CA Foundation
Accounts Theory

1.meaning & scope of Accounting

1) Define accounting. What are the sub-fields of accounting?
2) Who are the users of accounts?
3) Discuss the limitations which must be kept in mind while evaluating the Financial Statements.
4) What services can a Chartered Accountant provide to the society?

Answer :

1) Accounting is the art of recording, classifying, and summarising 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 result thereof. Various subfields of accounting are listed as: Financial Accounting; Management Accounting; Cost Accounting; Social Responsibility Accounting and Human Resource Accounting.

2) Users of accounts can be listed as Investors, Employees, Lenders, Suppliers and Creditors, Customers, Govt. and their agencies, public and Management.

3) Limitations which must be kept in mind while evaluating the Financial Statements are as follows:

- The factors which may be relevant in assessing the worth of the enterprise don't find place in the accounts as they cannot be measured in terms of money.
- Balance Sheet shows the position of the business on the day of its preparation and not on the future date while the users of the accounts are interested in knowing the position of the business in the near future and also in long run and not for the past date.
- Accounting ignores changes in some money factors like inflation etc.
- There are occasions when accounting principles conflict with each other.
- Certain accounting estimates depend on the sheer personal judgement of the accountant.
- Different accounting policies for the treatment of same item adds to the probability of manipulations.

4) The practice of accountancy has crossed its usual domain of preparation of financial statements, interpretation of such statements and audit thereof. Accountants are presently taking active role in company laws and other corporate legislation matters, in taxation laws matters (both direct and indirect) and in general management problems.

2. ACCOUNTING CONCEPTS, PRINCIPLES AND CONVENTIONS

1. Briefly explain the qualitative characteristics of the financial statements:

Answer :

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users.

SHORT NOTES :

1. Fundamental accounting assumptions.
2. Periodicity concept.
3. Accounting conventions.
4. Measurement.

Answer :

1 Fundamental Accounting Assumptions: Fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed. The Institute of Chartered Accountants of India issued Accounting Standard (AS) 1 on 'Disclosure of Accounting Policies' according to which the following have been generally accepted as fundamental accounting assumptions:

1. Going concern: The enterprise is normally viewed as a going concern, i.e. as continuing operations for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

2. Consistency: It is assumed that accounting policies are consistent from one period to another.

3. Accrual:Guidance Note on 'TermsusedinFinancialStatements'defines accrualbasis of accounting as "the method of recording transactions by which revenue, costs, assets and liabilities are reflected in the accounts in the period in which they accrue." The accrual 'basis of accounting' includes considerations relating to deferrals, allocations, depreciation and amortisation. Financial statements prepared on the accrual basis inform users not only of past events involving the payment and receipt of cash but also of obligations to pay cash in future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions. Accrual basis is also referred to as mercantile basis of accounting.

2. Periodicity concept: According to this concept accounts should be prepared after every period & not at the end of the life of the entity.

3. Accounting conventions: Accounting conventions emerge out of accounting practices, commonly known as accounting principles, adopted by various organizations over a period of time. These conventions are derived by usage and practice. The accountancy bodies of the world may change any of the convention to improve the quality of accounting information. Accounting conventions need not have universal application.

4. Measurementisvitalaspectofaccounting.Primarilytransactionsandeventsaremeasured in terms of money. Any measurement discipline deals with three basic elements of measurement viz., identification of objects and events to be measured, selection of standard or scale to be used, and evaluation of dimension of measurement standards or scale.
Kohler defined measurement as the assignment of a system of ordinal or cardinal numbers to the results of a scheme of inquiry or apparatus of observations in accordance with logical or mathematical rules.
Three important elements of measurement are:
(1) Identification of objects and events to be measured; (2)Selection of standard or scale to be used;
(3)Evaluation of dimension of measurement standard or scale.

DISTINGUISH BETWEEN

1) Money measurement concept and matching concept
2) Going concern and cost concept

1) Distinction between Money measurement concept and matching concept

As per Money Measurement concept, only those transactions, which can be measured in terms of money are recorded. Since money is the medium of exchange and the standard of economic value, this concept requires that those transactions alone that are capable of being measured in terms of money be only to be recorded in the books of accounts. Transactions and events that cannot be expressed in terms of money are not recorded in the business books.

In Matching concept, all expenses matched with the revenue of that period should only be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.

2) Distinction between Going concern and cost concept

Going Concern Concept
The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future.

Cost Concept
By this concept, the value of an asset is to be determined on the basis of historical cost, in other words, acquisition cost.

3.ACCOUNTING POLICIES

1. Define Accounting Policies in brief. Identify few areas wherein different accounting policies are frequently encountered.
2. "Change in accounting policy may have a material effect on the items of financial statements." Explain the statement with the help of an example.

Answer :

1. Accounting Policies refer to specific accounting principles and methods of applying these principles adopted by the enterprise in the preparation and presentation of financial statements.

2. Change in accounting policy may have a material effect on the items of financial statements. For example, if depreciation method is changed from straight-line method to written-down value method, or if cost formula used for inventory valuation is changed from weighted average to FIFO. Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts.

1) Define Measurement in brief. Explain the significant elements of measurement.
2) Describe in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the balance sheet or statement of profit and loss.

Answer :

1. Measurement is vital aspect of accounting. Primarily transactions and events are measured in terms of money. Three elements of measurement are: (1) Identification of objects and events to be measured; (2) Selection of standard or scale to be used;(3)Evaluation of dimension of measurement standard or scale.

2. Alternative measurement bases are: (i)Historical Cost; (ii)Current cost (iii) Realizables (Settlement) Value and (iv) Present Value.

5. CAPITAL AND REVENUE EXPENDITURES AND RECEIPTS

1. What are the basic considerations in distinguishing between capital and revenue expenditures?
2. Define revenue receipts and give examples. How are these receipts treated?

Answer:

1. The basic considerations in distinction
a) Nature of business.
b) Recurring nature of expenditure.
c) Purpose of expenses.
d) Effect on revenue generating capacity of business.
e) Materiality of the amount involved.

2. Receipts which are obtained in course of normal business activities are revenue receipts (e.g. receipts from sale of goods or services, interest income etc.).
Revenue receipts should not be equated with the actual cash receipts. Revenue receipts are credited to the Profit and Loss Account.

3) Capital and revenue expenditure.

The basic considerations in distinction between capital and revenue expenditures are:

(a) Nature of business: For a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset. Therefore, the nature of business is a very important criterion in separating expenditure between capital and revenue.

(b)Recurring nature of expenditure: If the frequency of an expense is quite oftenin an accounting year then it is said to be an expenditure of revenue nature while non-recurring expenditure is infrequent in nature and do not occur often in an accounting year. Monthly salary or rent is the example of revenue expenditure as they are incurred every month while purchase of assets is not the transaction done regularly therefore, classified as capital expenditure unless materiality criteria defines it as revenue expenditure.

(c) Purpose of expenses: Expenses for repairs of machine may be incurred in course of normal maintenance of the asset. Such expenses are revenue in nature. On the other hand, expenditure incurred for major repair of the asset so as to increase its productive capacity is capital in nature.

(d)Effect on revenue generating capacity of business: The expenses which helpto generate income/revenue in the current period are revenue in nature and should be matched against the revenue earned in the current period. On the other hand, if expenditure helps to generate revenue over more than one accounting period, it is generally called capital expenditure.

(e) Materiality of the amount involved: Relative proportion of the amount involved is another important consideration in distinction between revenue and capital.

6. INDIAN ACCOUNTING STANDARDS

1. Explain the objective of "Accounting Standards" in brief.
2. State the advantages of setting Accounting Standards.

Answer :

1. Accounting Standards are selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. The main objective of Accounting Standards is to establish standards which have to be complied with, to ensure that financial statements are prepared in accordance with generally accepted accounting principles. Accounting Standards seek to suggest rules and criteria of accounting measurements. These standards harmonize the diverse accounting policies and practices at present in use in India.

2. The main advantage of setting accounting standards is that the adoption and application of accounting standards ensure uniformity, comparability and qualitative improvement in the preparation and presentation of financial statements. The other advantages are: Reduction in variations; Disclosures beyond that required by law and Facilitates comparison.

7. CONTINGENT ASSETS AND CONTINGENT LIABILITIES

DISTINGUISH BETWEEN :

1. Provision and Contingent Liability.
2. Liability and Contingent liability.

Answer :

1. Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation. On the other hand, a Contingent liability is a possible obligation that may or may not crystallize depending on the occurrence or non-occurrence of one or more uncertain future events.

2. A liability is defined as the present financial obligation of an enterprise, which arises from past events. On the other hand, in the case of contingent liability, either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.

8. BASIC ACCOUNTING PROCEDURES - JOURNAL ENTRIES

SHORT NOTES :

1. classification of accounts.
2. Double entry system.
3. Journal.

Answer :

1. Accounts are broadly classified into assets, liabilities and capital. The basic accounting equation specifies broad categories, which are as follows:

i. Assets: These are resources controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise, namely cash, stock of goods, land, buildings, machinery etc.

ii. Liabilities: These are financial obligations of an enterprise other than owner's equity namely long term loans, creditors, outstanding expenses etc.

iii. Capital: It generally refer to the amounts invested in an enterprise by its owner(s), the accretion to it or a reduction in it. Since capital is affected by expenses and incomes of revenue nature, there are two more categories of accounts, namely expenses and incomes. The difference between incomes and expenses are taken into capital account.

- Expenses: These represents those accounts which show the amount spent or even lost in carrying on operations.
- Incomes: These represent those accounts which show the revenue amounts earned by the enterprise.

However, traditionally accounts are classified as follows:

i. Personal Accounts: These accounts relate to persons, institutions, debtors or creditors. Impersonal Accounts: These represent accounts which are not personal. These can be further sub-divided as follows:

ii. Real Accounts: These accounts relate to assets of the firm but not debt e.g. accounts relating to land, buildings, cash in hand etc.

iii. Nominal accounts: These accounts relate to expenses, losses, gains, revenues etc.

2. Double entry system may be defined as that system which recognizes and records both the aspects of a transaction.
Every transaction has two aspects and according to this system, both the aspects are recorded. This system was developed in the 15th century in Italy by Luca Pacioli. It has proved to be systematic and has been found of great use for recording the financial affairs for all institutions requiring use of money.

This system offers the under mentioned advantages:
a) By the use of this system, the accuracy of the accounting work can be established through the device of trial balance.
b) The profit earned or loss suffered during a period can be ascertained together with details.
c) The financial position of the firm or the institution concerned, can be ascertained at the end of each period, through preparation of the balance sheet.
d) The system permits accounts to be kept in as much detail as necessary and therefore, affords significant information for the purpose of control etc.
e) Result of one year may be compared with those of previous years and reasons for the change may be ascertained. It is because of these advantages that the double entry system has been used extensively in all countries.

3. Transactions are first entered in a book called 'Journal' to show which account should be debited and which should be credited. Journal creates preliminary records and, is also called subsidiary book. All transactions are first recorded in the journal as and when they occur, the record is chronological, otherwise it would be difficult to maintain the records in an ordinary manner. Journal gives details regarding any transaction. Thus journal tells the amounts to be debited and credited and also the accounts involved.

DISTINGUISH BETWEEN

1. Real account and nominal account.

Answer :

1. Real account and nominal account. - A real account is an account relating to properties and assets, other than personal accounts of the firm. Examples are land, buildings, machinery, cash, investments etc. Nominal accounts relate to expenses or losses, incomes and gains. Examples are: wages, salaries, rent, depreciation etc. The net result of all the nominal accounts is reflected as profit or loss which is transferred to the capital account. Nominal accounts are therefore, temporary. The real accounts are shown in the balance sheet along with personal accounts.

8. LEDGERS

1. What do you mean by principal books of accounts?
2. What are the rules of posting of journal entries into the Ledger?

Answer :

1. Ledger is known as principal books of accounts and it provides full information regarding all the transactions pertaining to any individual account. Ledger contains all set of accounts (viz. personal, real and nominal accounts).

2. Rules regarding posting of entries in the ledger:
a) Separate account is opened in ledger book for each account and entries from ledger posted to respective account accordingly.
b) It is a practice to use words 'To' and 'By' while posting transactions in the ledger. The word 'To' is used in the particular column with the accounts written on the debit side while 'By' is used with the accounts written in the particular column of the credit side. These 'To' and 'By' do not have any meanings but are used to the account debited and credited.
c) The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.

9. TRIAL BALANCE

1. What is the trial balance? And how it is prepared?
2. Explain objectives of preparation of trial balance.
3. Even if the trial balance agrees, some errors may remain. Do you agree? Explain.

1. Preparation of trial balance is the third phase in the accounting process. After posting the accounts in the ledger, a statement is prepared to show separately the debit and credit balances. Such a statement is known as the trial balance. Trial balance contains various ledger balances on a particular date. It forms the basis for preparing final statement i.e. profit and loss statement and balance sheet. It is tallies, it means that the accounts are arithmetically accurate but certain errors may still remain undetected. Therefore, it is very important to carefully journalise and post the entries, following are rules of accounting

2. The preparation of trial balance has the following objectives:
i. Trial balance enables one to establish whether the posting and other accounting processes have been carried out without committing arithmetical errors. In other words, the trial balance helps to establish arithmetical accuracy of the books.
ii. Financial statements are normally prepared on the basis of agreed trial balance; otherwise the work may be cumbersome. Preparation of financial statements, therefore, is the second objective.
iii. The trial balance serves as a summary of what is contained in the ledger; the ledger may have to be seen only when details are required in respect of an account.

3. In spite of the agreement of the trial balance some errors may remain. These may be of the following types:
i. Transaction has not been entered at all in the journal.
ii. A wrong amount has been written in both columns of the journal.
iii. A wrong account has been mentioned in the journal.
iv. An entry has not at all been posted in the ledger.
v. Entry is posted twice in the ledger.

10. SUBSIDIARY BOOKS

1. Which subsidiary books are normally used in a business?

Answer :

1. Normally, the following subsidiary books are used in a business:

i. Cash Book to record receipts and payments of cash, including receipts into and payments out of the bank.

ii. Purchases Book to record credit purchases of goods dealt in or of the materials and stores required in the factory.

iii. Purchase Returns Books to record the returns of goods and materials previously purchased.

iv. Sales Book to record the sales of the goods dealt in by the firm.

v. Sale Returns Book to record the returns made by the customers.

vi. Bills Receivable Books to record the receipts of promissory notes or hundies from various parties.

vii. Bills Payable Book to record the issue of the promissory notes or hundies to other parties.

viii. Journal (proper) to record the transactions which cannot be recorded in any of the seven books mentioned above.

SHORT NOTES

1. Advantages of subsidiary books.

Answer:

1. Advantages of Subsidiary Books

The use of subsidiary books affords the undermentioned advantages :

i. Division of work

ii. Specialisation and efficiency

iii. Saving of the time

iv. Availability of information's

v. Facility in checking

11. CASH BOOK

1. Is cash book a subsidiary book or a principal book? Explain.
2. What are the various kinds of cash book?
3. What are the advantages of a three column cash book?

Answer :

1. Cash transactions are straightaway recorded in the Cash Book and on the basis of such a record, ledger accounts are prepared. Therefore, the Cash Book is a subsidiary book. But the Cash Book itself serves as the cash account and the bank accoun the balances are entered in the trial balance directly. The Cash Book, therefore, is part of the ledger also. Hence, it has also to be treated as the principal book. The Cash Book is thus both a subsidiary book and a principal book.

2. The main Cash Book may be of the three types:
i. Simple Cash Book;
ii. Two-column Cash Book;
iii. Three-column Cash Book.
In addition to the main Cash Book, firms also generally maintain a petty cash book but that is purely a subsidiary book.

3. The advantages of three column Cash Book are that -
a) the Cash Account and the Bank Account are prepared simultaneously, therefore the double entry is completed in the Cash Book itself. Thus the contra entries can be easily cross-checked in Cash column in one side and the Bank column in the other side of the Cash Book. Also the chances of error are reduced.
b) the information regarding Cash in Hand and the Bank Balance can be obtained very easily and quickly as there is no need to prepare Ledger of the Bank Account.

12. BANK RECONCILIATION STATEMENT

1. Write short note on Bank reconciliation statement.
2. State the causes of difference between the balance shown by the pass book and the cash book.

Answer :

1. Bank reconciliation statement is prepared as on a particular date to reconcile and explain the causes of difference between the bank balance as per cash book and the same as per savings bank pass book or current account statement. At the end of each month, the bank balance as per cash book and that as per pass book /bank statement should be compared and, if there is disagreement, these balances should be reconciled stating exact reasons of disagreement. The reconciliation is made in a statement called the bank reconciliation statement.

2. The difference between the balance shown by the passbook and the cashbook may arise on account of the following:

i. Cheques issued but not yet presented for payment.
ii. Cheques deposited into the bank but not yet cleared.
iii. Interest allowed by the bank.
iv. Interest and expenses charged by the bank.
v. Interest and dividends collected by the bank.
vi. Direct payments by the bank.
vii. Direct deposits into the bank by a customer & Dishonour of a bill discounted with the bank.
viii. Bills collected by the bank on behalf of the customer.
ix. An error committed in cash book or by the bank etc.
x. Undercasting or Overcasting in cashbook.

SHORT NOTES

1. Importance of bank reconciliation to an industrial unit.

Answer :

1. Banks are essential to modern society, but for an industrial unit, it serves as necessary instrument in the commercial world. Most of the transactions of the business are done through bank whether it is a receipt or payment. Rather, it is legally necessary to operate the transactions through bank after a certain limit. All the transactions, which have been operated through bank, if not verified properly, the industrial unit may not be sure about its liquidity position in the bank on a particular date. There may be some cheques which have been issued, but not presented for payment, as well as there may be some deposits which has been deposited in the bank, but not collected or credited so far. Some expenses might have been debited or bills might have been dishonoured. It is not known to the industrial unit in time, it may lead to wrong conclusions. The errors committed by bank may not be known without preparing bank reconciliation statement. Preparation of bank reconciliation statement prevents the chances of embezzlement. Hence, bank reconciliation statement is very important and is a necessity of an industrial unit as it plays a key role in the liquidity control of the industry.

13. RECTIFICATION OF ERRORS

1. How does errors of omission differ from errors of commission?
2. What is error of principle and how does it affect Trial Balance?
3. When and how is Suspense account used to rectify errors?

Answer:

1.Errors of Omission: If a transaction is completely or partially omitted from the books of account, it will be a case of omission. Examples would be: not recording a credit purchase of furniture or not posting an entry into the ledger.

ii) Errors of Commission: If an amount is posted in the wrong account or it is written on the wrong side or the totals are wrong or a wrong balance is struck, it will be a case of "errors of commission."

2. Errors of principle: When a transaction is recorded in contravention of accounting principles, like treating the purchase of an asset as an expense, it is an error of principle. In this case there is no effect on the trial balance since the amounts are placed on the correct side, though in a wrong account. Suppose on the purchase of a typewriter, the office expenses account is debited; the trial balance will still agree.

3. The method of correction of error indicated so far is appropriate when the errors have been located before the end of the accounting period. After the corrections the trial balance will agree. Sometimes the trial balance is artificially made to agree inspite of errors by opening a suspense account and putting the difference in the trial balance to the account - the suspense account will be debited if the total of the credit column in the trial balance exceeds the total of the debit column; it will be credited in the other case. Each and every error detected can only be corrected by a complete journal entry. Those errors for which journal entries were not possible at the earlier stage will now be rectified by a journal entry(s), the difference or the unknown side is being taken care of by suspense account. Those errors for which entries were possible even at the first stage will now be rectified in the same way.

14. INVENTORIES

1. Define inventory. Explain the importance of proper valuation of inventory in the preparation of statements of the business entity.

Answer :

Inventory can be defined as assets held

- for sale in the ordinary course of business, or
- in the process of production for such sale, or
- for consumption in the production of goods or services for sale, including maintenance supplies and consumables other than machinery spares.

significance of inventory valuation arises due to the following reasons:

Determination of Income

Ascertainment of Financial Position

Liquidity Analysis

Statutory Compliance

SHORT NOTES :

1. Adjusted Selling Price method of determining cost of stock.
2. Principal methods of ascertainment of cost of inventory.

Answer :

1. Adjusted selling method is also called retails inventory method. It is used widely in retail
business or in business where the inventory comprises of items, the individual costs of which are not readily ascertainable. The historical cost of inventory is estimated by calculating it in the first instance at selling price and then deducting an amount equal to the estimated gross margin of profit on such stocks.

2. The specific identification method, First-In-First-Out (FIFO) and weighted average cost formulae are the principal methods of ascertaining the cost of inventory. The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by specific identification of their individual costs under the specific identification method.

DISTINGUISH BETWEEN:
1. LIFO and FIFO basis of costing of stock.
2. FIFO and weighted average price method of stock costing.

Answer :

1.Under FIFO method of inventory valuation, inventories purchased first are issued first. The closing inventories are valued at latest purchase prices and inventory issues are valued at corresponding old purchase prices. In other words, under FIFO method, costs are assigned to the units issued in the same order as the costs entered in the inventory. During periods of rising prices, cost of goods sold are valued at older and lower prices if FIFO is followed and consequently reported profits rise due to lower cost of goods sold.

On the other hand, under LIFO method of inventory valuation, units of inventories issued should be valued at the prices paid for the latest purchases and closing inventories should be valued at the prices paid for earlier purchases. In other words, closing inventories are valued at old purchase prices and issues are valued at corresponding latest purchase prices.

2.Under the First-In-First-Out (FIFO) method of valuation of stock, the actual issue of goods is usually the earliest lot on hand. Hence, the stock in hand will therefore consist of the latest consignments. The closing stock is valued at the price paid for such consignments.

The weighted average price method is not a simple average price method. Under this method of valuation of stock, a stock ledger is maintained, recording receipts and issues on daily basis. A new average would be calculated on receiving fresh consignment. The average price thus calculated after considering arrival of new consignment with the previous value of stock and dividing the preceding stock value and the cost of new arrival with the total units of preceding and new arrival will give the weighted average price.

15. CONCEPT AND ACCOUNTING OF DEPRECIATION

1. What factors are considered for calculation of depreciation of a plant?

Answer :

1. The factors considered for calculation of depreciation are as:

(i)Cost of asset including expenses for installation, commissioning, trial run etc.

(ii) Estimated useful life of the asset

(iii) Estimated scrap value (if any) at the end of useful life of the asset.

1. Depletion method of depreciation
2. Machine Hour Rate method of calculating depreciation.

Answer :

1. Natural resources include physical assets like mineral deposits, oil and gas resources and timber. These natural resources exhaust by exploitation. Depletion per unit is calculated as Acquisition cost-Residual value / Estimated life in terms of production units

2. Machine Hour Rate method of calculating depreciation: Where it is practicable to keep a record of the actual running hours of each machine, depreciation may be calculated on the basis of hours that the concerned machinery worked. Under machine hour rate method of calculating depreciation, the life of a machine is not estimated in years but in hours. Thus depreciation is calculated after estimating the total number of hours that machine would work during its whole life; however, it may have to be varied from time to time, on a consideration of the changes in the economic and technological conditions which might take place, to ensure that the amount provided for depreciation corresponds to that considered appropriate in the changed circumstances. Proper records are maintained for running hours of the machine and depreciation is computed accordingly. For example, the cost of a machine is `10,00,000 and life of the machine is estimated at 50,000 hours. The hourly depreciation will be calculated as follows:
Hourly Depreciation = Total cost of Machine / Estimated life of Machine = `10,00,000 / 50,000 hours = 20 per hour
If the machine runs for say, 2,000 hours in a particular period, depreciation for the period will be 2,000 hours x` 20 = `40,000.

DISTINGUISH BETWEEN:

1. Straight line method of depreciation and Written down value method of depreciation.

Answer :

1. Under straight line method an equal amount is written off each year throughout the working life of the depreciable tangible asset so as to reduce the cost of the asset to nil or to its scarp value at the end. Under reducing balance method, a fixed percentage is charged on the diminishing balance of the asset each year so as to reduce the value of the asset to its scarp value at the end of useful life. The basic distinction between these two methods are as follows: Under straight line method, annual depreciation charge is equal throughout the life of the asset; but under reducing balance method, depreciation charge is reduced over the years as the asset grows old.
Under straight-line method, the asset can be fully depreciated but under reducing balance method asset can never be fully depreciated.
Under straight line method the charge for depreciation is constant while repair charges increase with the life of the asset, so the total charge throughout the life of the asset will not be uniform. To the contrary, under reducing balance method, depreciation charges become high in the initial years but generally repair remains low. As the asset grows old depreciation charge reduces but repair expenses increase. Thus under reducing balance method depreciation and repairs are more or less evenly distributed throughout the life of the asset.

Define the following terms:

i. Capital Commitment
ii. Expired Cost
iii. Floating Charge
iv. Obsolescence

Answer

i. Capital commitment: Future liability for capital expenditure in respect of which contracts have been made.

ii. Expired cost: The portion of the expenditure from which no further benefit is expected. Also termed as expense.

iii. Floating charge: A general charge on some or all assets of an enterprise which are not attached to the specific assets and are given as security against a debt.

iv. Obsolescence: Diminution in the value of an asset by reason of its becoming out-of-date or less useful due to technological changes, improvement in production methods, change in market demand for the product or service output of the asset, legal or other restrictions.

16. BILLS OF EXCHANGE AND PROMISSORY NOTES

1. What is bill of exchange? How does it differ from Promissory Note?

Answer:

1. A bill of exchange has been defined as "an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to or to the order of certain person or to the bearer of the instrument". When such an order is accepted by the drawee, it becomes a valid bill of exchange. A promissory note is an instrument in writing (not being a bank note or a government currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

A promissory note needs no acceptance, as the debtor himself writes the document promising to pay the stated amount. Like bills of exchange, promissory notes are also negotiable instruments, and can be transferred by endorsement. In case of bill of exchange, the drawer and the payee may be the same person but in case of a promissory note, the maker and the payee cannot be the same person.

SHORT NOTES

1. Accommodation bill.
2. Renewal of bill.
3. Bill of exchange and the various parties to it.
4. Retirement of bills of exchange.

Answer:

1. Bills of Exchange are usually drawn to facilitate trade transmission, that is, bills are meant to finance actual purchase and sale of goods. But the mechanism of bill can be utilised to raise finance also. When bills are used for such a purpose, they are known as accommodation bills.

2. When the acceptor of a bill finds himself in financial straits to honour the bill on the due date, then he may request the drawer to cancel the original bill and draw on him a fresh bill for another period. And if the drawer agrees, a new bill in place of the original bill may be accepted by the drawee for another period. This is called the renewal of bill.

3. A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money to or to the order of certain person or to the bearer of the instrument. When such an order is accepted by the drawee on the face of the order itself, it becomes a valid bill of exchange.

There are three parties to a bill of exchange:

a) The drawer, who draws the bill, that is, the creditor to whom the money is owing;

b) The drawee, the person to whom the bill is addressed or on whom it is drawn and who accepts the bill that is, the debtor; and

c) The payee, the person who is to receive the payment. The drawer in many cases is also the payee.

4. Retirement of bills of exchange: Sometimes, the acceptor of a bill of exchange has spare funds much before the maturity date of the bill of exchange accepted by him. He may, therefore, desire to pay the bill before the due date. In such a circumstance, the acceptor shall ask the payee or the holder of the bill to accept cash before the maturity date. If the payee agrees, the acceptor may be allowed a rebate or discount on such early payment. This rebate is generally the interest at an agreed rate for the period between the date of payment and date of maturity. The interest/rebate/discount becomes the income of the acceptor and expense of the payee. It is a consideration for premature payment. When a bill is paid before due date, it is said to be retired under rebate.

DISTINGUISH BETWEEN:
1. Trade bill vs. Accommodation bill.

Answer:

1. Distinction between Trade bill and Accommodation bill

a) Trade bills are usually drawn to facilitate trade transmission, that is, these bills are meant to finance actual purchase and sale of goods. On the other hand, an accommodation bill is one which is drawn, accepted or endorsed for the purpose of arranging financial accommodation for one or more interested parties.

b) On discount of a trade bill, full amount is retained by the drawer. In an accommodation bill however, the amount may be shared by the drawer and the drawee in an agreed ratio.

c) Trade bill is drawn for some consideration while accommodation bill is drawn and accepted without any consideration.

d) Trade bill acts as an evidence of indebtedness while accommodation bill acts as a source of finance.

e) In order to recover the debt, the drawer can initiate legal action on a trade bill. In accommodation bill, legal remedy for the recovery of amount may not be available for immediate parties.

17. SALE OF GOODS ON APPROVAL OR RETURN BASIS

1. What are the features of sale of goods on approval or return basis? Explain in brief.
2. When 'sale or return basis' transactions are numerous, what books are maintained by the business entity.

Answer :

1. Features of sale of goods on approval or return basis: (i) There is a change in the possession of goods from one person to another. (ii) It does not involve transfer of ownership of goods. The ownership is passed only when the retailer gives his approval or if the goods are not returned within that specified period. (iii) The retailer (customer) does not incur any liability when the goods are merely sent to him.

2. When transactions are numerous, a business maintains the following books: (a) Sale or Return Day Book; and (b) Sale or Return Ledger. 'Ledger' contains the accounts of the customers and the 'Sale or Return' Total account. 'Day Book' is the primary book which records all transactions, and from there these are entered in the 'Sale or Return' Total account. It is important to remember that both are Memorandum Books, i.e., these records are not a part of regular books of accounts.

18. CONSIGNMENT

SHORT NOTES

1. Del-credere commission.
2. Account sales.
3. Over-riding commission.

Answer :

1. Del-credere commission is an additional commission paid by the consignor to the consignee for undertaking responsibility of collection of debts. Generally, the consignee gets ordinary commission for sales made by him as a percentage of gross sales, over and above, he may get del-credere commission for the additional responsibility of debt collection. Sometimes it is agreed that del-credere commission shall be allowed on credit sales only. However, in the absence of any such agreement the consignor allows del-credere commission on total sales and not merely on credit sales. If the consignee is entitled to del-credere commission, he has to bear the bad debts; if any, arising, out of credit sale of consignment goods.

2. Account sales is a periodic statement furnished by the consignee to the consignor stating therein, the quantity sold, price charged, expenses incurred on behalf of the consignee and commission payable to him in respect of a particular consignment, and the net amount due from him and remittance received if any. It also shows the details of quantity of goods received, destroyed, if any, and still held as stock.

3. Over-riding commission is an extra commission allowed to the consignee in addition to the normal commission. Such additional commission is generally allowed:-

To provide additional incentive to the consignee for the purpose of introducing and creating a market for a new product.

To provide incentive for supervising the performance of other agents in a particular area.

To provide incentive for ensuring that the goods are sold by the consignee at the highest possible price.

Distinguish between:
1. Consignment sale and Normal sale.
2. Commission and Discount.
3. provision and contingent liability.

Answer :
1. In case of consignment, the property in the goods remains with the consignor until the goods are actually sold. The consignee acts only as a custodian of goods sent by consignor. In consignment, the ownership of goods does not pass on to the consignee in any case. In case of ordinary sale, the ownership of goods passes to the buyer immediately after sale. In case of consignment, the risk attached to the goods remain with the consignor even after sending the goods to the consignee. However, in case of ordinary sale, as soon as the property in the goods passes on to the buyers, the risk attached to the goods also passes at the same time. The relationship between consignor and consignee is that of principal and agent. In case of credit sale, the relationship between the buyer and the seller is that of a debtor and a creditor.

2. Commission may be defined as remuneration of an employee or agent relating to services performed in connection with sales, purchases, collections or other types of business transactions and is usually based on a percentage of the amounts involved.
Commission earned is accounted for as an income in the books of accounts, and commission allowed or paid is accounted for as an expense in the books of the party availing such facility or service.
The term discount refers to any reduction or rebate allowed and is used to express one of the following situations:
An allowance given for the settlement of a debt before it is due i.e. cash discount.
An allowance given to the whole sellers or bulk buyers on the list price or retail price, known as trade discount. A trade discount is not shown in the books of account separately and it is shown by way of deduction from cost of purchases.

Difference between Provision and Contingent liability

(1) A provision meets the recognitioncriteria. A contingent liability fails to meet thesame.
(2) Provision is a present liability of uncertain amount, which can be measured reliably by using a substantial degree of estimation.
A Contingent liability is a possible obligation that may or may not crystallise depending on the occurrence or non-occurrence of one or more uncertain future events.
(3) Provision is recognized when (a) an enterprise has a present obligationarising from past events; an outflow of resources embodying economic benefits is probable, and (b) a reliable estimate can be made of the amount of the obligation.
Contingent liability includes present obligations that do not meet therecognition criteria because either it is not probable that settlement of thoseobligations will require outflow ofeconomic benefit or the amount cannot be reliably estimated.
(4) If the management estimates that itis probable that the settlement of an obligation will result in outflow ofeconomic benefits, it recognises a provision in the balance sheet.
If the management estimates, that it is less likely that any economic benefit will outflow from the firm to settle the obligation, it discloses the obligation as a contingent liability.

19. AVERAGE DUE DATE

1. Define Average Due Date.
2. List out the various instances when Average Due Date can be used.

Answer :

1. In business enterprises, many receipts and payments by and from a single party may occur
at different points of time. To simplify the calculation of interest involved for such transactions, the idea of average due date has been developed. Average Due Date is a break-even date on which the net amount payable can be settled without causing loss of interest either to the borrower or the lender.

2. Few instances where average due date can be used:
i. Calculation of interest on drawings made by the proprietors or partners of a business firm
at several points of time.
ii. Settlement of accounts between a principal and an agent.
iii. Settlement of contra accounts, that is, A and B sell goods to each other on different dates.

20 . Account current

1. Define Account Current. Explain ways of preparing an Account Current
2. Write short note on Red-ink interest.

Answer :

1. An Account Current is a running statement of transactions between parties for a given period of time and includes interest allowed or charged on various items. It takes the form of an ledger account. There are three ways of preparing an Account Current:

(I)With help of interest table.
(ii)By means of products.
(iii)By means of products of balances.

2. In case the due date of a bill falls after the date of closing the account, then no interest is allowed for that. However, interest from the date of closing to such due date is written in "Red-Ink" in the appropriate side of the 'Account current'. This interest is called Red-Ink interest. This Red Ink interest is treated as negative interest. In actual practice, however the product of such bill [value of bill X (due date-closing date) is written in ordinary ink in the opposite side on which the bill is entered]. It means interest from future date from date of account current i.e., present date. In earlier periods, it was written in red ink; hence it got the name of red ink interest. It implies that rebate will be allowed on interest paid/ received, if settlement of future due transaction is done on account current date

21. FINAL ACCOUNTS OF MANUFACTURING ENTITIES

1. Write short note on By-products.
2. Differentiate between Direct Manufacturing Expenses and Indirect Manufacturing expenses

Answer :

1. By-products generally have insignificant value as compared to the value of main product. They are generally valued at net realisable value, if their costs cannot be separately identified. It is often treated, as "Miscellaneous income" but the correct treatment would be to credit the sale value of the by-product to Manufacturing Account so as to reduce to that extent, the cost of manufacture of main product.

2. Direct manufacturing expenses are costs, other than material or wages, which are incurred for a specific product or saleable service.
Indirect Manufacturing expenses are also called Manufacturing overhead, Production overhead, Works overhead, etc. Overhead is defined as total cost of indirect material, indirect wages and indirect expenses.

22. FINAL ACCOUNTS OF NON-MANUFACTURING ENTITIES

1.Discuss the limitations which must be kept in mind while evaluating the Financial Statements.

Answer:

Limitations which must be kept in mind while evaluating the Financial Statements are as follows:

i. The factors which may be relevant in assessing the worth of the enterprise don't find place in the accounts as they cannot be measured in terms of money

ii. Balance sheet shows the position of the business on the day of its preparation and not on the future date while the users of the accounts are interested in knowing the position of the business in the near future and also in the long run and not for the past date.

iii. Accounting ignores changes in some money factors like inflation etc.

iv. There are occasions when accounting principles conflict with each other.

v. Certain accounting estimates depend on the sheer personal judgment of the accountant.

vi. Different accounting policies for the treatment of same item adds to the probability of manipulations.

SHORT NOTES
1. Balance sheet.
2. Trading account
3. Closing entries

Answer :

1. The balance sheet may be defined as "a statement which sets out the assets and liabilities of a firm or an institution as at a certain date." Since even a single transaction will make a difference to some of the assets or liabilities, the balance sheet is true only at a particular point of time. That is the significance of the word "as at."

2. At the end of the year, it is necessary to ascertain the net profit or the net loss. For this purpose, it is first necessary to know the gross profit or gross loss with the helps to Trading A/c. Gross Profit is the difference between the selling price and the cost of the goods sold.

3. Closing entries: The entries that have to be made in the journal for preparing the Trading and the Profit and Loss Account that is for transferring the various accounts to these two accounts are known as closing entries.

Distinguish between
1. Provision and reserve fund.

Answer :

1. Provision means "any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy". Reserve Fund: It signifies the amount standing to the credit of the reserve that is invested outside the business in securities which are readily realisable e.g., when the amounts set apart for replacement of an asset are invested periodically, in government securities or shares. The account to which these amounts are annually credited is described as the Reserve Fund.

23. INTRODUCTION TO COMPANY ACCOUNTS

SHORT NOTES :

1. Foreign company.
2. Small company.
3. Company limited by guarantee.

Answer :

1. Foreign Company

According to Section 2 (42) of the Companies Act, 2103, "Foreign company" means any company or body corporate incorporated outside India which –

a) Has a place of business in India whether by itself or through an agent physically or through electronic mode; and

b) Conducts any business activity in India in any other manner.

2. Small Company

Section 2(85) of the Companies Act, 2013 defines "Small company" means a company, other than a public company.

i. paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or

ii. turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.

3. Company limited by Guarantee

As per Section 2(21) of the Companies Act, 2013, "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

24.ISSUE, FORFEITURE AND RE-ISSUE OF SHARES

1. Can a company issue shares at discount?

Answer :

1. According to Section 53 of the Companies Act, 2013, a Company cannot issue shares at a discount except in the case of issue of sweat equity shares (issued to employees and directors). Thus any issue of shares at discount shall be void.

SHORT NOTES

1. Re-issue of forfeited shares

Answer :

1. A forfeited share is merely a share available to the company for sale and remains vested in the company for that purpose only. Reissue of forfeited shares is not allotment of shares but only a sale. The share, after forfeiture, in the hands of the company is subject to an obligation to dispose it off. In practice, forfeited shares are disposed off by auction. These shares can be re-issued at any price so long as the total amount received (from the original allottee and the second purchaser) for those shares is not less than the amount in arrears on those shares.

DISTINGUISH BETWEEN:

1. Calls-in-Arrears and Calls-in-advance
2. Issue of shares for cash and Issue of Shares for Consideration other than Cash

Answer :

1. Calls-in-Arrears: Sometimes shareholders fail to pay the amount due on allotment or calls.
The total unpaid amount on one or more instalments is known as Calls-in-Arrears or Unpaid Calls. Such amount represents the uncollected amount of capital from the shareholders; hence, it is shown by way of deduction from 'called-up capital' to arrive at paid-up value of the share capital.
Calls-in-advance: Some shareholders may sometimes pay a part, or whole, of the amount not yet called up, such amount is known as Calls-in-advance.

2. The shares can be issued by a company either for cash or for consideration other than cash. Public limited companies, generally, issue their shares for cash and use such cash to buy the various types of assets needed in the business. Sometimes, however, a company may issue shares in a direct exchange for land, buildings or other assets.

25. INTRODUCTION TO PARTNERSHIP ACCOUNTS

1. Features of Partnership
2. Powers of Partners

Answer :

1. The following four essential features of a partnership, namely:

i. Partnership is the result of an agreement: It means that the relation of partnership arises from contract and not from status.
ii. Business: A partnership can exist only in business.
iii. Sharing of profit: The persons concerned must agree to share the profits of the business.
iv. Mutual agency: It means that the business is to be carried on by all or any of them acting for all. Thus, if the person carrying on the business acts not only for himself but for others also so that they stand in the positions of principals and agents, they are partners.

2. Powers of partners are the following:
i. Buying and selling of goods;
ii. Receiving payments on behalf of the firm and giving valid receipt;
iii. Drawing cheques and drawing, accepting and endorsing bills of exchange and
promissory notes in the name of the firm;
iv. Borrowing money on behalf of the firm with or without pledging the inventories-in-
trade;
v. Engaging servants for the business of the firm.

DISTINGUISH BETWEEN:
1. Fixed capital and fluctuating capital.
2. Partnership and joint venture

Answer :

1. In fixed capital method, generally initial capital contributions by the partners are credited to partners' capital accounts and all subsequent transactions and events are dealt with through current accounts, Unless a decision is taken to change it, initial capital account balance is not changed.
In fluctuating capital method, no current account is maintained. All such transactions and events are passed through capital accounts. Naturally, capital account balance of the partners fluctuates every time. So in fixed capital method a fixed capital balance is maintained over a period of time while in fluctuating capital method capital account balances fluctuate all the time.

2. Partnership is a relationship between persons who have agreed to share profits or losses of a business carried on by all or any of them acting for all. Whereas, a joint venture is a contractual agreement whereby two or more parties undertake an economic activity which is subject to joint control. Thus joint venture is a temporary partnership formed for a particular economic activity or venture. The following differences exist between joint venture and other forms of partnership:

The owners of a partnership business are called partners, whereas the owners of a joint venture are called co-ventures.

Accrual basis of accounting is followed in case of partnership and a joint venture generally follows cash basis of accounting.

The financial results of a partnership are obtained at regular intervals. On the other hand, the financial results of a joint venture are obtained generally at the end of the venture.

However, there may be ventures in certain areas which may last for a longer period, for example, joint ventures in key areas like power, petroleum, telecommunication, etc. In these cases, the ventures may even last for ten/fifteen years. For these long term joint ventures, financial statements are prepared periodically by following accrual basis of accounting. Therefore, the line of distinction between long term joint ventures and other forms of partnership is very thin.

26.ADMISSION OF A NEW PARTNER

1. Write short note on Revaluation account.

Answer :

1. When a new partner is admitted into the partnership, assets are revalued and liabilities are reassessed. A Revaluation Account (or Profit and Loss Adjustment Account) is opened for the purpose. This account is debited with all reduction in the value of assets and increase in liabilities and credited with increase in the value of assets and decrease in the value of liabilities. The difference in two sides of the account will show profit or loss. This is transferred to the Capital Accounts of old partners in the old profit sharing ratio.

1. What is the difference between revaluation account and memorandum revaluation account?

Answer :

1. Difference between revaluation account and memorandum revaluation account

i. Revaluation account is prepared to find out the profit or loss on revaluation of assets and liabilities which appear in the new balance sheet at the new or revalued figures. Memorandum revaluation account is also prepared to record the effect of revaluation of assets and liabilities which of course are recorded at their old figures in the new balance sheet.

ii. Revaluation account is not divided into two parts. But the memorandum revaluation account has two parts: first part for old partners and second part for all partners including the new partner.

27. RETIREMENT OF A PARTNER

1. What is joint life policy? What is the objective of taking such a policy?

Answer :

A partnership firm may decide to take a Joint Life Insurance Policy on the lives of all partners. The firm pays the premium and the amount of policy is payable to the firm on the death of any partner or on the maturity of policy whichever is earlier. The objective of taking such a policy is to minimize the financial hardships to the event of payment of a large sum to the legal representatives of a deceased partner or to the retiring partner.

SHORT NOTES
1. Calculation of gaining ratio.
2. Final payment of a retiring partner.

Answer :

1. On retirement of a partner, the continuing partners will gain in terms of profit sharing ratio. For example, if A, B and C were sharing profits and losses in the ratio of 5:3: 2 and B retires, then A and C have to decide at which ratio they will share profits and losses in future. If it is decided that the continuing partners will share profits and losses in future at the ratio of 3:2, then A gains 1/10th [(3/5)-(5/10)] and C gains 2/10 [(2/5)-(2/10)]. So the gaining ratio between A and C is 1:2. If A and C decide to continue at the ratio 5:2, this indicates that they are dividing the gained share in the previous profit sharing ratio.

2. ThefollowingadjustmentsarenecessaryintheCapitalA/c:
(i)Transfer of reserve,
(ii)Transfer of goodwill,
(iii)Transfer of profit/loss on revaluation.
After adjustment of these items, the Capital Account balance standing to the credit of the retiring partner represents amount to be paid to him. The continuing partners may discharge the whole claim at the time of retirement.

28. DEATH OF A PARTNER

1. Explain distinction between retirement and death of a partner as relating to finalisation of amount payable.
2. What amount is payable to legal representatives of dead partner?

Answer :

1.The basic distinction between retirement and death of a partner relates to finalisation of amount payable to the Executor of the deceased partner. Although, revaluation of goodwill is done in the same way as it has been done in case of retirement, in addition, the executor of the deceased partner is entitled to share of profit upto the date of death

2.When the partner dies the amount payable to him/her is paid to his/her legal representatives. The representatives are entitled to the followings :

a) The amount standing to the credit to the capital account of the deceased partner;
b) Interest on capital, if provided in the partnership deed upto the date of death;
c) Share of goodwill of the firm;
d) Share of undistributed profit or reserves;
e) Share of profit on the revaluation of assets and liabilities;
f) Share of profit upto the date of death;
g) Share of Joint Life Policy.

DISTINGUISH BETWEEN

1. Receipt and Payment and Income and Expenditure Account.

Answer :

1. Non-profit making organizations such as public hospitals, public educational institutions, clubs etc., conventionally prepare Receipt and Payment Account and Income and Expenditure Account to show periodic performance for a particular accounting period. For distinguishing features of both the accounts,