept, every transaction has two aspects, a debit aspect and a credit aspect.
- Due to these two aspects, the total amount debited is always equal to the total amount credited (i.e. total assets are equal to total liabilities).

Note: Concept of Accounting Equation :

Accounting equation is based on the dual aspect concept.

Assets: These are the resources owned by the business.

Liabilities: These are the claims against the assets.

Liability to owners — capital

Liability to outsiders — liabilities.

As per the dual aspect concept, at any point of time, total assets of a business are equal to total liabilities.

Hence, based on above, the following equation can be framed :

Assets = Liabilities + Capital

OR

Capital = Asset - Liabilities

6. Realisation Concept

- According to this concept, revenue is recognized only when sale is made.
- This concepts says that any change in the value of an asset is to be recorded only when business realises it.
- This concept prevents business firms from inflating their profits by showing expected incomes. (which have not yet materialised)
- E.g. An increase in the value of asset cannot be considered as a profit until and unless the asset is sold and profit is realised.

Note : Going concern + Cost Concept + Realization Concept = Valuation criteria

7. Accrual Concept

- It is fundamental to the usefulness of financial accounting information.
- According to this concept, a transaction should be recorded at the time when it takes place and not when the cash is realised.
- Every transaction and event effects, one or more or all the three aspects, assets, liabilities and capital.
- They have their impact on both the Profit & Loss A/c and Balance Sheet.

- This concept implies that income should be measured as a difference between revenue and expenditure.

8. Accounting Period Concept

- This is also known as the concept of periodicity.
- According to this principle, the life of an enterprise is broken into smaller periods (generally one year) know as accounting period.
- The main objective of this concept is to know the performance of the enterprise at regular intervals.
- Accounting period is an interval of time at the end of which the income or revenue statement and balance sheet are prepared in order to show the results of the operations.

9. Matching Concept/Revenue match Concept

- Based on accounting period concept
- As per this concept, expenses of a period should be matched with the revenues of that period.
- It says, the cost incurred to earn the revenue should be recognized as expenses in the period when revenue is recognized.
- Matching principle requires that all revenues earned during an accounting year, whether received or not and all cost incurred, whether paid or not, have to be taken into account while preparing Profit/Loss Account. In the same manner all amounts received or paid during the current year but pertaining to the previous year or the next year should be excluded from current year's revenue and cost.
- The term matching means appropriate association of related revenues and expenses.

Accounting Conventions

1. Consistency

- According to this convention, accounting practices once selected and adopted should be applied consistently year after year.
- This convention helps in comparison of financial statements.

•	Consistency does not mean that accounting principles once adopted can never be changed. They can be changed, if the change is desirable.
2.	**Disclosure**
•	This is also known as the "Full disclosure" principle.
•	According to this convention, all significant information should be fully and fairly disclosed in the financial statements.
•	Ensuring this convention increases the relevance and reliability of financial statements. The companies act make ample provision for disclosure of essential information.
3.	**Conservatism**
•	The concept of conservatism states that we should not anticipate a profit but should provide for all possible losses while preparing financial statements.
•	It enables the financial statements to show a realistic picture of the state of affairs of the enterprise.
•	This convention understates the assets and overestimates the liabilities.
•	Financial statement are usually drawn up on a conservative basis.
•	Choice between two methods of valuing an asset, the accountant should choose a method which leads to lesser value.
4.	**Materiality**
•	According to the convention of materiality, accountant should record only those items which are material and ignore all insignificant items.
•	An item is said to be material if it is likely to influence the decision of the users. (like investors etc.)
•	Judgement of materiality depends from organisation to organisation and on the basis of professional experience and judgement.
Accounting Standards	
•	Accounting standards are the written policy documents guiding the measurement, treatment and disclosure of financial transactions.

- Accounting standards are issued by the regulatory body known as the "Institute of Chartered Accountants of India".
- The Institute of Chartered Accountants of India constituted Accounting Standard Board (ASB) on 21st April, 1977 for making these standards.
- The main objective of setting standards is to bring uniformity and harmony in the financial statements and enabling consistency and comparability in the data established by the enterprise.

Accounting Policies

- Accounting policies refers to specific accounting principles and the methods of applying those principles.
- Accounting policies are based on accounting concepts, principles and conventions.
- Choice of accounting policy is an important decision and hence, the following basis should be considered while choosing accounting policies:
  - (i) Prudence
  - (ii) Substance over form
  - (iii) Materiality.

Accounting Concept	Accounting Conventions
1. Theoretical idea forming a set of practices	Method or procedure accepted by general agreement
2. Not based on accounting conventions	Based on Accounting concept
3. Non internally consistent	Internally inconsistent
4. Personal judge has no role in adoption	Personal judgement may play crucial role
5. Established by law	Established by common accounting practices
6. Uniform application in all firm	Not so in conventions

Note:

Areas where different accounting policies are used:

(i) Methods of depreciation/depletion/amortization.

(ii) Valuation of inventories

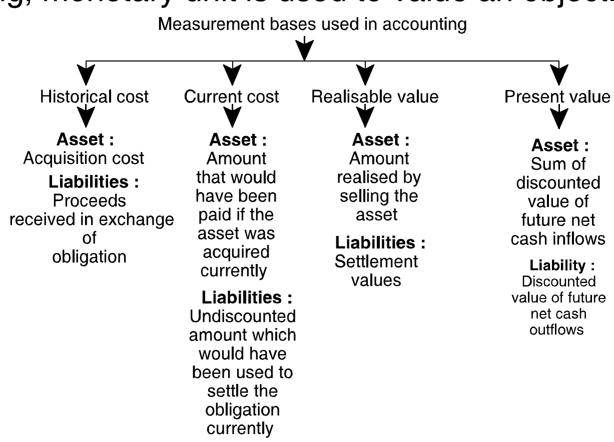
(iii) Treatment of goodwill

(iv) Valuation of investments

(v) Valuation of fixed assets, etc.

Accounting as a Measurement of Discipline

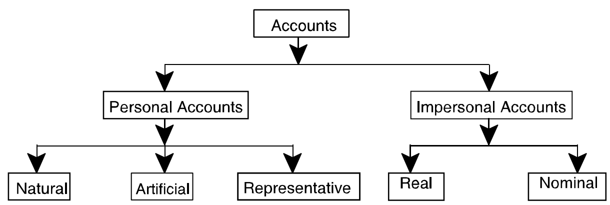
- Measurement means assigning numerical values to specific attributes. In accounting, we take money as a measurement tool.
- There are three elements of measurement:
  - (i) Identification of objects and events
  - (ii) Selection of standards or scale
  - (iii) Evaluation of dimensions of measurement standard or scale.
- Value refers to the benefits to be derived from objects, abilities or ideas.
- Measurement and valuation do not mean the same thing. Valuation is a part of measurement.
- Measurement is a broader concept than valuation.
- Valuation is an economic concept.
- In Accounting, monetary unit is used to value an object.



Accounts

An account is an individual records of a person, firm, thing and item of an income or expense.

Classification of Accounts



Personal Accounts

(i) **Natural personal account:** It relates to transactions of human beings like Ram, Shyam etc.

(ii) **Artificial (legal) personal account:** Business entities have a separate identity from that of its owners. These business entities are said to be artificial legal person. For e.g. : companies, clubs, co-operative societies.

(iii) **Representative personal accounts:** These accounts are not in the name of any person but are represented as personal accounts. For e.g: outstanding liability, prepaid account, capital account, drawings account etc.

Impersonal Accounts

(i) **Real Account :** Accounts which relate to the assets of the firm are known as real accounts e.g - Cash A/c, Building A/c, Investment A/c etc.

(ii) **Nominal Accounts :** Accounts which relate to expenses, losses, gains, revenue etc. are nominal accounts e.g - salary account, interest paid account, dividend-received account etc.

Notes:

- Real Accounts can be divided into tangible real accounts and intangible real accounts.
  Tangible Real Accounts - Land, building etc.
  Intangible Real Accounts - Goodwill, patent, copyright etc.
- Bank balance is an asset but bank account is not a real account but a personal account because it is an account of some banking company which is an artificial person.
- According to Kohler Dictionary for Accounts, an account has been defined as a formal record of a particular type of transaction expressed in money.

Systems of Record Keeping

There are two system of record keeping:
(i) Single Entry System
(ii) Double Entry System

Single Entry System

(i) Under this system some entries are recorded partially and some are entirely eliminated.
(ii) It is also known as accounting from incomplete records.
(iii) This system is economical and time saving but is unscientific and not reliable.

Double Entry System

(i) Under this system, every transaction has two aspects - debit and credit and at the time of recording a transaction, it is written once on the debit side and again on the credit side of another account.
(ii) This is a system which recognizes and records both aspects of a transaction.

Features of Double Entry System

- Complete record of transactions
- Recognizes dual aspect of every transaction.
- Under this, one aspect is debited and other is credited.
- The accounts will always balance.

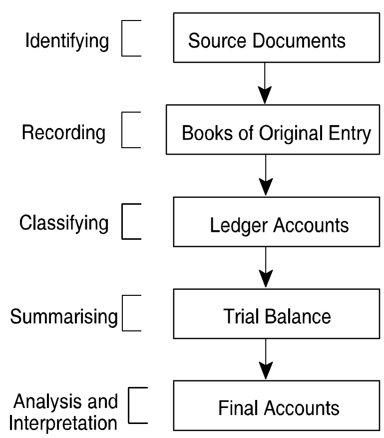
Merits of Double Entry System

- Keeps complete record of transactions.
- Keeps a check on arithmetical accuracy of accounts.
- Helps in the preparation of final accounts.
- Chances of frauds and errors are less.

Accounting is the language of business.

— Warren Buffet

Accounting cycle/Accounting process



Recording — Journal

⇒ A journal is a book of original entry/prime entry wherein transactions are first recorded before being posted to the ledger.

⇒ A journal is that book of accounts in which transactions are originally recorded in a chronological order.

⇒ An entry done in a journal is called a journal entry and the process of recording a transaction in a journal is known as journalising.

⇒ A journal records both debit and credit aspects of a transaction.

⇒ A journal contains the following columns :

(i) **Date:** The date on which the transaction took place.

(ii) **Particulars:** The two aspects (debit and credit) are recorded here.

(iii) **Ledger Folio (L.F.) :** It records the page number in the ledger in which the accounts of the given entry are posted.
(iv) **Amount (Debit) :** Debit amount is recorded in the Dr. column.
(v) **Amount (Credit) :** Credit amount is recorded in the Cr. column.

Ledger (Principal Book of Accounts)

- A ledger may be defined as a "book or register which contains in a summarized and classified form, a permanent record of all transactions".
- It is a book which contains all set of accounts - (real, personal, nominal).
- Ledger is known as a principal book of account as it helps in the preparation of Trial Balance and financial statements (like P/L, B/S etc.)

Difference between Journal and Ledger

Basis	Journal	Ledger
1. Nature of Book	It is a book of primary entry.	It is a book of final entry.
2. Basis for Preparation	Primary documents (such as vouchers, receipts etc.) are the basis for recording transactions in the journal.	Journal is the basis for recording transactions in the ledger.
3. Stage of Recording	Recording in the Journal is the first stage.	Recording in the ledger is the second stage.
4. Process	The process of recording in Journal is called journalising.	The process of recording in the ledger is called posting.

Subsidiary Book

- Subsidiary books are the journals in which transactions of similar nature are recorded at the first instance.

- Recording all the entries in the journal will make the journal too lengthy and complicated. So for similar nature transactions separate journals are prepared which are known as subsidiary books.
- The transactions will first time be recorded in subsidiary books.

Types of subsidiary books

1. Purchase Book

It records the **credit purchase** of goods **traded in.**
Ex- Stationery dealer purchased stationery in credit from Ram.

1. Entries in the Purchase Book are made from the Invoice received from supplier at the end of week/month, total of Purchase Book is Debited to Purchases A/c in ledger.
2. Entries in the purchase books are made from the invoice received from the supplier.

2. Sales Day Book

1. It records the credit sale of goods dealt in (traded in) Ex- Furniture dealer sold furniture on credit.
2. Sales Book is prepared on the basis of copies of invoice sent to customers.

3. Purchase Return Book (Return Outward Book)

It records the goods or material returned to the supplier that have been purchased on credit. When goods are returned to the supplier a debit note is issued to him indicating that his account has been debited with the amount mentioned in the debit note.

4. Sales Return Day Book (Return Inwards Book)

It records the goods or material returned by the purchaser that had been sold on credit. When goods are returned by a customer a credit note is sent to him mentioning that his account has been credited with the value of goods returned.

5. Bills Receivable Book
It records the bills of exchange or promissory note received by a business entity.
6. Bills Payable Book
It records the acceptance given to the creditor in the form of bills or promissory notes.
7. Cash Book
It is used to record all cash transactions of the business.
8. General Journal OR Journal Proper
All entries which cannot be recorded in the above subsidiary books are recorded in this book. **E.g.** opening entries, closing entries, rectification entries, purchase and sale of asset etc. In Journal proper book, following types of transactions are recorded: 1. opening journal entry 2. closing journal entry 3. adjustment entry 4. transfer entry 5. rectification entry 6. purchase of fixed asset/stationary on credit 7. sale of worn out or obsolete assets on credit
Trial Balance
• "A trial balance is a statement prepared with the debit and credit balances of the ledger accounts including cash and bank balances to test the arithmetical accuracy of books". • Trial balance is a statement and not an account and it is **not** a part of double entry system. • As per double entry system, totals of debit shall always be equal to totals of credit. To check this trial balance is prepared. All the accounts

showing either a debit balance or a credit balance are placed in the trial balance and the debit and credit balances of the accounts are placed at the debit and credit columns respectively. At last, total of debit and credit columns are done. • If both sides are equal - the accounts are arithmetically correct. However, there may be some hidden errors.
Objectives of Trial Balance
(i) Check arithmetical accuracy of ledger accounts. (ii) Helps in preparation of final accounts. (iii) Helps in detection of errors.
Methods of Preparing Trial Balance
(i) Totals method: Here totals of debits and credit columns of ledger accounts are taken to the trial balance. **(ii) Balance method:** Here the debit or credit balances of the ledger accounts are taken to the debit or credit column of trial balance respectively.

DISTINGUISH BETWEEN

2000 - June [4] (b) Distinguish between `balance sheet' and `statement of affairs'. **(8 marks)**

Answer:

Balance Sheet	Statement of Affairs
• It is prepared only from ledger accounts	• It is prepared from ledger balances and partly from other particulars and estimates etc.
• Capital account is taken from the ledger	• Capital account is excess of asset over liabilities.

• Accuracy can be assumed in balance sheet. • In it omission of an item can easily be located as both the sides if balance sheet will not tally. • The values of an asset or liability can be taken as the relevant. Transactions are posted in the respective accounts of general ledger. • It depicts the financial position of the business on a particular date.	• Accuracy can not be assumed • Omission of assets and liabilities can not be traced easily • The values of assets are arbitrary in the statement of affairs. • It also shows the financial position as well as it helps in ascertaining the trading profit or loss for a particular period.

2000 - Dec [2] Distinguish between the following:

(iii) 'Capital receipts' and 'revenue receipts'. **(8 marks)**

Answer:

Capital Receipts	Revenue Receipts
• Receipts of non recurring nature are called capital receipts	• Receipts of recurring nature are called revenue receipts.
• Capital receipt is a substitution of a source of income.	• Revenue receipts is a substitution of an income.
• Amount is realized by sale of fixed assets.	• Amount is realized by sale of goods.
• Amount realized by sale of shares or debentures is a capital receipt.	• Amount realized by rendering services is a revenue receipt.
• Capital asset being given up, to the surrender of certain rights under an agreement is a capital receipt.	• Amount received as compensation under an agreement for the loss of future profits is a revenue receipt.

2001 - June [3] (a) Distinguish between `trade discount' and `cash discount'. **(8 marks)**

Answer:

Trade Discount	Cash Discount
• It is allowed to promote the sales.	• It is allowed to encourage quick payment.
• It is allowed on purchase of goods.	• It is allowed on payment of money.
• It is shown a deduction in the invoice itself.	• It is not shown in the invoice.
• Trade discount a/c is not opened in the ledger.	• Cash discount a/c is opened in the ledger.
• It may vary with the quantity purchased	• It may vary with the time period within which the payment is received.

2002 - June [4] (b) Distinguish between 'profit and loss account' and 'balance sheet'. **(5 marks)**

Answer:

Profit and Loss A/c	Balance Sheet
• It provides a 'historical' review of the accounts of the past transaction. i.e, how profit is earned or loss is incurred.	• It gives a static picture of the financial position as on the last day of the accounting period.
• It is itself an account.	• It is a statement of assets and liabilities.
• It is prepared for the accounting period ended.	• It is prepared as at the last day of the accounting period.
• The accounts that are transferred to Profit and Loss A/c are closed and cease to exist.	• The accounts that are transferred to the balance sheet do not lose their identity and become the opening balances for the next period.

2002 - Dec [2] Distinguish between —

(i) 'Capital expenditure' and 'revenue expenditure'. **(8 marks)**

Answer:

Capital Expenditure	Revenue Expenditure
• It is incurred in acquiring or improving permanent assets which are not meant for resale.	• It is a routine expenditure incurred in the normal course of business and includes cost of sales and also the upkeep of fixed assets etc.
• It seeks to improve the earning capacity of the business.	• It purposes to maintain the earning capacity of the business.
• It is normally nonrecurring outlay.	• Revenue expenditure is usually a recurring item.
• It produces benefits over several years. Hence, only a small part is charged to income statement as depreciation and the rest appears in the balance sheet.	• It is consumed within an accounting year and the entire amount is charged to the current years income statement. Hence it does not appear in the balance sheet. (Deferred Revenue expenditures is however an exception).

2003 - Dec [2] (b) Distinguish between the following :

(i) 'Accrual basis of accounting' and 'cash basis of accounting'.

(4 marks)

Answer:

Accrual Basis of Accounting	Cash Basis of Accounting
• It takes into account the monetary effect of the events or transactions in the period in which they are earned.	• The financial effect of the transactions is recorded only in the period in which cash is received.
• Under this, items such as prepaid, outstanding expenses, and	• Such items do not appear in the cash basis of accounting.

accrued income received in advance etc are shown, in the balance sheet.	
• Accrual Basis of accounting is recognized under the Companies Act- 1956.	• Cash basis of Accounting is not recognized under the Companies Act-1956.

2004 - Dec [2] (b) Distinguish between the following:
(iii) \`Provision' and \`reserve'. **(4 marks)**

Answer:

Provision	Reserve
• It is created for specific purposes.	• It is created for probable losses.
• It is a charge to profit and loss A/c	• It is an appropriation of profit.
• It cannot be distributed as profit.	• It can be distributed as profit.
• It cannot be invested in securities.	• It can be invested in securities
• It is made because of legal necessity	• It is a matter of financial prudence.
• Provision is shown by way of deduction from the amount of the items for which it is created	• It is shown separately under Reserves and Surplus on the liabilities side of the Balance Sheet.

2008 - Dec [2] (b) Distinguish between the following :
(ii) 'Statement of affairs' and 'balance sheet' **(4 marks)**

Answer:

Statement of affairs

Statement of Affairs	Balance Sheet
• The primary purpose of statement of affairs is to show the financial position as well as ascertaining the trading profit or loss for a particular period.	• Balance sheet is to show the financial position of the business on a particular date.

• It is prepared from ledger accounts as well as other estimates, etc. • In statement of affairs, accuracy cannot be assumed. • Omission of assets and liabilities cannot be traced early. • The value of assets can be arbitrary in a statement of affairs. • Capital can be taken as the excess of assets over liabilities. • Trial balance is not prepared.	• It is prepared with the help of ledger account only. • Accuracy can be assumed in a balance sheet. • Omissions of an item can be early traced since both sides of the balance sheet will not tally. • In balance sheet, the balance of any asset or liability can be taken as true as the relevant transaction are posted in their respective accounts. • Capital account is taken from the ledger itself. • Trial balance is prepared before balance sheet.

2009 - June [2] (b) Distinguish between the following :

(iii) 'Trading account' and 'profit and loss account'. **(4 marks)**

Answer:

	Trading A/c	**Profit and Loss A/c**
(a)	Trading A/c is prepared to calculate the gross profit or loss for a particular period.	Profit & Loss A/c is prepared to ascertain net profit or loss.
(b)	In this account, cost of goods sold, sales and direct expenses are accounted.	In this account, indirect expenses such as administrative expense, selling expenses, etc. are charged against gross profit and other incomes.
(c)	The gross profit or loss is transfered to Profit & Loss A/c.	The net profit or loss is transfered to capital account in the balance sheet.

2009 - Dec [2] (b) Distinguish between the following :

(i) 'Book keeping' and 'accounting'. **(4 marks)**

Answer:

S.N.	Book-keeping	Accounting
1.	The main objective of book-keeping is to maintain systematic records of financial transactions.	The main objective is to ascertain the net profit or loss and the financial position of the business.
2.	Book-keeping is the primary stage.	Accounting is the secondary stage. It starts where book-keeping ends.
3.	It is a routine function and clerical in nature and performed by junior staff.	It is analytical in nature and performed by senior staff.
4.	It is done in accordance with basic accounting concepts and conve-ntions and performed by persons having limited level of knowledge.	The methods and procedure for accounting may vary from firm to firm because it is analytical and performed by persons having higher level of knowledge.

2010 - June [2] (b) Distinguish between the following:

(iii) 'Trial balance' and 'balance sheet'. **(4 marks)**

Answer:

Trial Balance	Balance Sheet
1. It is prepared to check the arithmetical accuracy of the books of accounts.	It is prepared to know the time financial position of the business.
2. Though desirable, its preparation is not necessary.	It is necessary to prepare a balance sheet.
3. All types of accounts whether personal, real or nominal must be there.	Only personal and real accounts are there in a balance sheet.

4. Closing stock does not appear in the trial balance.	Closing stock is shown on the assets side of the balance sheet.
5. It is prepared every month or whenever needed.	It is usually prepared at the end of the accounting year.
6. It cannot be served as documentary evidence in a Court of law	It is accepted by the court as documentary evidence.

2010 - Dec [2] (b) Distinguish between the following :

(i) 'Journal' and 'ledger'. **(4 marks)**

Answer:

Journal	Ledger
(a) The transactions are recorded first in the Journal as this is referred as 'book of primary entry'	(a) All the transactions entered in Journal are later transferred to ledger. As such, it is called a, 'book of final entry'.
(b) Transactions are entered in a chronological order as and when they occur. This process of recording is called 'journalising'.	(b) Transactions are recorded in an analytical order and this is known as 'posting'.
(c) These books are considered more authentic and reliable as they are the book of original entry.	(c) Ledger is considered as less authentic and reliable as entries are recorded at a later stage.
(d) Final accounts/statements cannot be prepared with the help of books of original entry.	(d) Final statements can be prepared with the help of ledger balances.
(e) Accuracy of these books cannot be tested.	(e) Accuracy of the ledger accounts is tested by preparing a Trial Balance.

2011 - June [2] (b) Distinguish between the following :

(i) 'Real account' and 'nominal account'. **(4 marks)**

(ii) 'Revenue expenditure' and 'deferred revenue expenditure'. **(4 marks)**

Answer:

(i) Real accounts represent the properties of a business concern, which can be classified as tangible assets and intangible assets such as furniture, Machinery and goodwill, trade marks, etc. Rule for Journalising real accounts is :-

Dr. what comes in

Cr. what goes out

all the balances of real accounts are taken to Balance Sheet of the concern. On the other hand, Nominal accounts represent expenses, losses and incomes, gains of a business concern. For example- rent, wages, discount received, interest received, etc.

Rule for Journalising nominal accounts is :-

Dr. all Expenses and losses

Cr. All Incomes and Gains

Nominal Accounts are closed by transfer to Trading and Profit & Loss Account of the concern.

(ii)

Revenue Expenditure	**Deferred Revenue Expenditure**
(a) Any expenditure, the benefit of which is received during the current year is termed as Revenue Expenditure. For example- wages & salaries, Manufacturing expenses, etc.	Any Expenditure whose benefit is extended over a number of years are known as Deferred Revenue Expenditure. For example- heavy advertisement expenditure, preliminary expenses, etc.
(b) Revenue Expenditures are charged entirely in the year in which they incurred.	Deferred Revenue Expenditure are spread proportionately over the years in which the benefit is received.
(c) They are a charge against the profits of a concern and are debited to profit & Loss etc.	They are charged to the profits but its unwritten off part is shown on the assets side of Balance Sheet.

2011 - Dec [2] (b) Distinguish between the following :

(iii) 'Trial balance by balance method' and 'trial balance by totals method'.

(4 marks)

Answer:

	Trial balance by balance method	Trial balance by totals method
1	In this method, the balances of ledger accounts are taken to respective debit and credit columns of the trial balance and then the two columns are totalled.	In this method, the totals of debit and credit sides of all ledger accounts are shown in the trial balance.
2	The total of balance in the debit column must be equal to the total of balances in the credit column.	The total of debit and credit columns of the trial balance must be equal.
3	This method is more popular.	This method is less popular.

DESCRIPTIVE QUESTIONS

1998 - Dec [1] {C} Briefly explain the following:

(i) Objectives of accounting. **(5 marks)**

(ii) Subsidiary books of account. **(5 marks)**

(iii) Manufacturing account. **(5 marks)**

(iv) Dual aspect concept. **(5 marks)**

(v) Going concern concept. **(5 marks)**

Answer:

(i) Various objectives of accounting include providing reliable information about:

(i) Changes in financial position resulting from the income-producing efforts of an enterprise;

(ii) Earnings of an enterprise, presented in a manner that emphasizes sources and trends of earnings;

(iii) Economic Resources and obligations of an enterprise;

(iv) Changes in net financial resources which result from the financial and investment activities of an enterprise; and

(v) any additional information, in the form of disclosures, which is relevant statement user is assessing a particular enterprises prospects.

(ii) The Journal is a primary entry book, but as the business grows and number of transactions increase, the recording of all transactions in one Journal will not only be inconvenient but also cause delay in collecting the information required. The Journal is therefore, divided in to many subsidiary books of accounts.

(a) Purchase Book (b) Sales Book (c) Purchase Return Book (d) Sales Return Book (c) Bills Receivable Book (f) Bills Payable Book (g) Cash Book.

(a) Purchase Book : It is meant for recording the purchase of goods on credit. Cash purchases are not recorded in this book. The posting is done in the personal account daily from the purchases book. At the end of the month, or week the total of purchases book is debited to the purchases account in the ledger.

The Ruling of the Purchases book is as follows :

Purchase's Book

Date	**Particulars**	**Invoice No.**	**Ledger Folio**	**Details (₹)**	**Amount (₹)**

(b) Sales Book : In it, only Credit Sales of goods in trade are recorded. It is maintained in the same way as that of Purchases Book is maintained. Sales Book is prepared on the basis of copies of invoice sent to customers. Sales A/c is credited with the monthly total of the Sales Book.

Cash Sales will be entered in the Cash Book.

The following is a Specimen of Sales Book :

Sales Book

Date	Particulars	Invoice No.	Ledger Folio	Details (₹)	Amount (₹)

(c) Purchases Returns Book : It records the details of goods returned by the business enterprise to the supplier (s). The goods purchased for cash and returned are not recorded in this book.

The total amount column of the purchases return book is credited to the purchases returns account and the account of the supplier (s) or to whom debit notes have been sent are debited individually in their respective column.

Purchase Returns Book

Date	Particulars	Debit Note No.	Ledger Folio	Amount (₹)	Amount (₹)

(d) Sales Returns Book : The details of the goods returned by the customers are recorded in this books of account.

Goods sold for cash and returned are not recorded in this books of account. A credit note is issued to the customer which returns the goods intimating that his account has been credited with the value of goods returned.

Sales Return Book

Date	Particulars	Credit Note No.	Ledger Folio	Details (₹)	Amount (₹)

(e) Bills Receivable Book and Bills Payable Book : For any organization, where a number of bills are drawn and/or accepted, bills are recorded in special subsidiary books-particulars of all bills receivable in the Bills Receivable Book and particulars of all the Bills Payable in Bills Payable Book.

At regular intervals, the amounts of the various bills are added together and posted to their relevant accounts in the main ledger. The total of Bills Receivable Book is posted to the debit side of the Bills Receivable A/c and the total of the Bills Payable book is posted to the credit side of the Bills Payable A/c. In respect of each the Bill Receivable, the customers account, i.e. the drawee from whom it is received, is credited in the ledger.

The format of both the books is given below:

Bills Receivable Book

Sl. No.	Bill No.	Name of the Acceptor	From whom Received	Date of Bill	Term	Date of Maturity	Amt. (₹)	How Dealt with

Bills Payable Book

Sl. No.	Bill No.	Date of Bill	Name of the Drawer	Payee	Term	Date of Maturity	Amt. (₹)	Remarks

(iii) A manufacturing concern may like to ascertain the cost of goods during the accounting period and may prepare manufacturing account for this purpose.

In the preparation of Manufacturing A/c, it is necessary to identify all the costs of manufacturing goods. The cost of manufacturing a product consists of:

(a) Materials

(b) Labour

(c) Expenses

Trading A/c is not capable of showing the cost of goods manufactured because it deals with stock of finished goods also, and because some of the expenses connected with the manufacture of goods are debited to Profit and Loss A/c. (eg. depreciation and repairs of machinery and factory)

Manufacturing A/c is debited with all expenses incurred in the factory on production of goods. The total cost of manufacturing are divided into two groups :

(a) **Prime cost :** an aggregate of direct materials, direct labour and direct expenses.

(b) **Overheads :** an aggregate of indirect materials, indirect labour and indirect expenses.

In manufacturing A/c only factory overheads are taken into account. The necessary details required to draw up a manufacturing account are shown below :

Dr. Manufacturing A/c for the year ended... Cr

Particulars	**Amount**	**Particulars**	**Amount**
To Raw Materials consumed	—	By closing stock of work-in - progress.	—
To Direct labour	—	By Trading Account c/d (cost of goods business transferred)	—
To Direct expenses	—		—
PRIME COST	—		
To Factory overhead			
To opening stock of work in progress			

(iv) Dual Aspect Concept : According to this, every business transaction is recorded as having a dual aspect. In other words, every transaction affects at least two accounts, if one account is debited, any other account must be credited.

Whenever a transaction is to be recorded it has to be recorded in two or more accounts to balance the equation. The system of recording transactions based on this principle is called as "Double Entry System".

It is because of this principle that the two sides of the Balance Sheet are always equal and the following accounting equation will always hold good.

ASSETS = LIABILITIES + CAPITAL

(v) As per this concept, it is assumed that the business will continue to exist for a long period in the future. The transactions are recorded in the books of the business on the assumption that it is a continuing enterprise.

It is on this assumption that we record fixed assets at their original cost and depreciation is charged on these assets without reference to their market value.

It is also because of the going concern assumption that outside parties enter into long term contracts with the enterprise, give loans and purchase the debentures and shares of the enterprise.

Also without this assumption, the classification of current and fixed assets and short and long term liabilities cannot be made and such classification would be difficult to justify.

1999 - June [1] {C} Explain the following:

(i) Accounting equation. **(5 marks)**

(ii) Revenue match concept. **(5 marks)**

Answer:

(i) The claims against the assets of a business unit are by the creditors and the owners. Therefore, at any point of time the total assets of a business are equal to its total liabilities.

Liability to outsiders is known as liability, but liability to the owners, in accounting parlance, is referred to as capital.

Accounting equation represents the relationship as—

ASSETS = LIABILITIES + CAPITAL.

This accounting equation is the basis for double entry accounting. It states that every time a transaction takes place, there is always a two sided effect.

Assets and liabilities are two independent variable where as capital is a dependent variable.

(ii) Revenue means the amount which is added to the capital as a result of business operations. Revenue is earned by sale of goods or by providing a service. Revenue match concept is based on accounting period concept.

In order to determine the profit earning or earned or loss suffered by the business in a particular accounting period, it is necessary that all expenses of that period should be matched with the revenues of that period.

The term matching means appropriate association of related revenues and expenses.

According to this concept, adjustments should be made for all outstanding expenses, accrued incomes, unexpired expenses and unearned incomes etc. while preparing the final accounts at the end of the accounting period.

1999 - Dec [1] {C} Explain the following:

(i) Business entity concept. **(5 marks)**

(ii) Convention of consistency. **(5 marks)**

(iii) Petty cash book. **(5 marks)**

(v) Branches of accounting. **(5 marks)**

Answer:

(i) According to this concept, business is treated as a unit of entity separate from its owners, creditors, managers and others.

Accounts are kept for the business entity as distinguished from the persons associated with it. All transactions of the business are recorded in the books of the business from the point of view of the business.

This concept is based on the sense that proprietors entrust resources to the management and the management is expected to use these resources to the best advantage of the firm and to account for the resources placed at its disposal.

The overall effect of adopting this concept is:

(a) Only the business transactions are recorded and reported and not the personal transactions of the owners.

(b) Income or profit is the property of the business unless distributed to its owners.

(c) The personal assets of the owners are not treated as the assets of the business entity.

(ii) This principle states that accounting principles and methods should remain consistent from one year to another, these should not be changed from year to year, in order to enable the management to compare the Profit and Loss A/c and Balance Sheet of the different periods and draw important conclusions, about the working of an enterprise.

For ex: A firm adopting straight line method of depreciation should adopt the same for different accounting periods.

But the principle of consistency should not be taken to mean that it does not allow a firm to change the accounting methods according to the changed circumstances of the business. Otherwise, the accounting will become non-flexible and the improved techniques of accounting will not be used.

However, the effect of change, and the justification of the change must be stated clearly by way of footnotes.

(iii) All small or petty day to day transactions of cash are recorded in Petty Cash Book. Petty Cash is the Cash Balances held in the form of notes and coins rather than bank deposits and is used in payment of minor expenditures, for ex.- bus fares, office teas, purchasing of newspapers, pins etc.

Payment of such petty expenses by cheque is almost impractical, as a solution, a Petty Cash Fund, is established, and recording of all such petty expenses is recorded in Petty Cash Book.

All receipts of Cash are entered in the debit side of the Petty Cash Book and if petty cash is paid or payments made are entered in the Credit side.

Dr. **Analytical Petty Cash Book** **Cr.**

Cash Received	C.B Folio	Date	Particulars	Petty Cash V.No	Total Paym-ent	Postage	Traveling Expenses	Stationary	Sundry Expenses	Ledger Acco-unt	Folio

Systems of Petty Cash :

(a) Ordinary System :

Under this system, the Petty Cashier is given a lump sum amount of cash. After spending the whole amount, he submits the account to the Head Cashier.

(b) Imprest System of Petty Cash :

Under this system, a fixed sum or float is allocated as sufficient to meet petty cash expenditure for an agreed period of time (say, a week or a month). At the end of this period, the Petty Cashier submits the account of the amount spent by him.

The sum expended, is reimbursed, thus making up the balance to the original sums. It is therefore a system of controlling petty cash.

Advantages :

- It saves time of the Chief Cashier.
- Chances of misuse of cash is reduced by the cashier.
- Since, the imprest sum is small, mishandling of cash is suppressed.
- Petty Cash record is checked periodically, and therefore mistakes are reduced.

(c) Analytical Petty Cash Book :

In it a separate column is used for each commonly occurring item of expenditure such as postage, stationery, travelling, wages, etc. When a petty expense is recorded in the right hand total payment column, the same amount is immediately recorded in the appropriate analysis column. At the end of a period, all the analysis columns are added and posted to the debit side of the respective accounts.

(v) Management now- a days requires various types informations to perform its functions more efficiently. To meet the increasing requirement of management, various specialized branches of accounting have come into existence such as :

(a) Financial Accounting : The main purpose of this branch of accounting is to record the business transaction in a systematic manner, to ascertain the profit and loss of the accounting period by preparing Profit and Loss A/c, and to present the financial position of the business by preparing a Balance Sheet.

(b) Cost Accounting : The main purpose of this branch of accounting is to ascertain the total cost and per unit cost of goods produced and services rendered by a business. It also estimates the cost in advance and therefore help the management in exercising strict control over cost.

(c) Management Accounting : It helps the management by assisting it in planning and controlling the operations of a business. Techniques like Ratio Analysis, Budgetary Control, Fund Flow Statement etc. help the management in taking rational decisions and affecting the overall growth of the business.

(d) Tax Accounting: The branch of accounting which is used for tax purposes (Income & Sales Tax, Service Tax etc) is called Tax Accounting.

(e) Social Responsibility Accounting : Social Responsibility accounting is the process of identifying, measuring and communicating the contribution of a business to the society. In it, techniques have been developed for measuring the cost of contributions like providing employment, product safety, environmental safety etc. and the benefits to the society.

2000 - June [1] {C} Explain the following:

(ii) Accounting on cash basis. **(5 marks)**

(v) Contingent liabilities. **(5 marks)**

Answer:

(ii) Cash Basis of Accounting : It is a method of accounting in which transactions are recorded in the books of account when cash is actually received or paid out and not when transactions take place. Therefore, it is the recording of cash and bank transactions without taking account of Fixed Assets, Debtors, Creditors and the like. No attempt is made to record prepayments or accruals. Cash Basis of accounting cannot be used as an accounting model that attempts to produce a Profit and Loss A/c and Balance Sheet.

Thus, Net Profit under this method represents simply the difference between Cash receipts and Cash payments.

It is used widely by professionals, and other service enterprises. Under this method, an income is not considered to be earned until payment is received.

Under a modified basis of Cash Accounting fixed assets are capitalised and the purchase of a fixed asset is recorded as an asset. It is necessary to spread its cost over the periods in which it works and must, therefore be deducted from incomes as an expense in each of these periods.

According to Cash Basis of Accounting, recognition of revenue is not always contingent upon the actual receipt of cash. Income cases, income is said to be constructively received at the time it becomes available to the business unit, regardless of when it is converted into cash.

Ex: A cheque is received immediately before the closing of the accounting year and it is converted into cash in the next account period.

Advantages:

- Recording of accounting transactions become simpler.
- The method is most suitable for firms that do not mention significant amount of inventories.
- Reliability of accounting transaction is increased.

Disadvantages:

- It is in appropriate for most businesses.
- It does not recognize charges in resources and obligations of a business, unit
- Generally accepted accounting principles do not recognize cash basis of accounting.
- Financial statements do not fairly represent the results of operations in terms of financial portion of the business entity.

(v) Contingent liabilities are conditions which exist at the balance sheet date, the outcomes of which can only be confirmed on the occurrence of one or more uncertain future events. These are not actual liabilities but then becoming actual liabilities depend on the happening of certain events. If such events do not occur, no liability is incurred.

These do not include uncertainties connected with accounting estimates, e.g provision for doubt ful debts or provision for discount on debtors. The situation must exist currently, hence, future losses from fire or flood , natural calamities or out break of war are not contingent liabilities.

A contingent liability may also exist when a current situation may result in a future liability but the amount of liability in the monetary terms can not be reasonably anticipated as on the balance sheet date.

For example : contingent liabilities are possible penalties discounting of bills receivable, fines and penalties payable to the Government or Income-Tax authorities etc. Contingent liabilities are not recorded in the books of account, hence it does not appear on the liability side of the Balance Sheet.

They are disclosed as a footnote at the bottom of the Balance-Sheet.

2000 - Dec [1] {C} Explain the following:

(v) Money measurement concept. **(5 marks)**

Answer:

Only those transactions and events are recorded in accounting which are capable of being expressed in terms of money. An event, even though it may be very important for the business, will not be recorded in the books of the business unless its effect can be measured in terms of money with a fair degree of accuracy.

It should also be noted into account that money is the only measurement which enables various things of diverse nature to be added up together and dealt with.

As such, to make accounting records relevant, simple, understandable and homogenous. They are expressed in a common unit i.e. money.

2001 - June [1] {C} Explain the following:

(i) Adjustment entries. **(5 marks)**

(iii) Capital expenditure and revenue expenditure. **(5 marks)**

Answer:

(i) Final accounts are usually prepared from the balances given in the trial balance.

However, at times some account balances in the trial balance do not reflect the correct amount when considered in relation to the accounting period.

for example : Prepaid rent, outstanding rent for any period. Even revenue items such as interest received may vary for the same accounting period.

In order to ensure that the final accounts disclose the true trading results and correct balances it is necessary that all expenses incurred whether paid or not and the whole amount of loss sustained whether ascertained or estimated should be taken into consideration. Similarly all incomes and gains whether actually received or not during the accounting period should be accounted for.

All this, requires adjustment entries which are used to establish correct values of account balances at the end of an accounting period.

Thus adjustment entries are those entries which are passed at the end of each accounting period for the purpose of adjusting various nominal and other accounts so that true net profit or loss can be ascertained.

By ascertaining correct and fair net profit or net loss in the Trading, Profit and Loss A/c and in the Balance Sheet a fair view of the financial conditions of an enterprise can be ascertained.

(iii) Capital expenditure is that expenditure which results in acquisition of an asset or which results in the increase in the earning capacity of a business. Capital expenditure is normally a non recurring outlay. It produces benefits over several years.

Ex : Money paid for land, buildings, machinery, furniture, patents etc.

Expenditure which does not result increase in capacity or in reduction of day to day expenses is not a capital expenditure unless there is a tangible asset to show for it. All sums spent up to the point an asset ready for use should also be treated as capital expenditure.

Ex : fees paid to lawyer for drawing a purchase deed of land money spent to install a machinery etc.

Expenses whose benefit expires within the year of expenditure and which are incurred to maintain the earning capacity of existing assets are termed as revenue expenditure. Revenue expenditure is usually a recurring item. It is a routine expenditure incurred in the normal course of business and includes cost of sales and also the upkeep of fixed assets etc. Such revenue expenditure are consumed within an accounting year and the entire amount is charged to the current years income statement. Hence it does not appear in the Balance Sheet For Eg : fee paid to a lawyer for checking whether all the papers are in order before land in purchased is a capital expenditure. But if later a suit is filed against the purchaser the legal costs will be a revenue type.

2001 - Dec [1] {C} Explain the following:

(i) Accounting period concept **(5 marks)**

(iii) Convention of disclosure **(5 marks)**

(iv) Cash book **(5 marks)**

Answer:

(i) The true results of the business operations can be ascertained only when the life of business is completely divided into time intervals for the measurement of the profits of the business.

A period of 12 months is usually adopted for this purpose. The accounting period here refers to the interval of time at the end of which the income or revenue statement and the Balance Sheet are prepared to show the results of operations.

(iii) This convention of disclosure requires that all the significant information relating to the economic affairs of the enterprise should be completely disclosed. All information which is of material interest to proprietors, creditors and investors should be disclosed fully and fairly in the accounting statements.

(iv) Cash book may be defined as the record as the record of transactions concerning cash receipts and cash payments. In other words, in cash book, all transactions (i.e., receipts and payments of cash) are recorded as soon as they take place. Cash book is in the form of an account and actually it serves the purpose of Cash Account also. It has two sides—debit side and credit side. On the debit side, all receipts of cash are recorded while on the credit side, all the payments of cash are recorded. In case of cash transactions, only a single aspect of transactions is recorded in ledger because the other aspect has to be recorded in Cash Book. Cash Book, thus, serves the purpose of a book of original entry as well as that of a ledger account.

2002 - June [1] {C} Explain the following:

(ii) Deferred revenue expenditure **(5 marks)**

(v) Imprest system of petty cash **(5 marks)**

Answer:

(ii) Deferred revenue expenditure is revenue in character but :

(a) The benefit of which is not is not exhausted in the same year or

(b) is applicable either wholly or in part of the future years, or (c) is accidental with heavy amount and it is not prudent to charge against the profit of one year.

Deferred revenue expenditure is further classified as.

(i) Expenditure wholly paid in advance, where no service has yet been performed, necessitating it being carried forward eg : office rent paid in advance.

(ii) Amounts representing loss of an expentional nature eg : loss of uninsured assets.

Deferred revenue expenditure results in a benefit which will accrue in future period but for 3 to 5 years, as compared to capital expenditure which may last for 10 or 15 years.

(v) Imprest system of petty cash

In every business, there may be payments which are of small amounts and high frequency e.g. payments for postage, stationery, telegrams, carriage, cleaning, travelling, etc. and these transactions are recorded in the petty cash book maintained by a petty cashier.

It is the system under which imprest cash is disbursed from time to time and restored to its original amount through reimbursements equal to sums expended. This system is generally followed where petty cash account system is maintained. Under the imprest system of maintaining petty cash, the petty cashier is given a certain sum of money at the beginning of the fixed period, e.g. a month/fortnight) which is called ‘float’. The amount of float is so fixed that it may be adequate to meet petty expenses of the prescribed period. The petty cashier makes payment of petty expenses for which he is authorised and records them in his petty cash book. At the end of such period, petty cashier submits the accounts of the amount spent by him during the period and the cashier gives him cash equal to the amount spent so that the petty cashier begins the next period with the fixed amount of float.

The advantages of the imprest system are as follows :

(i) It saves the time of the chief cashier.

(ii) Petty cashier is not allowed to keep idle cash with him. If the float is found to be more than adequate, its amount will be immediately reduced. This reduces the chances of misuse of cash by the petty cashier.

(iii) As the sum of float is small, it does not provoke the person in charge of it or others in the office to misappropriate it.

(iv) The record of petty cash is checked by the cashier, periodically, so that a mistake, if committed, is soon rectified.

(v) The system trains young staff to handle money responsibilities.

2002 - June [8] (b) Explain the various accounting conventions. **(8 marks)**

Answer:

The term 'convention' denotes customs or traditions which guide the accountant while preparing the financial statements. In fact financial statements, namely, the profit and loss account and balance sheet are prepared accounting to these accounting conventions. The following are the various accounting Conventions:

(i) **Consistency :** The consistency convention implies that the accounting practices should remain the same from one year to another. The result of different years will be comparable only when accounting rules are contiguously adhered to from year to year.

Example, the same method of depreciation should be followed year after year. The rationale behind this principle is that frequent changes in accounting treatment would make the financial statement unreliable to the persons who use it.

(ii) **Disclosure :** Good accounting practice demands all significant information should be fully and fairly disclosed in the financial statements. All information which is of material interest to proprietors, creditors and investors should be disclosed in accounting statements. This convention is gaining more importance because most of big business units are in the form of joint stock companies where ownership is divorced from management.

(iii) **Conservatism :** Financial statements are usually drawn up on a conservative basis. There are two principles which stem directly from conservatism
   (a) the accountant should not anticipate income and should provide all possible losses; and
   (b) Faced with the choice between two methods of valuing an asset the accountant should choose a method which leads to the lesser value.

(iv) **Materiality :** According to the convention of materiality accountants should report only what is material and ignore insignificant details while preparing the final accounts.

2002 - Dec [1] {C} Explain the following:
(ii) Convention of conservatism **(5 marks)**

Answer:

All financial statements are drawn up on a conservative basis. The two principles which arise directly from conservatism are:

(a) The accountant should not anticipate income and should provide all possible losses.

(b) Faced with the choice between the two methods of valuing an asset the accountant should choose a method which leads to the lesser value.

   Ex:
   (i) Making provisions for bad debts.
   (ii) Closing stock is valued at lower of cost or market value.

2004 - June [1] {C} Explain the following:

(i) Convention of materiality **(5 marks)**

(ii) Journal proper **(5 marks)**

Answer:

(i) **Convention of materiality :** In order to make financial statements more meaningful and to minimize cost, only important and relevant information should be provided. Materiality cannot be defined precisely. The general rule is that an item should be considered as material (i.e. significant), if the knowledge of that item could affect the users of the financial statements in taking some decisions such as to invest or not to invest in a business entity or to give loan or not to give loan to a firm.

Thus, according to the convention of materiality accountants should report only what is material and ignore insignificant details while preparing the final accounts. Otherwise accounting will unnecessarily be overburdened with minute details. It is not possible to lay down any fixed standard by which materiality can be judged. The decision is to be made by the accountant or the auditor on the basis of professional experience and judgement where there is no unanimous opinion on the subject.

Moreover, an item may be material for one purpose while immaterial for another. It is generally felt that in respect of items appearing in the profit and loss account and having an effect on the profit for the year, materiality should be judged in relation to the profits shown by the profit and loss account as also the expenditure under the concerned head As regards items appearing on the balance sheet, it is generally felt that, if they have no effect upon the profit for the year, materiality may be judged in relation to the groups to which the assets or liabilities belong e.g. for any item of current liabilities in relation to total current liabilities.

(ii) Journal Proper or General Journal is used for making the original record of those transactions because of their importance or rareness of occurrence which do not find a place in any of the other books of original entry.

Entries recorded in the Journal proper may be as follows :

(a) **Opening Entries :**

Assets A/c Dr.

To Liabilities A/c

To Capital A/c

(b) **Closing Entries :** Such entries are used at the end of the accounting year for closing off accounts relating to expenses and revenues. These accounts are closed off by transferring their balances to the Trading and Profit and Loss A/c.

(c) **Transfer Entries :** These are passed in the Journal proper for transferring an item, entered is one account to another account.

(d) **Rectification Entries :** Mistake made in passing an entry should be corrected by passing another entry in the Journal Proper and the practice of erasers should not be tolerated.

(e) **Adjustment Entries :** Adjustment entry is an amendment to an accounting figure which is basically correct but which needs to allow for some circumstances not recorded in the Book-Keeping System.

Adjustment entries have a dual effect, they affect either Trading and Profit and Loss A/c but definitely the Balance-Sheet.

(f) **Purchases of Assets on Credit :** The following entry is made:

Assets A/c Dr.

To Creditors for Asset A/c.

(g) **Sales of worn out or Obsolete Asset (on Credit) :** When obsolete Assets are sold out on credit, these are recorded in the Journal Proper.

(h) **Purchase of Stationery on (Credit) :** The following entry is made:

Stationery A/c Dr.

To Creditors for Stationery A/c

2005 - June [1] {C} Explain the following:

(iii) Closing entries **(5 marks)**

Answer:

(iii) The preparation of the trading account requires that the balances of all such accounts which are due to appear in the Trading account are transferred to it. The entries required for such transfer are termed as closing entries.

For example :

Trading A/c Dr.
To Opening stock.
To Purchases
To Sales Return
To Carriage Inwards
(transfer of various account to Trading A/c)
Sales A/c Dr.
Purchase return A/c Dr.
Closing stock A/c Dr.
To Trading A/c.
(transfer of various account to the credit side of the trading A/c.)
Trading A/c Dr.
To Profit and Loss A/c.
(transfer of gross profit to Profit and Loss A/c)
Profit and Loss A/c Dr.
To Rent A/c
To Salaries A/c
To Sundry expenses A/c
To Depreciation A/c
(transfer of various nominal accounts to Profit and Loss A/c)
Profit and Loss A/c Dr.
To Capital A/c.
(transfer of Net Profit to Capital A/c)

2005 - June [3] Elucidate the following statements:

(i) "Agreement of trial balance is not a conclusive proof of the accuracy of accounting records." **(4 marks)**

(iv) "Revenue earned and cost of earning revenue should be properly identified for a period." **(4 marks)**

Answer:

(i) The agreement of Trial Balance indicates arithmetical accuracy of the ledger accounts but it is not a conclusive proof of accuracy of accounting records. There are many errors, which may be undetected even when the Trial Balance agrees. Such errors are :

(a) **Errors of Omission :** If a particular transaction is omitted altogether from the books of original entry, it will not disturb the agreement of the Trial Balance.

(b) **Errors of Principle :** These error arise because of an incorrect application of the principle of accountings. For e.g. failure to differentiate between Capital and Revenue expenditure, or vice-versa. It may also take place if a revenue receipt is taken to be capital receipt or vice-versa. The existence of such type of errors is not disclosed by the Trial Balance.

(c) **Compensating Errors :** These are group of errors, the total effect of which is not reflected in the Trial Balance. These errors are of a neutralising nature.

(d) **Recording Wrong Amount in Journal :** If a transaction is wrongly recorded in the books of original entry and is subsequently carried through the ledgers, it will not cause disagreement in the Trial Balance.

(e) **Recording both Aspects of a Transactions more than once in the books of account :** The Trial Balance will agree if both aspects of a transaction are recorded twice in the books of journal entry.

(iv) The very objective of financial accounting is to calculate profits earned from various business operations during a financial year.

Profit is the excess of income over the expenses incurred for generating such income.

According to the matching principle the income of a given period should be matched with the expenses of the same period. This can only be done if the matching of revenue with expenses is based on the accrual system of accounting.

Few important adjustments that are to be incorporated in the final accounts.

(a) closing stock is carried forward to the next year as it has not contributed to generate any revenue in the current year.

(b) cost of fixed assets is spread over their useful life through depreciation method.

(c) adjustments are made for expenses actually used in the current year but not paid in cash.

2005 - Dec [1] {C} Explain the following:

(i) Cash system of accounting. **(5 marks)**

Answer:

(i) Under the Cash System of Accounting, accounting entries are made only when cash is received or paid. No entry is made when a payment or receipt is merely due. It may not treat any revenue to have been earned or even sales to have taken place unless cash is actually paid by the customers.

2006 - June [1] {C} Explain the following:

(iv) Contra entries in columnar cash book **(5 marks)**

(v) Accounting cycle **(5 marks)**

Answer:

(iv) The term 'Contra' refers to the opposite side. Contra is an entry in a double entry account representing the reversal or cancellation of an entry on the other side. When both debit and Credit aspects of a transaction are recorded in the same account but in different columns, each entry whether in the debit side or in the credit side shall be deemed to be the Contra entry of the other.

The following are the transactions for which Contra entries are passed:

(i) Cash deposited with Bank;

(ii) Cash withdrawn from Bank for office use;

When cash is deposited, Bank A/c is debited and Cash A/c is to be credited. Debit aspect is to be recorded in the debit side of the double Column Cash Book (Bank Column) and Credit aspect is to be recorded in the Credit side of the Cash Book (Cash Column). The letter 'C' is marked to indicate the contra effect.

When cash is withdrawn, the reverse entries are passed of the above. and in all the cash is treated as Contra of Bank and Bank as Contra of Cash.

(v) Accounting Cycle :

It refers to the sequence of accounting procedures used to record, classify and summarize the business transactions.

The Accounting Cycle includes :

(i) **Recording :** At the first instance, all transactions are recorded in the Journal or subsidiary books of account as and when they take place.

(ii) **Classifying :** All journal entries recorded are posted into their respective ledger accounts, to locate the total effect of all such transactions in a particular account.

(iii) **Summarizing :** The last stage is to prepare the Trial Balance, Profit and Loss A/c and the Balance Sheet with a view to ascertain Profit or Loss for any period.

2006 - Dec [1] {C} Explain of the following:

(i) Accrual concept. **(5 marks)**

Answer:

(i) In the Accrual Concept of Accounting the transactions are recorded on the basis of amounts having become due for payment or receipt.

In Accrual Concept of Accounting attempts are made to record the financial effects of the transactions, events and circumstances of an enterprise in the period in which they occur rather then in the period in which cash is received.

In accrual basis of accounting, the following are the features :

(a) Revenue is recognized as it earned.

(b) Costs are matched against revenues on the basis of relevant time period to determine periodic income.

(c) Any cost that appear to have cost its utility or its power to generate future revenue is written off as a loss.

It also recognizes assets, liabilities or components of revenues and expenses for amounts received or paid in cash in past and the amounts expected to be received or paid in cash in future.

2007 - June [2] (a) Comment on the following statements :

(ii) Trial balance and balance sheet serve the same purpose. **(4 marks)**

Answer:

No, the trial balance and balance sheet do not serve the same purpose, because:

(a) Trial balance is prepared to check the arithmetical accuracy of the books of accounts, where as the balance sheet is prepared to know the true financial position of the firm.

(b) Trial balance and it preparation though desirable is not necessary but the preparation of balance sheet is mandatory for any firm.

(c) Trial balance do not provide the role of documentary evidence in the court of law where as the balance sheet is acceptable as a documentary evidence in the court of law.

(d) The preparation of balance sheet is not possible without the incorporation of adjustments such as out standing expenses and prepaid expenses, accrued incomes, etc where as the preparation of the trial balance can be done without incorporating the adjustments.

2007 - Dec [3] (b) Elucidate the following :

(i) Balance sheet is a statement of sources and uses of capital. **(5 marks)**

(ii) Columnar cash book is a combination of cash account and bank account. **(5 marks)**

Answer:

(i) A balance sheet is a statement of the assets, liabilities and capital of an organisation at a particular date which gives a true and fair view of the state of affairs of the business. The financial position of a business is indicated by its assets on a given date and its liabilities (excluding capital) on that date. Excess of assets over liabilities represents capital and is indicative of the financial soundness of the business. The two sides of the Balance Sheet i.e, Assets and Liabilities should always be equal.

(ii) Cash Column and Bank Column of the Cash Book represents Cash A/c and Bank A/c of the ledger, no separate account for Cash and Bank are to be opened in the ledger.

Therefore one book represents two separate accounts and transactions are recorded accurately. When a transaction involving Cash and bank is occurred, it is entered on both sides of the Cash book, by way of Contra entries. Thus Columnar Cash Book is a combination of Cash account and Bank Account.

2008 - Dec [1] {C} (a) Explain the following:

(ii) Users of accounting information **(5 marks)**

Answer:

Users of accounting information : These are various internal and external users of accounting information. They are :

(1) **Shareholders :** The primary purpose of accounting is to provide necessary material information to the owners of the business.

(2) **Managers :** In business corporation, there is separation of ownership and management functions. Managers require information for the proper conduct of business affairs as they are answerable to the owners of the business.

(3) **Creditors, Bankers and other lending institutions :** Creditors, bankers and other lending institutions rely heavily upon accounting disclosures for determining the actual credit worthiness of the applicant and the acceptability of their loan application.

(4) **Employees :** They seek accounting information because their wage increase and bonus depend on the size of the profit earned.

(5) **Government :** The Government is always interested in the accounting statements of the business on account of taxation, corporate and other prevalent laws.

(6) **Researchers :** Research scholars want accounting information for their research in accounting theory as well as business affairs & practices.

2009 - June [1] {C} (a) Explain the following :

(i) Limitations of accounting **(5 marks)**

Answer:

Limitations of accounting : The following are the limitations of accounting:

(a) Influenced by personal judgement : Accounting is not an exact science and an accountant has to exercise his personal judgement in respect of various items. For example, it is very difficult to predict what is the exact useful life of an asset or what is the right method of valuation of stock, etc. Different persons are bound to have different opinions in respect of such things and hence it will result in different accounting figures.

(b) Omission of qualitative information :- Accounting contains only those informations which can be expressed in terms of money. Qualitative aspects of business are omitted as these cannot be expressed in monetary terms. Thus, changes in management, reputation of business, loyalties of employees, etc. which have a vital impact on the profitability of the firm are ignored and omitted from being recorded in the books of accounts.

(c) Based on historical cost :- Accounts are prepared on the basis of historical cost i.e. original cost and as such the figures given in the financial statements donot show the effect of changes in price level and hence, do not show the true and fair view of the business.

(d) Affected by window dressing :- Profits for a period can be manipulated omitting costs such as advertisement, depreciation, etc. For the purchases made at the end of the year may not be recorded or the closing stock may be over valued. Hence, the correct decisions cannot be taken on the basis of such financial statements.

(e) Unsuitable for forecasting :- Accounts are only a record of past events. Changes take place in the demand of the product, position of competition, etc. As such, financial analysis based on past events may not be of much use for forecasting.

2009 - Dec [3] (b) Explain the following statements :

(i) A cash book is a journal as well as a part of ledger. **(4 marks)**

(ii) From the point of view of accounting, it is essential to distinguish between 'capital profit' and 'revenue profit'. **(4 marks)**

Answer:

(i) When a cash book is maintained, all cash transactions are not separately recorded in the journal. Like journal, all transactions are recorded in it for the first time from the source documents and thereafter posted to the respective accounts in the ledger. Cash book is in the form of an account and thus, it serves the purpose of cash account also. Items on the debit side of the cash book are posted on the credit side of the ledger and items on the credit side are posted on the debit side of the ledger. Its balancing is also done periodically like ledger accounts. Hence, cash book is a journal as well as a ledger and may be called 'journalised ledger'.

(ii) It is very essential to distinguish between capital profits and revenue profits. Revenue profits are earned in the ordinary course of business and are available for distribution as profits after certain statutory deductions. However, capital profits are earned as a result of selling some fixed assets or some other capital nature transactions. For example, if a company issues shares at a premium, that amount of premium is the capital profit. Capital profits are either capitalised i.e. added to capital fund of the concern or tranferred to capital reserve for contingencies.

2009 - Dec [3] (b) Explain the following statements:

(iii) Capital expenditure provides benefit to the firm for a number of years. **(4 marks)**

Answer:

Capital expenditure are incurred for the acquisition or erection of a permanent/fixed asset which increases the earning capacity of the business and provides benefit for a number of years. Expenditures for acquisition of a fixed asset like land, building, plant, motor vehicles, etc. is called capital expenditure as there can be used in the business for a number of years.

All amount spent upto the point an asset is being put to use is treated as capital expenditure like legal fees, brokerage paid, interest paid, etc. are added to the cost of such asset. Even expenses incurred on issuing shares and debentures are capital expenditure as the benefit of there expenses will be available over a number of years. All development expenditures are also treated as capital expenditure.

2010 - June [1] {C} (a) Explain the following:

(i) Combined journal entries **(5 marks)**

(ii) Sub-division of journal **(5 marks)**

(iii) Balancing ledger accounts **(5 marks)**

Answer:

(i) Sometimes, two or more transactions relating to one particular account take place on the same date. In such cases, instead of passing separate entries for all those transactions, only one entry is passed. Such a journal entry is turned as compound journal entry. For example, on 15th June, ₹ 5,000 paid for insurance and ₹ 2,000 paid for rent, the entry will be–

15th June	Insurance A/c	Dr.	5,000	
	Rent A/c	Dr.	2,000	
	To Cash A/c			7,000
	(Being expenses paid)			

Thus, in compound entries–

(a) One account may be debited while two or more accounts may be credited, or

(b) Two or more accounts may be debited while only one account may be credited, or

(c) Two or more accounts may be debited while two a more accounts may be credited.

But, the sum total of debited accounts should be equal to the sum of credited accounts.

(ii) In accounting process, Journal is the book of original entry. But when the size of the business grows and the number of transactions increases, it is no longer possible to record all transactions in one Journal only. As such, Journal is sub-divided into a number of special books which are also known as Special Purpose, Books or Subsidiary Books. This sub-division facilitates recording transactions of similar nature at one place in various subsidiary books. Following books are generally kept in a business :

(a) **Cash Book :** This book is used for recording all transactions relating to cash receipts and cash payments.

(b) **Purchase Book :** This is used for recording all the credit purchases of goods.

(c) **Sales Book :** This book is used for recording all the credit sales of goods.

(d) **Purchases Return Book :** This books records all transactions relating to the goods purchased on credit, returned to the supplier.

(e) **Sales Return Book :** When the goods are returned by the customers, such returns are recorded in this good.

(f) **Bills Receivable Book :** This book is used for recording the receipts of bills, receivables, promissory notes or hundies from various parties.

(g) **Bills Payable Book :** This book is used for recording the issue of bills, promissory notes or hundis to various parties.

(h) **Journal Proper :** This book is used for recording the transactions which cannot be recorded in any aforesaid books.

(iii) Balancing of an account means equalising the both sides of an account in such a manner that the difference between the two sides is inserted on the side which is shorter. If the debit side exceeds the credit, the balance is called a debit balance and on the other hand, if the credit side exceeds the debit, the balance is called a credit balance.

There are different modes of balancing the Personal Accounts, Real Accounts and Nominal Accounts.

(a) **Personal Accounts :** If a Personal Account shows a debit balance, it indicates the amount owing from him. On the other hand, if a personal account shows a credit balance, it indicates the amount owing to him. The account is balanced by using the words 'To/By Balance c/d' on either sides of the accounts.

(b) **Real Accounts :** Real Accounts such as cash account and other asset account is closed in the same manner as Personal Accounts. When balances, these will always show debit balances. Some accounts like Purchase A/c, Sales Return A/c, etc. are not balanced. These accounts are closed by transferring them to Trading A/c at the end of the year.

(c) **Nominal Accounts :** These accounts do not require balancing. As the main purpose of opening the nominal accounts is to ascertain the net profits or loss of the firm, all such accounts are transferred to Trading & Profit & Loss A/c at the end of the financial year.

2010 - June [3] (b) Explain the following statements:

(iii) Every transaction has debit and credit aspects. **(4 marks)**

Answer:

According to Duality Principle of accounting, every business transaction has two aspects. Every transaction affects at least two accounts. If one is debited, other must be credited. The system of recording transactions based on this principle, what is commonly known as Double Entry System. It is because of this principle that the two sides of Balance Sheet are always equal and the accounting equation will always hold good at any point of time i.e.

ASSETS = LIABILITIES + CAPITAL

Whenever a transaction is recorded, it has to be in two or more accounts to balance the equation. If a transaction affects the one side of the equation, it has to have affect on the other side of equation. And, equation remains balanced whenever a transaction taken place.

Thus, every business transaction has debit and credit aspects.

2011 - June [1] {C} (a) Explain the following :

(i) Classification of assets **(5 marks)**

(ii) Principal book of accounts **(5 marks)**

Answer:

(i) Assets may be classified into the following categories :-

- **(i) Fixed Assets :** Those assets which are held for continued use in the business and are not meant for resale are fixed assets. For example- Plant & Machinery, furniture, land & building, etc.
- **(ii) Current Assets :** Those assets which are meant for sale or are converted into cash within one year are known as current assets for example, stock, bills receivables, debtors, etc.
- **(iii) Wasting Assets :** Those assets which are consumed through being worked or used such as mines or oilfields.
- **(iv) Intangible Assets :** Those assets which do not have a physical existence and which cannot be seen or felt are intangible assets such as goodwill of a business, patents rights, trade makes, etc.

(v) **Fictitious Assets :** Those assets which are valueless but are shown in the financial statements of a concern are known as fictitious assets. For example, preliminary expenses, use of trade makes, etc.

(ii) Ledger is the principal book of accounts as it provide complete picture of all the transactions relating to a particulars, person or property or revenue or expenses, at a glance. Thus, position of an account can be easily ascertained at any point of time. Final statements can only be prepared with the help of ledger balances, that is, why this is the book of final entry and is of utmost importance in any enterprise.

2011 - June [3] (b) Explain of the following statements :

(i) Non-monetary events are not recorded in the books of account. **(4 marks)**

(ii) Trial balance is a link between ledger and final accounts. **(4 marks)**

Answer:

(i) According to Money Measurement Concept, only those transactions and events are recorded in accounting which are capable of being expressed in terms of money. Anything, even through it may be very important for the business, will not be recorded unless its effect can be measured in terms of money. For example- dispute between manager and employee, expertise of demised chairman, etc. are not recorded in the books, even through they affect the business to a great extent.

(ii) According to Cortor, "Trial Balance is the list of debit and credit balances, taken out from ledger. It also includes the balances of cash and bank taken from cash book".

A Trial Balance serves as a summary of all the ledger accounts. As it contains the list of all ledger accounts, it provides a basis for further processing of accounting date ie. preparation of final accounts. Thus, it is a link between ledger and final accounts.

2011 - Dec [1] {C} (a) Explain the following :

(i) Accounting Policies. **(5 marks)**

(iii) Accrual system of accounting. **(5 marks)**

Answer:

(i) Accounting Policies are the specific accounting bases judged by any business enterprise to be mst appropriate to their business and adopted by them for the purpose of preparing their financial statements. Those specific principles and practices which are selected by the enterprise should be in conformity with Generally Accepted Accounting Principles (GAAP) and the Accounting Standards (AS) for example, the provision for depreciation of fixed assets depends upon the policy decided upon, i.e. straight line method or diminishing balance method to be used, and in effect, the rates of depreciation.

(iii) Under Accrual system of accounting, incomes are recorded when they are earned or accrued, irrespective of the fact whether cash is received or not similarly, expenses are recorded when they are incurred or due and not when the cash payments are made. The purpose of accrual basis of accounting is to match the revenue earned to cost incurred so that it ascertains the correct profit or loss during the period under consideration. Under the Companies Act, 1956, all companies are required to maintain their accounts according to this accrual system of accounting.

2011 - Dec [3] (b) Explain the following statements:

(i) If stock at the end appears in the trial balance, it will be shown only in the balance sheet in final accounts. **(4 marks)**

(iii) Accounting is a science as well as an art. **(4 marks)**

Answer:

(i) If closing stock appears in the trial balance it will be shown only in balance sheet. It means that double entry has been completed in the said accounting period and will not appear in the trading account but appear in the balance sheet at the end of that accounting period.

(iii) Accounting is a science as well as an art. It is a science because it provides a systemise body of knowledge through various accounting principles, practices and procedures in reporting financial status and periodic performances of a business unit. However, it is not an exact/pure science. It is a social science based on human behaviour/intelligence and other socio-economic factors.

Accounting is also an art of recording, classifying and summarising financial data which require special knowledge, experience and judgement. It is an art of interpreting the results of operations to determine position of an enterprise, its progress and its potentials.
Hence, accounting is both a science well as art which requires experience and constant practices.

2023 - Dec [4A] (Or) (i)"The three golden rules of accounting are the very foundation of double entry system of financial accounting." Elucidate.
(5 marks)

Answer:
The three golden rules of accounting are the very foundation of double entry system of financial accounting. This statement underlines the important role played by golden rules of accounting in double-entry accounting process.
Double Entry System of accounting actually classifies all the accounts opened in books under three broad categories, which are as follows:

1. **Personal Accounts:** Accounts of Natural, Artificial and Representative Persons
2. **Real Accounts:** Accounts of Things and Properties, and
3. **Nominal Accounts:** Accounts of Expenses/Losses and Incomes/Gains

Three golden rule, one dealing to one of the above three categories of accounts, have been provided under Double Entry System of accounting. These three rules are as follows:

1. **Personal Accounts:** Debit the receiver account,
   Credit the account of Giver
2. **Real Accounts:** Debit what comes in,
   Credit what goes out
3. **Nominal Accounts:** Debit all expenses and Losses,
   Credit all incomes and gains

Through these three golden rules of accounting all the transactions entered into by a business firms are duly categorized and recorded. Not only this, these accounts duly takes care of both the aspects. i.e., debit and credit, of each and every accounting transaction to be entered in books of accounts. Therefore, it is rightly said that "the three golden rules of accounting are the very foundation of double entry system of financial accounting".

PRACTICAL QUESTIONS

2004 - Dec [3] The following is the trial balance of Arman as on 31st March, 2004:

	Dr. (₹)	Cr. (₹)
Capital account	—	8,00,000
Drawings account	60,000	—
Stock on 1st April, 2003	4,50,000	—
Purchases	26,00,000	—
Sales	—	31,00,000
Furniture	1,00,000	—
Sundry debtors	4,00,000	—
Freight and Octroi	46,000	—
Trade expenses	5,000	—
Salaries	55,000	—
Rent	24,000	—
Advertising expenses	50,000	—
Insurance premium	4,000	—
Commission	—	13,000
Discount	2,000	—
Bad debts	16,000	—
Provision for bad debts	—	9,000
Creditors	—	2,00,000
Cash in hand	52,000	—
Bank	58,000	—
Goodwill (at cost)	2,00,000	—
	41,22,000	41,22,000

Adjustments:

(i) Stock on 31st March, 2004 was valued at ₹ 5,30,000.
(ii) Salaries have been paid so far for 11 months only.
(iii) Unexpired insurance included in the figure of ₹ 4,000 appearing in the trial balance is ₹ 1,000.
(iv) Commission earned but not yet received amounting ₹ 1,220 is to be recorded in books of account.

(v) Provision for bad debts is to be brought upto 3% of sundry debtors.
(vi) Manager is to be allowed a commission of 10% of net profits after charging such commission.
(vii) Furniture is depreciated @ 10% per annum.
(viii) Only one-forth of advertising expenses are to be written off.

Prepare the trading and profit and loss account for the year ended 31st March, 2004 and balance sheet as on that date. **(16 marks)**

Answer:

Trading & P & L A/c for the year ended 31st March, 2004

Particulars		₹	Particulars		₹
To Opening Stock		4,50,000	By Sales		31,00,000
To Purchases		26,00,000	By Closing Stock		5,30,000
To Freight & Octroi		46,000			
To Gross Profit Transfered To P & L A/c		5,34,000			
		36,30,000			36,30,000
To Trade expenses		5,000	By Gross Profit b/d		5,34,000
To Salaries	55,000		By Commission	13,000	
+ Outstanding salaries	5,000	60,000	*Add* : Commission earned but not received	1,220	14,220
To Rent		24,000			
To Advertising Exp.	50,000				
Less : Carried forward	37,500	12,500			
To Insurance	4,000				
Less :Unexpired insurance	1,000	3,000			
To Discount		2,000			
To Bad debts	16,000				
Add : New provision @ 3% on 4,00,000					
Less : Old provision	12,000				
	28,000				
To Depreciation	9,000	19,000			
To Commission payable to Manager		10,000			
To Net profit transfered to Capital A/c		37,520			
		3,75,200			
		5,48,220			5,48,220

Balance Sheet as on 31st March, 2004

Liabilities		₹	Assets		₹
Capital	8,00,000		Furniture	1,00,000	
Add : Net profit	3,75,200		*Less*: Depreciation	10,000	90,000
	11,75,200		Goodwill		2,00,000
Less : drawings	60,000	11,15,200	Stock		5,30,000
Outstanding Salaries		5,000	Debtors	4,00,000	
Outstanding commission		37,520	*Less*: Provision	12,000	3,88,000
Creditors		2,00,000	for bad debts		
			Unexpired insurance		1,000
			Unexpired advertising expenses		37,500
			Commission earned but not received		1,220
			Cash-at-bank		58,000
			Cash - in - hand		52,000
		13,57,720			13,57,720

2005 - Dec [6] From the following figures extracted from the books of Mohan, you are required to prepare a trading account and profit and loss account for the year ended 31st March, 2005 and a balance sheet as on that date after making the necessary adjustments:

	(₹ in '000)
Mohan's capital	22,880
Mohan's drawings	1,320
Plant and machinery	9,900
Freehold property	6,600
Purchases	11,000
Returns outwards	110
Salaries	1,320
Office expenses	715
Office furniture	550
Discount (*Dr.*)	132
Sundry debtors	2,926
Loan to Krishna @ 10% per annum, balance on 1st April, 2004	4,400
Cash at bank	2,926
Bills payable	550

Stock on lst April, 2004	3,850
Wages	3,520
Sundry creditors	4,400
Gas and fuel	297
Bad debts	66
Freight	990
Loose tools on 1st April, 2004	220
Factory lighting	286
Provision for doubtful debts	88
Interest on loan to Krishna	110
Cash in hand	264
Sales	23,144

Adjustments :

(i) Stock on 31st March, 2005, was valued at ₹ 7,260 thousand;

(ii) Depreciate plant and machinery by $33\frac{1}{3}$%, furniture by 10% and freehold property by 5%;

(iii) Loose tools were valued at ₹176 thousand on 31st March, 2005; and

(iv) Of the sundry debtors, ₹6 thousand are bad and should be written off. Maintain a provision of 5% on sundry debtors for doubtful debts.

(16 marks)

Answer:

Trading & P & L A/c for the year ended 31st March, 2005

Particulars		**₹**	**Particulars**	**₹**
To Opening Stock		3,850	By Sales	23,144
To Purchases	11,000		By Closing Stock	7,260
Less: Returns	110	10,890		
To Wages		3520		
To Gas & Fuel		297		
To Freight		990		
To Factory lighting		286		
To Gross Profit				
Transfered to P & L A/c		10,571		
		30,404		30,404

To Salaries		1,320	By Gross profit b/d		10,571
To Office expenses		715	By Interest on loan		
To Provisions for doubtful			to Krishna	110	
debts:			*Add :* Outstanding	330	440
Required - 5% of	146				
₹ 2920 =	72				
+ Bad Debts (66+6)	218				
Less: Existing Provisions	88	130			
To Discount (Dr.)		132			
To Depreciation on :					
Plant & Machinery		3,300			
Furniture		55			
Freehold Property		330			
Loose tools		44			
To Net Profit		4,985			
		11,011			11,011

Balance Sheet as on 31st March, 2005 (₹ in 000)

Liabilities		₹	Assets		₹
Sundry creditors		4,400	Cash - in - hand		264
Bills Payable		550	Cash - at - bank		2,926
Capital	22,880		Sundry debtors	2,920	
Add: Net Profit	4,985		*Less*: Provision for bad	146	2,774
	27,865		debts		
Less: Drawings	1,320	26,545	Loan to krishna	4,400	
			Add: Outstanding interest	330	4,730
			Stock		7,260
			Loose tools	220	
			Less : Depreciation	44	176
			Furniture	550	
			Less: Depreciation	55	495
			Plant & Machinery	9,900	
			Less: Depreciation		
			Freehold property	3,300	6,600
			Less: Depreciation	6,600	
				330	6,270
		31,495			31,495

2007 - June [8] The following is the schedule of balances on 31st March, 2007 extracted from the books of Dinesh:

Particulars	*Debit (₹)*	*Credit (₹)*
Cash in hand	1,400	—
Cash at bank	2,600	—
Sundry debtors	86,000	—
Stock as on 1st April, 2006	62,000	—
Furniture and fixtures	21,400	—
Office equipments	16,000	—
Buildings	60,000	—
Motor car	20,000	—
Sundry creditors	—	43,000
Loan	—	30,000
Provision for bad debts	—	3,000
Purchases	1,40,000	—
Purchases return	—	2,600
Sales	—	2,30,000
Sales return	4,200	—
Salaries	11,000	—
Rent for godown	5,500	—
Interest on loan	2,700	—
Rates and taxes	2,100	—
Discount allowed to debtors	2,400	—
Discount received from creditors	—	1,600
Freight on purchases	1,200	—
Carriage outwards	2,000	—
Drawings	12,000	—
Printing and stationery	1,800	—
Electric charges	2,200	—
Insurance premium	5,500	—
General office expenses	3,000	—
Bad debts	2,000	—
Bank charges	1,600	—
Motor car expenses	3,600	
Capital account	—	1,62,000
	4,72,200	4,72,200

Prepare the trading and profit and loss account for the year ended 31st March, 2007 and the balance sheet as on that date after making the following adjustments:

(i) Provide depreciation on —
  (a) Building @ 5%
  (b) Furniture and fixture @ 10%
  (c) Office equipments @ 15%; and
  (d) Motor car @ 20%.

(ii) Value of stock at the close of the year was ₹ 44,000.

(iii) Provision for bad debts is to be maintained at 5% of sundry debtors.

(iv) Insurance premium includes ₹ 4,000 paid towards proprietor's life insurance policy and the balance of the insurance charges covers the period from 1st July, 2006 to 30th June, 2007. **(16 marks)**

Answer:

Shri Dinesh

Dr. Trading & P & L A/c for the year ended 31/03/07 Cr.

Particulars		₹	Particulars		₹
To Opening stock		62,000	By Sales	2,30,000	
To Purchases	1,40,000		*Less*: Return	4,200	2,25,800
Less : Returns	2,600	1,37,400	By Closing stock		44,000
To Freight on purchases		1,200			
To Gross profit		69,200			
		2,69,800			2,69,800
To Salaries		11,000	By Gross Profit b/d		69,200
To Rent for godown		5,500	By Discount received		1,600
To Interest on loan		2,700			
To Rates & taxes		2,100			
To Discount Allowed		2,400			
To Carriage Outwards		2,000			
To Printing & Stationery		1,800			
To Electric Charges		2,200			
To Insurance Premium	5,500				
Less: Drawings	4,000				
	1,500				
Less: Unexpired	375	1,125			
To General Office Exp.		3,000			
To Bank Charges		1,600			
To Motor car expenses		3,600			

To Bad debts	2,000				
Add : New provision	4,300				
Less : Old Provision	6,300				
	3,000	3,300			
To Depreciation on :					
Building	3,000				
Furniture	2,140				
Equipments	2,400				
Motor car	4,000	11,540			
To Net profit Transfer-ed to capital A/c		16,935			
		70,800			70,800

Balance Sheet as on 31st March, 2007

Liabilities		₹	Assets		₹
Creditors		43,000	Cash-in-hand		1,400
Loan		30,000	Cash-at-bank		2,600
Capital	1,62,000		Unexpired Insurance		375
Add: Net profit	16,935		Debtors	86,000	
	1,78,935		*Less*: Provision		
Less: Drawings	16,000	1,62,935	for bad debts	4,300	81,700
(12000 + 4,000)			Stock		44,000
			Motor car	20,000	
			Less: Depreciation	4,000	16,000
			Furniture	21,400	
			Less: Depreciation	2,140	19,260
			Equipments	16,000	
			Less: Depreciation	2,400	13,600
			Buildings	60,000	
			Less: Depreciation	3,000	57,000
		2,35,935			2,35,935

2007 - Dec [4] (b) From the following data, you are required to prepare the trading and profit and loss account for the year ended 31st March, 2006 and a balance sheet as on that date:

	As on 1st April, 2005 (₹)	As on 31st March, 2006 (₹)
Creditors	1,57,700	1,24,000
Sundry expenses outstanding	6,000	3,300

Sundry assets	1,16,100	1,20,400
Stock-in-trade	80,400	1,11,200
Cash in hand and at bank	69,600	80,800
Trade Debtors	1,65,300	1,78,700

The following are the details relating to transactions during the year:

	₹
Cash and discount credited to debtors	6,40,000
Sales return	14,500
Bad debts	4,200
Sales (cash and credit)	7,18,100
Discount allowed by trade creditors	7,000
Purchase returns	4,000
Additional capital–paid into bank	85,000
Realisations from debtors –paid into bank	6,25,000
Cash purchases	10,300
Cash expenses	95,700
Paid by cheque for furniture purchased	4,300
Household expenses drawn from bank	31,800
Cash paid into bank	50,000
Cash drawn from bank	92,400
Cheques issued to trade creditors	6,02,700

(8 marks)

Answer:

Trading & P&L A/c For the year ended 31st March, 2006

Particulars			₹	Particulars			₹
To Opening Stock			80,400	By Sales :			
To Purchase :				Cash	46,000		
Cash	10,300			Credit	6,72,100	7,18,100	
Credit	5,80,000	5,90,300		*Less:* Return		14,500	7,03,600
Less: Returns		4,000	5,86,300	By Closing Stock			1,11,200
To Gross profit transfered to P&L A/c			1,48,100				
			8,14,800				8,14,800

To Sundry Expenses	95,700		By Gross Profit b/d	1,48,100
Add: Outstanding on 31/03/06	3,300		By Discount Received	7,000
	99,000			
Less: Outstanding on 31/03/05	6,000	93,000		
To Discount allowed		15,000		
To Bad debts		4,200		
To Net profit transfered to capital A/c		42,900		
		1,55,100		1,55,100

Balance Sheet as on 31st March, 2006

Liabilities		₹	Assets	₹
Capital	2,67,700		Sundry Assets	1,20,400
Add: Additional Capital	85,000		Stock	1,11,200
Net profit	42,900		Sundry Debtors	1,78,700
	3,95,600		Cash	80,800
Less: Drawings	31,800	3,63,800		
Sundry Creditors		1,24,000		
Outstanding expenses		3,300		
		4,91,100		4,91,100

Working Notes:

Dr. Cash & Bank A/c (Combined) Cr.

Particulars	₹	Particulars	₹
To Balance b/d	69,600	By Sundry creditors	6,02,700
To Sundries (contra)	50,000	By Sundries (contra)	50,000
To Sundries (contra)	92,400	By Sundries (contra)	92,400
To Sundry Debtors	6,25,000	By Drawings	31,800
To Capital A/c	85,000	By Furniture	4,300
To Sales (bal. Figure)	46,000	By Sundry expenses	95,700
		By Purchases	10,300
		By Balance c/d	80,800
	9,68,000		9,68,000

Dr. Total Creditors A/c Cr.

Particulars	₹	Particulars	₹
To Bank A/c	6,02,700	By Balance b/d	1,57,700
To Discount A/c	7,000	By Purchases A/c	5,80,000
To Purchase Return A/c	4,000	(Bal. Fig)	
To Balance c/d	1,24,000		
	7,37,700		7,37,700

Balance Sheet as on 1st April, 2005

Liabilities	₹	Assets	₹
Capital (Bal. Fig.)	2,67,700	Sundry Assets	1,16,100
Sundry Creditors	1,57,700	Stock	80,400
Outstanding Expenses	6,000	Sundry Debtors	1,65,300
		Cash-in-hand & bank	69,600
	4,31,400		4,31,400

2010 - June [7] From the following balances extracted from the books of Karan and the additional information, prepare the trading and profit and loss account for the year ended 31st March, 2010 and also show the balance sheet as on that date:

	Debit Balance	*Credit Balance*
	(₹ '000)	*(₹ '000)*
Stock on 1st April, 2009	625	—
Purchases and sales	903	1,372
Returns	22	13
Capital account	—	300
Drawings	45	—
Land and buildings	300	—
Furniture and fittings	80	—
Trade debtors and trade creditors	250	450
Cash in hand	35	—
Investments	100	—
Interest	—	5

Commission	—	30
Direct expenses	75	—
Postage, stationery and telephone	25	—
Fire insurance premium	20	—
Salaries	90	—
Bank overdraft	—	400
	2,570	2,570

Additional information:

(i) Closing stock on 31st March, 2010 is valued at ₹ 6,50,000. Goods worth ₹ 5,000 are reported to have been taken away by the proprietor for his personal use at home during the year.

(ii) Interest on investments ₹ 5,000 is yet to be received while ₹ 10,000 of the commission received is yet to be earned.

(iii) ₹ 5,000 of the fire insurance premium paid is in respect of the quarter ending 30th June, 2010.

(iv) Salaries ₹ 10,000 for March, 2010 and bank overdraft interest estimated at ₹ 20,000 are yet to be recorded as outstanding charges.

(v) Depreciation is to be provided on land and buildings @ 5% per annum and on furniture and fittings @ 10% per annum.

(vi) Make a provision for doubtful debts @ 5% of trade debtors.

(16 marks)

Answer:

Trading & Profit & Loss A/c for the year ended 31st March, 2010

Dr. **Cr.**

Particulars		₹ ('000)	Particulars		₹ ('000)
To Opening stock		625	By Sales	1,372	
To Purchases	903		(−) Returns	22	1,350
(−) Returns	13		By Closing Stock		650
	890				
(−) Drawings	5	885			
To Direct Expenses		75			
To Gross Profit to P&L A/c		415			
		2,000			2,000

To Postage, Stationery & telephone		25	By Gross Profit b/d		415
			By Interest	5	
To Free Insurance Premium	20	15	(+) Accrued interest on		
(−) Prepaid	<u>5</u>		investment	<u>5</u>	10
To Salaries	90	100	By Commission	30	
(+) Outstanding	<u>10</u>	20	(−) received in advance	<u>10</u>	20
To Interest on bank overdraft					
To Depreciation on :					
Land & Building	15				
Furniture & Fittings	<u>8</u>	23			
To Provision for doubtful debts		12.5			
To Net Profit Transferred to Capital A/c		249.5			
		445.0			445.0

Balance Sheet as on 31st March, 2010

Liabilities		Amount	Assets		Amount
Capital	3,000		Land & Building	300	
(+) Net profit	<u>249.5</u>		(−) Depreciation	<u>15</u>	285
	549.5		Furniture & Fixture	80	
(−) Drawings (45 + 5)	<u>50.0</u>	499.5	(−) Depreciation	<u>8</u>	72
Creditors		450	Debtors	250	
Bank overdraft	400		(−) Provision for		
(+) interest due	<u>20</u>	420	doubtful debts	<u>12.5</u>	237.5
Commission received-in-			Investments	100	
advance		10	(+) Accrued interest	<u>5</u>	105
Outstanding Salaries		10	Cash-in-hand		35
			Prepaid fire insurance premium		5
			Closing stock		650
		1,389.5			1,389.5

Working Notes:

(1) Depreciation on land & building = $300 \times \frac{5}{100} = 15$

(2) Depreciation on furniture & fittings = $80 \times \frac{10}{100} = 8$

(3) Provision for doubtful debts = $250 \times \frac{5}{100} = 12.5$