CA Foundation Chapter 1.

Unit 1

Meaning and Scope of Accounting:

Introduction

Every individual performs some kind of economy activity. Some of the economy activities are run for individual benefit (salary received) and some of the economic activities are run for social benefit (school college hospital etc). All these economic activities are performed through 'Transaction and Events'.

Transaction is used to mean a business, performance of an act, an agreement while Event is used to mean 'a happening as a consequence of transaction, a result'.

As an aid to decision making, everybody wants to keep record of transactions and events and to have adequate information about the economic activities.

Accounting has universal application for recording transactions and events and presenting suitable information for decision making regarding any type of economic activity.

Meaning of Accounting:

'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 '.

Thus accounting is simply an art of record keeping. The process of accounting starts by first identifying the events and transactions which are of financial character and then be record in the books of accounts.

This recording is done in journal or subsidiary books also known as a primary books. Every good record keeping system include suitable classification of transactions and events as well as their summarisation for ready reference. After the transactions and events are recorded, they are transferred to subsidiary books i.e. Ledger. In ledger transactions and events are classified in terms of income, expense, assets and liabilities according to their characteristics and summarized in financial statements.

The transactions and events must be measured in terms of money. Measurement in terms of money means measuring at the ruling currency of a country for example rupee in India, dollar in USA. Accounting also interprets the recorded, classified and summarised transactions and events ends with communicating the results to the users of accounting.

Procedural Aspects of Accounting:

Basically the procedure of accounting can be divided into following two parts -

1) Generating financial information and

2) Using the financial information.

Generating Financial Information:

1) Recording: This is the basic function of accounting. All business transactions of a financial character, as evidenced by some documents are recorded in the books of accounts. Recording is done in a book called 'Journal' this book may further be divided into several 'Subsidiary Books'.

2) Classifying: Classification means to group the transactions or entries of similar nature at one place in usable form. The book containing classified information is called 'Ledger.'

3) Summarising: It is concerned with the preparation and presentation of the classified data in a manner useful to the internal as well as the external users of financial statements this process leads to the preparation of the financial statement

4) Analysing: The term 'Analysis' means methodical classification of the data given in the financial statements. Thus, analysing means, presentation of the financial information in a readable and simplified form.

5) Interpreting: This is the final function of accounting. It is concerned with explaining the meaning and significance of the relationship establishd by the analysis of accounting data. Analysis and Interpretation of the recorded data will enable the end user to make a meaningful judgement about the profitability and financial position of the business operations.

6) Communicating: It is concerned with the transmission of summarized, analysed and interpreted information to the end users to enable them to make rational decision. This is done by preparation and distribution of accounting reports which includes financial statements, accounting ratios, graphs diagrams, fund flow statements etc.

Using the Financial Information

There are certain users of accounts, Which include the investors, employees, lenders, suppliers, customers, government and other agencies and the public at large. They would like to know and understand whether the business of the company is going well or there are challenges to run the business. Accounting provides the art of presenting information systematically to the users of accounts.

Objective of Accounting:

The objectives of accounting can be given as follows.

1) Systematic Recording:

To record the financial aspects of a business transaction in a systematic manner so it can be used to prepare the financial statements.(Journal ledger and trial balance).

2) Ascertainment of results:

To ascertain the results of business operations on the basis of recorded transactions which helps the management and stakeholders to take rational decisions.(income statement)

3) Ascertainment of financial position:

To know the financial position of the business, the accountant prepares a Balance Sheet on the basis of accounting record which helps in ascertaining the financial help of the business. (Balance Sheet)

4) Provide information to the users:

To communicate the financial results to the various stakeholders by means of financial statements which helps them in rational decision making.(financial reports)

5) Solvency position:

To know the liquidity and solvency position of the business enterprise with the help of accounting records such as Income and position statement (accounting ratios).

Functions of Accounting

The main functions of accounting are as follows

a) It measures past performance of the business entity and depicts its current financial position

b) It helps in forecasting future performance and financial position of the business using past data.

c) It provides information to the users of accounts to add rational decision making.

d) It assesses performance achieved in relation to targets and discloses information regarding accounting policies.

e) It identifies weaknesses of the operational system and provide feedback regarding effectiveness of measures adopted to check such weaknesses.

f) It provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues.

Book Keeping

Book Keeping is an activity concerned with the recording of financial data relating to the business operations in a significant and orderly manner. It classifies the financial data according to transactions and events.

The purpose behind book-keeping record is to show the correct position of each head of income and expenditure. Similarly to know the amount due and receivable. If a proper financial record is not maintained, it is not possible to get all these details.

Book-keeping is a process by means of which financial data relating to transactions and events is recorded in the books of accounts. Thus book-keeping constitutes as the base for the accounting.

Objectives of Book-keeping:

1) To provide complete and permanent record of all transactions in a systematic and logical manner.

2) To show the financial effect of the transaction and events on the business.

3) To ascertain the financial effect of all the transactions upon the financial position of the business.

Distinguish between Book-keeping and Accounting

Sub - F**ields of Accounting**

Accounting is a fairly wide term and encompasses within it many meanings and types of recording and analyzing activities. These various types of accounting are known as subfields of accounting. They include financial accounting, management accounting, human resource accounting, etc.

The important sub- fields of accounting are :

A) Financial Accounting

Financial accounting largely concerns itself with the preparation and interpretation of financial statements and accounts of a company. It is historical in nature as it records transactions which had already been occurred. The final step of financial accounting is the preparation of profit and loss account and balance sheet. It primarily helps in determination of the net result for an accounting period and the financial position as on that date.

B) Management Accounting:

In management accounting, the information is grouped and organized in a way desired by the managers who are the internal users of this information. So such reports, budgets, memos make the information easier to understand and analyze for the managers. Thus they can plan their managerial activities accordingly and take better and smarter decisions as well. One of the main functions of management accounting is to modify the data according to the needs of the top, middle and lower levels of management.

C) Cost Accounting

Cost accounting is the process of accounting and ultimately controlling the costs related to a product or job or process or an operation. It allocates the expenditures of the company to their correct product/service/job to help determine the exact cost of such a cost center. And cost accounting also organizes and presents this information suitable for the purpose and use of the management.

D) Human Resource Accounting

Human resource accounting **is a**n attempt to identify, quantify and report investments made in human resources of an organisation that are not presently accounted for under conventional accounting practice.

One of the main objectives of human resource accounting is to determine the cost of recruiting, developing, training and maintaining the human resources of an organization.

E) Social Responsibility Accounting

An organization does not function in a vacuum. It is a part of a society and the economy. In fact, every company benefits from the society by using its resources and inputs. So a company should also be responsible for the welfare of such a society and must make some contribution towards the same. So social accounting is associated with determining the social costs of the company and the social benefits it contributed.

Users of Accounting Information:

Accounting information serves both internal and external users, including management, employees, owners, investors, creditors, government agencies, and the public, who use it for various purposes like decision-making, performance evaluation etc.,

A) Internal Users:

a) Management: Uses accounting information to make operational and strategic decisions, evaluate performance, and plan for the future.

b) Employees: Use accounting information to understand the company's financial health, which can impact their compensation, job security, and other benefits.

c) Owners/Shareholders:.Use accounting information to assess the company's performance, profitability, and growth potential, which affects their investment returns.

B).External Users:

a) Investors: Use accounting information to assess the company's financial health and potential for future returns, helping them make investment decisions.

b) Creditors/Lenders: Use accounting information to evaluate a company's ability to repay loans and meet financial obligations.

c) Government Agencies: Use accounting information for tax assessment, regulatory compliance, and economic analysis.

d) Customers: Use accounting information to assess the company's financial stability and ability to deliver on promises.

e) The General Public: Use accounting information to understand the overall economic situation and make informed decisions.

f) Regulatory Agencies: Use accounting information to ensure compliance with regulations and standards.

g) Researchers: Use accounting information for research and analysis.

Relationship of accounting with other disciplines

Accounting, as a multifaceted discipline, interacts with and relies on other fields like economics, mathematics, statistics, law, and management, to effectively identify, measure, and communicate an organization's economic health.

Here's a breakdown of these relationships:

a) Accounting and Economics:

Both disciplines focus on the efficient allocation of scarce resources, with accounting providing the data for economic analysis and decision-making.

b) Accounting and Mathematics:

Accounting relies heavily on mathematical principles for calculations, including interest, annuities, and financial ratios.

c) Accounting and Statistics:

Statistical methods are crucial for collecting, analyzing, and interpreting financial data, which is essential for accounting practices.

d) Accounting and Law:

Accounting must comply with various laws and regulations, including partnership acts, company acts, and labor laws, ensuring legal compliance in financial reporting and auditing.

e) Accounting and Management:

Accounting provides valuable information to management for decision-making, planning, and control, enabling them to make informed choices regarding resource allocation and operational strategies.

f) Accounting and other business functions:

Accounting coordinates with other business functions like purchasing, production, marketing, and service provision. Purchasing coordinates on credit terms, prices, payments, data capture, inventory, and budgeting with accounting.

Limitations of Accounting

While accounting plays a crucial role in providing financial information and supporting decision-making, it is important to recognize the limitations of accounting. The key limitations of accounting are:

a) Measurability:

One of the biggest limitations of accounting is that it cannot measure things/events that do not have a monetary value.

If a certain factor, no matter how important, cannot be expressed in money, it finds no place in accounting.

b) No Future Assessment:

The financial statements show the financial position of the firm on the date of preparation. Due to the dynamic nature of the business environment, a lot can change between such dates.

c) Historical Costs:

Accounting often uses historical costs to measure the values, failing to take into consideration factors such as inflation, price changes, etc.

d) Accounting Policies:

There is no global standard in accounting policies. Different countries and organizations follow different standards, such as Accounting Standards, GAAP, and IFRS.

This can lead to conflicts and confusion, as not all accounting policies follow the same line of thinking.

e) Estimates:

Sometimes, in accounting, estimation may be required as it is not possible to establish exact amounts. These estimates will depend on the personal judgment of the accountant and are extremely subjective in nature.

f) Errors and Frauds:

Accounting is done by humans, so there will always be the scope of human errors.

There is also the fear of possible manipulation of accounts to cover up a fraud, which is that much harder to spot.

Role of Accountant in the Society

There are few professions in the world having high esteem in public eyes, Accounting profession is one of them. It helps business to see its financial position and plan for the future. It serves for welfare of society in numbers of ways by having education, training and experience. Accountants help not only in the matter of taxation, costing, management accounting, financial layout but also for financial planning and policies, budgetary policies even economics principle. Activities of accounting are not limited.

Area of service

Some of services are as follows:-

(1) Maintenance of books of accounts:

Record transactions in systematic manner. Help ascertaining profit and loss and financial position. Help in planning, decision-making, controlling function.

(2) Statutory Audit:

Every company requires to audit their accounts by an external auditor. Accountant helps auditor to audit the accounts.

(3) Internal Audit:

Internal auditor examines the accounting system and ensures management that accounts have been properly maintained. It improves operational efficiency of business.

(4) Taxation:

An accountant can handle taxation matter of business as well as of individual and can represent himself on their behalf to taxation authorities and settle tax liabilities. It can also reduce tax liability by proper planning.

(5) Management Accounting and consultancy services:

Management accountant is mainly responsible for internal reporting to management. It provides services for planning controlling current operation, decision-making and special matter and making long term plans. Accountant also provides consultancy service in area of management information system, expenditure control, new investment, working capital management, corporate planning etc.

(6) Financial advise:

Financial advise in following area:-

Investment, Insurance, Business expansion, Investigation etc, To ascertain financial position, to make or buy decision, to ascertain reason of profit fallen, to increase efficiency, for valuation of business etc

Other services

1) Secretarial work

2) Share Registration work

3) Company formation

4) liquidation of company.

5) Arbitrations

6) Cost Accounting.

Unit 2

Accounting concepts principles and conventions

Meaning

Accounting is an important part of a business, providing an organised and systematic way to record the financials. However, to implement the accounting processes efficiently, it is important to follow certain principles pointed out in the form of accounting concepts and conventions. If you follow the accounting concepts and principles accurately, it will help you make informed business decisions to grow your company.

Meaning of Accounting Concepts

The accounting concept is a process that helps prepare and record the financial transactions in an organisation, along with organising the book-keeping processes.

It is always important for business accountants and owners to clearly understand the basic accounting concepts. Such understanding helps in integrating uniformity and consistency within the business accounting processes.

Accounting principles are important because they provide uniformity and comparability in financial reporting.

Types of Accounting Concepts

Here is a list of different types of accounting concepts that you can implement in your business as per the requirements and situations of the company:

1. Going concern concept

According to the going concern concept, a firm will continue to operate indefinitely. This assumption has an impact on financial statement preparation, allowing accountants to portray long-term assets at their historical cost and giving stakeholders a more realistic picture of a company's financial health in the long run.

2. Business entity concept

In terms of the business entity concept, a business is a distinct economic entity from its owners. This notion guarantees that personal and corporate money are kept separate, allowing for transparent financial reporting. It facilitates measuring the success of the firm independent of its owners' financial actions, fostering openness and accountability.

3. Accrual concept

The accrual concept mandates that revenues and costs be recognised as they are received or spent, regardless of financial movements. This idea improves financial statement accuracy by matching them with the economic content of transactions and giving stakeholders a more complete knowledge of a company's financial status.

4. Money measurement concept

According to the money measurement concept, only monetary transactions should be documented in accounting. This approach makes quantification and comparison easier, ensuring that financial statements contain relevant and comparable information for decision-making.

5. Accounting period concept

The accounting period concept separates a company's economic existence into discrete periods, often a fiscal year, for financial reporting. This approach enables timely and consistent reporting, assisting stakeholders to evaluate a company's performance and make educated decisions at precise intervals.

6. Dual aspect concept

According to the dual aspect concept, every financial transaction includes two components: a debit and a credit. This double-entry technique keeps the accounting equation (Assets = Liabilities + Equity) balanced, allowing for a systematic approach to documenting and assessing financial transactions.

7. Revenue realisation concept

As to the income realisation concept, income should be recognised when it is earned, regardless of when payment is received. This notion prevents revenue from being recognised prematurely, aligning financial statements with the actual delivery of products or services and improving the trustworthiness of reported revenues.

8. Historical cost concept

The historical cost concept assesses assets at their original cost, giving financial reporting a solid and objective foundation. This notion improves dependability by minimising subjective values and guaranteeing that financial statements accurately represent asset purchase costs.

Accounting Conventions

Accounting conventions, also known as doctrine, are known to be principles that act as restrictions regarding organisational transactions that are unclear or complicated. Even though accounting conventions do not act as legally binding, these are considered generally accepted principles helping to maintain consistency within the financial statements of a company.

Types of Accounting Conventions

Similar to accounting concepts, accounting conventions also have different types that help implement the concept in business financials efficiently. Here is a list showcasing the types of accounting conventions:

1. Convention of conservatism

One of the most important accounting conventions that accountants apply in the business is the conservatism principle. This principle suggests that if two values are associated with a specific transaction, the lowest must be recorded on the asset or income side of the financial statement. In this case, the possibility of loss is taken care of.

This accounting convention aims to understate profits and assets while dealing with business losses. Such practice mostly helps in enhancing the overall reliability of company stakeholders on the financial statements.

2. Convention of materiality

This accounting convention is related to all the relative information available for an item or event of a company's financial transactions. An item is generally considered material with respect to the influence it has on an investor's decisions. The aspect of materiality differs from one organisation to another.

3. Convention of consistency

Consistency convention denotes that the same principles of accounting must be implemented to prepare the business financial statements, year after year. From the prepared financial statements, it is important to draw a meaningful conclusion of the same company when a comparison is made of the statements over a period.

4. Convention of full disclosure

The principle of full disclosure mandates the comprehensive revelation of all pertinent details in financial statements. This entails a thorough, impartial, and ample disclosure of accounting information.

Fundamental Accounting assumptions

There are three fundamental accounting assumptions that are presumed to be followed in every accounting transactions of an entity. Howsoever, it is not important that the business has followed these fundamental accounting assumptions.

A) Going Concern

Going concern is an assumption that an entity has no plan of winding up in the nearer future at the time of preparing financial statements. In other words, the entity will continue to exist indefinitely or it will be a going concern.

B) Consistency

As per the basic accounting assumptions, it is assumed that an entity is following the same concept until the changes are mentioned in the accounting policies, standards, and so forth. Consistency assumption helps the company to have uniform financial statements. This consistency helps the user of financial statements to compare the different period’s financial statements.

C) Accrual Assumption

As per the accrual fundamental accounting concept all the accounting transactions are recorded in the books of accounts once they are accrued irrespective the actual cash is received or not. As per the accrual concept, the income and expenditure are recorded in the year they are accrued.

Qualitative characteristics of financial statements

The qualitative characteristics of financial statements include

a) Understandability

The information must be readily understandable to users of the financial statements. This means that information must be clearly presented, with additional information supplied in the supporting footnotes as needed to assist in clarification. This means that you must avoid all obfuscation, where readers are buried in meaningless details.

b) Relevance

The information must be relevant to the needs of the users, which is the case when the information influences their economic decisions. This may involve reporting particularly relevant information, or information whose omission or misstatement could influence the economic decisions of users.

c) Reliability

The information must be free of material error and bias, and not misleading. Thus, the information should faithfully represent transactions and other events, reflect the underlying substance of events, and prudently represent estimates and uncertainties through proper disclosure.

d) Comparability

The information must be comparable to the financial information presented for other accounting periods, so that users can identify trends in the performance and financial position of the reporting entity. Comparability allows users to benchmark an entity's financial performance and position against its peers or against its past performance.

e) Materiality - The relevance of information is affected by its materiality. Information is material if its misstatement could influence the economic decisions of users taken on the basis of the financial information. Materiality depends on the size and nature of the item or error judged in the particular circumstances of its misstatement.

CA Foundation Chapter 1

Unit 3

Capital and Revenue Expenditures and Receipts

1. Capital and Revenue Expenditures and Receipts

The main functions of accounting include the ascertainment of profit/loss for an accounting period and financial position as at the end of that period. The distinction between capital and revenue items is important both from the Income Statement (Profit and Loss Account) as well as the Position Statement (Balance Sheet) point of view. For example, if a depreciable asset is purchased, the depreciation on that asset is charged to the Profit and Loss Account, and the written down value of the asset (or original cost of the asset less accumulated depreciation) is shown in the Balance Sheet. If the purchase of a depreciable asset, which is a capital expenditure, is treated as revenue expenditure it will understate the profit of the current year and overstate the profits of the subsequent years. Similarly, the Balance Sheet will not give a true and fair view of the assets and equity of the enterprise till the useful life of the asset is over assuming that the asset is not sold earlier.

Capital Expenditure

Expenditure that acquires a capital asset is capital expenditure. A capital asset is one that is used in or for the purposes of the business and not meant for sale in the ordinary course of business of the enterprise. Expenditure on the purchase and installation of machinery is a capital expenditure. Further when an expenditure is made with a view to bringing into existence an asset or advantage for the enduring benefit of trade is a capital expenditure in the absence of special circumstances leading to the opposite conclusion.

Capital expenditure increases the earning capacity or reduces the operating expenses of a business.

The following are the examples of capital expenditure :

a) Expenditure incurred for acquisition of fixed tangible assets such as land, building, machinery, furniture, motor vehicle etc.

b) Expenditure incurred for improvement or extension of fixed assets such as increasing the seating capacity of a theatre.

c) Expenditure incurred to bring the fixed assets to the place of their use and expenditure incurred on their installation or erection such as freight on fixed assets, wages paid for installation.

d) Expenditure incurred for the purchase of intangible assets such as goodwill, patent rights, and trademarks, copyright, etc.

e) Expenditure incurred for reconditioning of old fixed assets such as expenditure incurred on repairing or overhealing of secondhand machinery.

f) Major repairs and replacement of plant which increase the efficiency of the plant.

g) The cost of shifting a plant to another place is a capital expenditure.

Treatment of Capital Expenditure.

- Capital expenditure is capitalised. It is written off over the estimated useful life of the asset. For example, when machinery is purchased, Machinery Account is debited at the price paid for it and later shown in the Balance Sheet as an asset after deducting depreciation. Similarly, wages paid for the installation of machinery is capitalised by debiting the Machinery Account.

- Rules for Determining Capital Expenditure. The following are the rules for determining capital expenditure :
- An expenditure is capital expenditure, if it is incurred for acquiring a long term asset (having a useful life of more than one year) for use in the business to earn revenue and not meant for sale.
- An expenditure is capital expenditure, if it is incurred to put an asset into working condition. For example, the transportation and installation charges, legal charges like registration and stamp, architect fee paid for supervising construction of building is capitalised.
- An expenditure incurred for putting an old asset into working condition,
- An expenditure incurred to increase the earning capacity of a business is treated as capital expenditure. For example, expenditure incurred for shifting the factory to convenient site is a capital expenditure.
- Borrowing costs (e., interest and other costs incurred by an enterprise in connection with the borrowing of funds) that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset till the asset is ready for its intended use or sale as per AS-16 : Borrowing costs.

Revenue Expenditure

If an expenditure is made not for the purpose of bringing into existence any capital asset or advantage of enduring nature but for running the business or working it with a view to produce the profits is revenue expenditure. Such expenditure benefits the current period only. It is incurred to maintain the existing earning capacity of the business. For example, the amount spent on purchase of stock-in-trade is of revenue nature. Administrative expenses and selling and distribution expenses are other examples of revenue expenditure.

Rules for Determining Revenue Expenditure.

a) An expenditure incurred for the purpose of acquiring goods purchased for resale, consumable items, etc. is a revenue expenditure, purchase of raw material in the case of manufacturing unit

b) Expenditures incurred on other direct expenses, e., expenses on production and purchase of goods such as wages, power, freight etc. are revenue expenditure.

c) Expenditure incurred for maintaining fixed assets in working order is revenue expenditure. For example, amount spent on repairs and renewals is revenue expenditure.

d) Depreciation on fixed assets is revenue expenditure.

e) Expenditures incurred on office and administrative and selling and distribution departments (not covered above) in the normal course of business are revenue expenditures.

f) Expenditures incurred on non-operating expenses and losses are revenue expenditures. For example, interest on loan taken after commencement of commercial production, loss on sale of a long term asset, loss by theft, loss by fire are revenue expenditures.

g) Expenditure incurred by an enterprise to discharge itself from recurring liability is of revenue nature. For example, a lump sum amount paid to a pensioner by the employer is revenue expenditure.

h) Expenditure incurred for protecting the business is a revenue expenditure. For example, the amount spent on propaganda campaign to oppose the threatened nationalisation of industry is of revenue nature.

i) Expenditure incurred to maintain the existing efficiency or the earning capacity is of revenue type.

Distinction Between Capital Expenditure and Revenue Expenditure:

The following are the points of distinction between capital expenditure and revenue expenditure :

a) Enduring benefit : Capital expenditure is meant for enduring benefit, e., for more than one accounting period. Revenue expenditure benefits one accounting period only.

b) Nature of asset : Capital expenditure relates to the acquisition of fixed asset and revenue expenditure relates to the acquisition of stock-in-trade.

c) Effect on net profit : Capital expenditure is capitalised while revenue expenditure is transferred to the Trading or Profit and Loss Account. Unexpired portion of the capital expenditure is shown as an asset in the Balance Sheet. Revenue expenditure is expired cost.

d) Nature of liability discharged : Expenditure incurred by an assessee to free himself from a capital liability, for instance, disadvantageous lease is a capital expenditure, while the amount spent in discharging himself from a recurring liability is of revenue nature.

e) Periodicity of occurrence : Capital expenditure is usually of non-recurring nature while revenue expenditure is usually of recurring nature.

f) Earning capacity : Capital expenditure helps to increase the earning capacity of the business or to reduce the operating cost. Revenue expenditure is incurred to maintain the existing earning capacity of the business.

g) Matching : Capital expenditure are not matched against capital receipts. Revenue expenditures are matched against revenue receipts for income determination.

h) Commencement of business : Capital expenditures may be incurred even before the commencement of business. Revenue expenditures are incurred only after the commencement of business.

Deferred Revenue Expenditure

Deferred revenue expenditure is a revenue expenditure by nature but it is not treated as revenue expenditure on the ground that its benefit is not fully exhausted in the accounting period in which it is incurred. The Guidance Note on 'Terms used in Financial Statement', issued by the Institute of Chartered Accountant of India, states that "Deferred revenue expenditure is that expenditure for which payment has been made or a liability incurred but which is carried forward on the presumption that it will benefit over a subsequent period or periods."

Deferred revenue expenditure is, for the time being, deferred from being charged against revenue. The unwritten off portion of the deferred revenue expenditure is shown on the asset side of the Balance Sheet. A portion of the total deferred revenue expenditure is charged as revenue expenditure. Deferred revenue expenditure should be written off over a certain number of years.

Capital and Revenue Receipts

The distinction between capital receipt and revenue receipt is important because capital receipt is taken to the Balance Sheet and revenue receipt is taken to the Trading and Profit and Loss Account.

Capital receipts are the receipts which are not obtained in course of normal business activities of the enterprise. The examples of capital receipts are : capital contributed by the owner(s), secured or unsecured loans taken, receipts from sale of fixed assets and non-current investments.

In case of not for profit organisation, legacy and life membership are capital receipts.

Revenue receipts

- These are the receipts which are obtained in course of normal business activities. They include proceeds from sale of goods, fee received from the services rendered in the ordinary course of business, receipts. The nature of receipt is decided from the point of view of the person receiving it.

- The following broad principles may be laid down as guide for determining whether a particular receipt is of capital nature or of revenue nature :
- A receipt on account of fixed assets is a capital receipt whereas a receipt on account of current assets or circulating capital is a revenue receipt. For example, sale proceeds from sale of fixed assets is a capital receipt while proceeds from sale of stock-in-trade is a revenue receipt. Capital profit from sale of fixed asset is to be shown in Profit and Loss Accounts.
- A receipt in substitution of source of income is a capital receipt whereas a receipt in substitution of income alone is a revenue receipt. For example, compensation for loss of employment or agency is a capital receipt (though taxable) whereas damages for breach of business contract is a revenue receipt.
- An amount received for surrender of certain right under an agreement is a capital receipt whereas amount received by way of compensation of loss of future profits is a revenue receipt. For example, pension is a revenue receipt whereas lump sum received in commutation of pension is a capital receipt (though taxable).
- The nature of a receipt is determined exclusively by its character in the hands of the receiver.
- Where an asset is held as an investment, the sale proceeds of such asset is a capital receipt. But where an asset is held as stock-in-trade, the sale proceeds of such asset is a revenue receipt. For example, profit on sale of shares to a dealer in shares is a revenue receipt.

Distinction between Capital Receipts and Revenue Receipts

- Capital receipts are not obtained in the course of normal business activities of the enterprise whereas revenue receipts are obtained in the course of normal business activities.
- Capital receipts are usually obtained in case of a company from issue of shares, debentures, borrowings and sale of fixed assets or investments. Revenue receipts are usually obtained from sale of goods, rendering of services or use of enterprise resources yielding interest, royalties and dividend.
- Capital receipts are usually of non-recurring nature and revenue receipts are usually of recurring nature.

- Capital receipts from financing activities such as issue of shares, debentures and borrowings are shown on the liabilities side of the balance sheet as these receipts create liabilities payable at a future date whereas interest on borrowings is shown as a charge in the Profit and Loss Account and dividends to shareholders are shown as appropriation of profit in the appropriation section of Profit and Loss Account. Interest accrued/outstanding will also be shown as a liability.

CA Foundation Chapter 1

Unit 4

Contingent Liabilities:

Contingent liabilities and assets are potential obligations and gains, respectively, that may or may not materialize in the future due to uncertain events. They are not recognized in financial statements unless the likelihood of their occurrence is deemed probable. Contingent liabilities are disclosed if there's a possibility of an outflow of economic resources, while contingent assets are disclosed if an inflow of economic benefits is probable.

Contingent Liabilities:

Definition: A potential obligation whose existence will be confirmed by the occurrence of a future event that is not wholly within the control of the entity.

Examples: Pending lawsuits, warranties, and indemnities.

Accounting Treatment: Not recognized on the balance sheet, but disclosed if the possibility of an outflow of economic resources is more than remote.

Contingent Assets:

Definition: A possible asset whose existence will be confirmed by the occurrence of a future event that is not wholly within the control of the entity.

Examples: Potential gains from lawsuits or tax refunds.

Accounting Treatment: Not recognized on the balance sheet, but disclosed if an inflow of economic benefits is probable.

Key Differences:

Recognition:

Neither contingent liabilities nor assets are recognized in financial statements unless the event's occurrence becomes probable.

Disclosure:

Contingent liabilities are disclosed when there is a possibility of an outflow, while contingent assets are disclosed when there is a probability of an inflow.

Nature:

Contingent liabilities represent potential obligations, while contingent assets represent potential benefits.

CA foundation chapter 1

Unit 5

Accounting policies

INTRODUCTION

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.

Policies are based on various accounting concepts, principles and conventions that have already been explained in Unit 2 of Chapter 1. There is no single list of accounting policies, which are applicable to all enterprises in all circumstances. Enterprises operate in diverse and complex environmental situations and so they have to adopt various policies. The choice of specific accounting policy appropriate to the specific circumstances in which the enterprise is operating, calls for considerate judgement by the management.

Meaning and Need of Accounting Policies. Accounting Policies refer to

(a) the specific accounting principles, and

(b) the methods of applying those principles, adopted by the enterprise in the preparation and presentation of Financial Statements

Example: Inventory is valued at Cost or Net Realisable Value, whichever is lower. This is a principle. Cost can be determined either by First in First out (FIFO) method or Weighted Average Cost (WAC) or other suitable methods.

Need for disclosure:

Accounting Policies should be disclosed in the Financial Statements due to following reasons.

(a) To promote better understanding of Financial Statements.

(b) To provide meaningful Inter-Firm Comparison.

(c) To ensure compliance with Law, for example, where in case of Companies, disclosure is mandatory

(d) To comply with ICAI Requirements, in order to bring uniformity in disclosure.

Selection/Choice of Accounting Policies

Choice of accounting policy is an important policy decision which affects the performance measurement as well as financial position of the business entity. Selection of inappropriate accounting policy may lead to understatement or overstatement of performance and financial position. Thus, accounting policy should be selected with due care after considering its effect on the financial performance of the business enterprise from the angle of various users of accounts.

It is believed that no unified and exhaustive list of accounting policies can be suggested which has universal application. Three major characteristics which should be considered for the purpose of selection and application of accounting policies. viz., Prudence, Substance over form, and Materiality. The financial statements should be prepared on the basis of such accounting policies, which exhibit true and fair view of state of affairs of Balance Sheet and the Profit & Loss Account.

Examples wherein selection from a set of accounting policies is made, can be given as follows:

a) Inventories are valued at cost except for finished goods and by-products. Finished goods are valued at lower of cost or market value and by-products are valued at net realizable value.

b). Investments (long term) are valued at their acquisition cost. Provision for permanent diminution in value has been made wherever necessary.

Sometimes a wrong or inappropriate treatment is adopted for items in Balance Sheet, or Profit & Loss Account, or other statement. Disclosure of the treatment adopted is necessary in any case, but disclosure cannot rectify a wrong or inappropriate treatment.

CHANGE IN ACCOUNTING POLICIES

A change in accounting policies should be made in the following conditions:

(a) It is required by some statute or for compliance with an Accounting Standard

(b) Change would result in more appropriate presentation of financial statement

Change in accounting policy may have a material effect on the items of financial statements. For example, if cost formula used for inventory valuation is changed from weighted average to FIFO, or if interest is capitalized which was earlier not in practice, or if proportionate amount of interest is charged to inventory which was earlier not the practice, all these may increase or decrease the net profit.

Unless the effect of such change in accounting policy is quantified, the financial statements may not help the users of accounts. Therefore, it is necessary to quantify the effect of change on financial statement items like assets, liabilities, profit/loss.

CA Foundation Chapter 1

Unit 6

Accounting as a Measurement Discipline

Introduction:

Accounting is a very crucial part of any stream or subject. As a measurement discipline, it deals with measuring all the monetary inputs and outputs.

Measurement is one of the crucial aspects of accounting. It has inevitable regulation and evaluating techniques that impact the final valuation. It is the cordial assignment relating all the values according to the mathematics rules and observations. The valuation in accounting defines the availability of all the monetary values essential for measurement. It includes the liability, assets, and variations in investment with a rate of interest, which are some of the standard monetary values relevant to the accounting measurement.

Accounting measurement –Concept:

The concept of accounting measurement has values relative to ideas, investments, and profits. According to the data, such measurement is defined by many alternative units and the overall perspective of observation. The data and other information are received by constantly observing any working body's functionality that has the capital investment.

Definition:

The definition and total concept of the accounting measurement define the fact that any organisation must report the data in the active currency. It is according to the particular place where the company operates instead of the actual transaction type.

For example, when a company receives its funding in Euros, the primary transaction currency in which the company deals are pounds. In this situation, in the accounting data, the funding is represented with the converted value in the current currency that the company follows, i.e., from Euros to pounds. This method is highly followed in accounting when preparing annual and general statements.

There are various categories of the measurement system which deal with the account's calculations. All these measurement systems have variable standards which follow various government and organisation level regulations. The financial accounting measurement of accounts in terms of assets and liabilities has variable measurement standards.

Method:

The accounting measurement measures the monetary data in terms of money, units, working hours, etc. which means the accounting measurement method the company or organisation can represents their profits in terms of units sold or any other transactional values. All the economic data with financial profits and losses are in terms of units. If the payments or investment is received in some other currency, it should be added to the company accounts after the conversions. In some cases, the average working hours in which the company completes the order and records the profits are included in the accounting in the measurement discipline.

Critical Features of Accounting Measurement:

There are many vital features of the measurement regarding the company accounts and statements. These features play a crucial role in the accounting measurement, which also reflects the accurate valuation of all the monetary aspects. Below are the mentions:

Such measurement techniques use the particular data of working hours, units sold or purchased, and payments in specific currencies

The foreign currencies are included after conversion in the current active currency the company is using

According to the accounting measurement, the data calculations are done in many ways

It increases the accuracy after it matches every aspect of the calculation

Measurement Bases of Accounting:

The measurement is a different concept from the valuation. It has a wide range of methods that calculate valuation from different methods. This valuation depends upon the measurement value matching with variable methods. This calculation depends upon four integral bases for calculating cost accounting and other accounting, which mark a difference in the final valuation of an organisation. Below are the mentions:

Historical cost

Accounting as a measurement discipline works with a broad platform of calculating techniques. The historical cost calculation works by calculating the cash payments list of an asset. The historical cost is the acquisition price the company uses to acquire an asset. For liabilities, calculation records the payment of the procedure in return for any obligation, which must have a record of accounting.

Current cost

This cost accounting measurement calculates the liabilities by the cash or equivalent to balance the current obligation. The liability in such a case carries the undiscounted value of cash or equivalents. In the case of an asset, the current cost is calculated by reporting the acquired asset paid or line-up for payment of cash or equivalent in the current position. This amount in asset calculation can be discounted.

Realisable cost

The valuation basis in this type of financial accounting performs the calculation based on the realised value after any action. The asset records value by selling value in cash or equivalent values. In terms of liabilities, it records its valuation by the settlement amount after the payment.

Present value

This cost calculation in accounting calculates the assets by the current discounted values of cash of equivalents. It takes place with the sum of net cash inflows which the asset will generate after the normal business activities during the year. The liabilities are calculated by the net cash outflows of the discounted capital, which are expected to fulfil the liabilities with routine business performance in the coming year.

Conclusion:

These are some of the points which define accounting from a measurement perspective. The calculation with this perspective becomes easy and finite because of separate calculations in terms of units, currency and working hours. The prime step in the accounting model includes the objects or the event for the measurement. Cash invoices and cash receipts are objects which are essential for cost accounting. Similarly, the predictions are an integral part of accounting which helps in loan generation or investment. The prediction is based upon the organisation's past performance and market value. Specific standards work with the monetary calculation and regulation of accounting procedures in the measurement scale.

CA Foundation Chapter 1-

UNIT 7

ACCOUNTING STANDARDS

INTRODUCTION TO ACCOUNTING STANDARDS

Accounting standards are written policy documents issued by expert accounting body or by Government or other regulatory body covering the aspects of recognition, measurement, presentation and disclosure of accounting transactions in the financial statements.

Accounting Standards are in the nature of a structural framework within which credible financial statements can be prepared. These are formulated with a view to harmonize different accounting policies and practices.

The objective of Accounting Standards is to reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality. It ensures comparability of financial statements of different enterprises with a view to provide meaningful information to various users of financial statements.

The Accounting Standards describes the accounting principles and the methods of applying these the preparation and presentation of financial statements so that they give a true and fair view, the greater transparency and market discipline. Accounting Standards also helps the regulator benchmarking the accounting accuracy.

Accounting standards deal with the following issues:

(a) Recognition of events and transactions in the financial statements,

(b) Measurement of these transactions and events,

(c) Presentation of these transactions and events in the financial statements in a manner that is meaningful and understandable to the users, and

(d) Disclosure requirements which should be there to enable the public at large and the stakeholders and the potential investors in particular, to get an insight into what these financial statements reflect and thereby facilitating them to take prudent and informed business decisions.

Objective of accounting standards

1) To eliminate the non-comparability of financial statements and thereby improving the reliability of financial statements.

2) To provide a standard set of accounting policies, valuation norms and disclosure requirements.

3) To make accounting principles used in India at par with internationally recognised standards.

4) To adopt a uniform set of accounting principles for financial reporting.

5) To create a single recognised framework of the accounting system.

6) To ensure transparency in the financial statements of companies.

Importance or benefits of accounting standards

1) Promoting Uniformity and Comparability:

By establishing a uniform set of rules, accounting standards ensure that financial statements from different companies can be compared, both within a specific company over time and across different companies.

2) Enhancing Transparency and Clarity:

Accounting standards help organizations report their assets, liabilities, revenues, and expenses in a clear and understandable manner, making financial information accessible to stakeholders like investors, creditors, and regulators.

3) Ensuring Reliability and Accuracy:

Accounting standards ensure that financial statements accurately reflect a company's financial position and performance, providing a solid foundation for decision-making.

4) Facilitating Decision-Making: Reliable and comparable financial information, provided by accounting standards, enables stakeholders to make rational decisions about investments, lending, and other financial matters.

Limitations of Accounting standards

1) Inflexibility and Rigidity:

Accounting standards often lack the flexibility to adapt to unique circumstances or evolving business practices.

2) Choice of Alternative Treatments:

When multiple accounting treatments are permitted, selecting the most appropriate one can be difficult and require judgment, potentially leading to inconsistencies.

3) Limited Scope:

Accounting standards may not encompass all aspects of a business or industry. They primarily focus on financial reporting and may not address non-monetary factors or qualitative aspects.

4) Focus on Historical Costs:

Accounting standards often rely on historical costs, which may not accurately reflect current market values or the impact of inflation.

List of accounting standards in India

AS 1 Disclosure of accounting policies

AS 2 Valuation of inventories

AS 3 Cash flow statements

AS 4 Contingencies and events occurring after the balance sheet date

AS 5 Net profit or loss for the period, prior period items and changes in accounting policies.

AS 7 Accounting for construction contracts

AS 9 Revenue recognization

AS 10 Property plant and equipment

AS 11 The effects of changes in foreign exchange rates

AS 12 Accounting for government grants AS 13 Accounting for investment

AS 14 Accounting for amalgamations

AS 15 Employee Benefits

AS 16 Borrowing Costs

AS 17 Segment Reporting

AS18 Related Party Daciosures

AS 19 Leases

AS 20 Earnings Per Share

AS 21 Consolidated Financial Statements

AS 22 Accounting for Taxes on income

AS 23 Accounting for investments in Associates in Consolidated Financial State

AS 24 Discontinuing Operations

AS 25 Interim Financial Reporting

AS 26 Intangible Assets

AS 27 Financial Reporting of Interests in Joint Ventures

AS 28 Impairment of Assets

AS 29 Provisions, Contingent Liabilities & Contingent Assets