1. Explain in brief objective and advantages of setting Accounting Standards

Objective and Advantages of Accounting Standards: An Accounting Standard is a selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. The Accounting Standards Board formulates Accounting Standards to be established by the Council of the Institute of Chartered Accountants of India.

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 standards. 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.

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 as follows:

(i) Reduction in variations.

(ii) Disclosure beyond that required by law.

(iii) Facilities comparison.

2. Explain the differences 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.

3. Explain, in brief, the basic considerations for distinguishing between capital and revenue expenditures.

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

i. 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.

ii. Recurring nature of expenditure: If the frequency of an expense is quite often in 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.

iii. 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.

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

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

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 andalso 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 ofthe accountant.
- Different accounting policies for the treatment of same item adds to the probability of manipulations.

5. Explain in brief objectives of preparing Trial Balance.

The preparation of trial balance has the following objectives:

i. Checking of the arithmetical accuracy of the accounting entries: 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 thearithmetical accuracy of the books.

ii. Basis for preparation of financial statements: Trial Balance forms the basisfor preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period. In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements to know the profit or loss made by the business during a particular period or its financial position on a particular date.

iii. Summarized ledger: Trial Balance contains the ledger balances on a particular position of a particular account can be judged simply by lookingat the Trial Balance. The ledger may be seen only when details regarding the accounts are required.

6. What are the rules of posting of journal entries into the Ledger? Explain inbrief.

Rules regarding posting of entries in the ledger

i. Separate account is opened in ledger book for each account and entriesfrom journal are posted to respective account accordingly.

ii. It is a practice to use words 'To' and 'By' while posting transactions in the ledger.

iii. The concerned account debited in the journal should also be debited inthe ledger but reference should be of the respective credit account.

7. Explain Cash and Mercantile system of accounting.

Cash and mercantile system: Cash system of accounting is a system by which a transaction is recognized only if cash is received or paid. In cash system of accounting, entries are made only when cash is received or paid, no entry being

made when a payment or receipt is merely due. Cash system is normally followed by professionals, educational institutions or non-profit making organizations.
On the other hand, mercantile system of accounting is a system of classifying and summarizing transactions into assets, liabilities, equity (owner's fund),costs, revenues and recording thereof. A transaction is recognized when either aliability is created/ impaired or an asset is created /impaired. A record is made on the basis of amounts having become due for payment or receipt irrespective of the fact whether payment is made or received actually.
Mercantile system of accounting is generally accepted accounting system by business entities

8. Difference between Going Concern Concept 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 operationfor the foreseeable future. Hence, it is assumed that the enterprise has neitherthe intention nor the need to liquidate or curtail materially the scale of itsoperations; if such an intention or need exists, the financial statements mayhave to be prepared on a different basis and, if so, the basis used is disclosed. The valuation of assets of a business entity is dependent on this assumption. Traditionally, accountants follow historical cost in majority of the cases.
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. Although there are various measurement bases, accountants traditionally prefer this concept in theinterests of objectivity. When a machine is acquired by paying ` 5,00,000, following cost concept the value of the machine is taken as ` 5,00,000. It is highlyobjective and free from all bias. Other measurement bases are not so objective. Current cost of an asset is not easily determinable. If the asset is purchased on 1.1.1995 and such model is not available in the market, it becomes difficult to determine which model is the appropriate equivalent to the existing one. Similarly, unless the machine is actually sold, realisable value will give only a hypothetical figure. Lastly, present value base is highly subjective because to know the value of the asset one has to chase the uncertain future.

9. Explain the differences between Money measurement concept andMatching 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 onlyto 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.

10. Classify the following errors under the three categories – Errors of Omission, Errors of Commission and Errors of Principle.

a. Sale of furniture credited to Sales Account.
b. Purchase worth ` 500 from M not recorded in subsidiary books.
c. Credit sale wrongly passed through the Purchase Book.
d. Machinery sold on credit to Mohan recorded in Journal Proper but omittedto be posted.
e. Goods worth ` 5,000 purchased on credit from Ram recorded in thePurchase Book as `. 500.

Solution:

a. Error of Principle.
b. Error of Omission.
c. Error of Commission.
d. Error of Omission.
e. Error of Commission

11. State the causes of difference between the balance shown by the passbook and the cash book.

The difference between the balance shown by the passbook and the cashbookmay 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.
viii. Dishonour of a bill discounted with the bank.
ix. Bills collected by the bank on behalf of the customer.
x. An error committed by the bank etc.

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

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

a. Cash book to record receipts and payments of cash, including receipts intoand payments out of the bank.

b. Purchases book to record credit purchases of goods dealt in or of the materials and stores required in the factory.
c. Purchase Returns Books to record the returns of goods and materials previously purchased.
d. Sales Book to record the sales of the goods dealt in by the firm.
e. Sale Returns Book to record the returns made by the customers.
f. Bills receivable books to record the receipts of promissory notes or hundiesfrom various parties.
g. Bills Payable Book to record the issue of the promissory notes or hundiesto other parties.
h. Journal (proper) to record the transactions which cannot be recorded inany of the seven books mentioned above.

13. Define revenue receipts and give examples. How are these receipts treated? Explain.

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. Revenuereceipts are credited to the Profit and Loss Account.

14. Change in accounting policy may have a material effect on the items of financial statements." Explain the statement with the help of an example.

Change in accounting policy may have a material effect on the items of financial statements. For example, cost formula used for inventory valuation ischanged 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.

NIRAJ ACADEMY FOR EXCELLENCE YOUR SUCCESS IS OUR GOAL

15. Classify the following expenditures as capital or revenue expenditure:

a. Amount spent on making a few more exists in a Cinema Hall to complywith Government orders.
b. Travelling expenses of the directors for trips abroad for purchase of capital assets.
c. Amount spent to reduce working expenses.
d. Amount paid for removal of stock to a new site.
e. Cost of repairs on second-hand car purchased to bring it into working condition.

Solution:

a. Revenue Expenditure.
b. Capital Expenditure.
c. Capital Expenditure.

d. Revenue Expenditure.
e. Capital Expenditure.

16. Write short notes on the following:

a. Fundamental Accounting Assumptions

Fundamental Accounting Assumptions: Fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because theiracceptance 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 isassumed 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 'Terms used in Financial Statements' defines accrual basis of accounting as "the method of recording transactions by which revenue, costs, assets and liabilities are reflected inthe 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 paymentand 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.

b. Objectives of preparing Trial Balance

The preparation of trial balance has the following objectives:
1 Checking of the arithmetical accuracy of the accounting entries: 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 thearithmetical accuracy of the books.

2. Basis for preparation of financial statements: Trial Balance forms the basis for preparing financial statements such as the Income Statementand the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period.In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements to know the profit or loss made by the business during a particular period or its financial position on a particulardate.

3. Summarized ledger: Trial Balance contains the ledger balances on a particular date. Thus, the entire ledger is summarized in the form of a Trial Balance. The position of a particular account can be judged simply by looking at the Trial Balance. The ledger may be seen only when details regarding the accounts are required

c. 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.

d. 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 butin hours. Thus depreciation is calculated after estimating the total numberof 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 aremaintained 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:

$$\text{Hourly Depreciation} = \frac{\text{Total Cost of the Machine}}{\text{Estimated Life of Machine}} = \frac{10,00,000}{50,000} = \text{` } 20 \text{ per hour}$$

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.

e. Trade bill vs. 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 orendorsed for the purpose of arranging financial accommodation for one ormore interested parties.
(b) On discount of a trade bill, full amount is retained by the drawer. Inan accommodation bill however, the amount may be shared by the drawerand 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 accommodationbill acts as a source of finance.
(e) In order to recover the debt, the drawer can initiate legal action ona trade bill. In accommodation bill, legal remedy for the recovery of amount may not be available for immediate parties.

17. State the advantages of setting Accounting Standards.

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.

18. Classify each of the following transactions into capital or revenue transactions:

a. Complete repaint of existing building.
b. Installation of a new central heating system.
c. Repainting of a delivery van.
d. Providing drainage for a new piece of water-extraction equipment.
e. Legal fees on the acquisition of land.
f. Carriage costs on a replacement part for a piece of machinery.

Solution:

a. Complete repaint: revenue.
b. Installation of new heating system: capital.
c. Repainting van: revenue.

d. Drainage for new equipment: capital.
e. Legal fees on acquisition of land: capital
f. Carriage costs on replacement part: revenue

19. Classify the following errors under the three categories – Errors of Omission, Errors of Commission and Errors of Principle.

a. Sale of furniture credited to Sales Account.
b. Purchase worth ` 4,500 from M not recorded in subsidiary books.
c. Credit sale wrongly passed through the Purchase Book.
d. Machinery sold on credit to Mohan recorded in Journal Proper but omittedto be posted.
e. Goods worth ` 5,000 purchased on credit from Ram recorded in thePurchase Book as ` 500.

Solution:

a. Error of Principle.
b. Error of Omission.
c. Error of Commission.
d. Error of Omission.
e. Error of Commission

NIRAJ ACADEMY FOR EXCELLENCE
YOUR SUCCESS IS OUR GOAL

20. Write short notes on any three of the following:

a. Double entry system

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 Aioli. 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, canbe 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.

b. Importance of bank reconciliation to an industrial unit

Banks are essential to modern society, but for an industrial unit, it servesas a 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 maynot be sure about its liquidity position in the bank on a particular date. There may be some cheques which have been issued, but not presentedfor 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 reconciliationstatement is very important and is a necessity of an industrial unit as it plays a key role in the liquidity control of the industry.

c. Bill of exchange and the various parties to it

A bill of exchange is an instrument in writing containing an unconditionalorder, signed by the maker, directing a certain person to pay a certain sumof 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 ofthe order itself, it becomes a valid bill of exchange.

There are three parties to a bill of exchange:

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

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

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

d. Journal.

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 anordinary manner. Journal gives details regarding any transaction. Thus journal tells the amounts to be debited and credited and also the accountsinvolved.

21. Define Accounting Policies in brief. Identify few areas whereindifferent accounting policies are frequently encountered.

Accounting Policies refer to specific accounting principles and methods ofapplying these principles adopted by the enterprise in the preparation and presentation of financial statements. Policies are based on various accounting concepts. 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. Different accounting policies are frequently encountered in the areas like valuation of inventory and investments etc.

22. Classify the following expenditures and receipts as capital or revenue:

a. ` 10,000 spent as import duty on machinery purchased.
b. Amount received from debtors during the year.
c. Cost of testing whether the equipment is functioning properly.
d. Insurance claim received on account of a machinery damaged by fire

Solution:

a. Capital expenditure
b. Revenue receipt.
c. Capital expenditure.
d. Capital receipt.

23. Write short notes on:

a. Noting Charges

It is necessary that the fact of dishonour and the causes of dishonour should be established. If there is a fear of dishonour, the bill will be given to the public official known as "Notary Public". These officials present the bill for payment and if the money is received, they will hand over the money to the original party. But, if the bill is dishonoured they will note the factof dishonour, and the reasons given and give the bill back to their client.For this service, they charge a small fee. This fee is known as noting charges. The amount of noting charges is recoverable from the party whois responsible for dishonour.

b. Retirement of bills of exchange

Sometimes, the acceptor of a bill of exchange has spare funds much beforethe maturity date of the bill of exchange accepted by him. He may, therefore, desire to pay the bill before the due date. In such acircumstance, 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 maybe 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 tobe retired under rebate.

c. Over-riding Commission

In the case of consignment accounts, the consignor pays a commission to the consignee in consideration of services rendered by the latter for selling the goods consigned. This commission may be either normal commission or special commission. Again, the special commission may be del- credere commission or over riding commission.

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

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

(ii) To provide incentive for supervising the performance of other agentsin a particular area.

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

24. Differentiate between provision and contingent liability

	Provision	***Contingent liability***
(1)	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 crystallize depending on the occurrence or non-occurrence of one or more uncertain future events.
(2)	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
(3)	Provision is recognized when (a) an enterprise has a present obligation arising 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 the recognition criteria because either it is not probable that settlement of those obligations will require outflow of economic benefits, or the amount cannot be reliably estimated.
(4)	If the management estimates that it is probable that the settlement of an obligation will result in outflow of economic 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.

25. Short Note on Red Ink Interest

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 suchdue 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 ofbill 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

26. Distinction between Receipts and Payments Account & Income and Expenditure Account

Receipts and Payments Account	Income and Expenditure Account
It is a summarized Cash Book	It closely resembles the Profit & Loss Account of a Trading concern.
Receipts are debited and Payments are credited.	Incomes are credited and Expenditures are debited.
Transactions are recorded on Cash basis.	Transactions are recorded on Accrual Basis
Amounts related to previous period or future period may remain included. Outstanding amount for current year is excluded.	Transactions are recorded on accrual basis. All amounts not related to the current period are excluded. Outstanding amounts of current period are added.
It records both Capital and Revenue transactions	It records Revenue transactions only
It serves the purpose of a Real Account.	It serves the purpose of a Nominal Account
It starts with opening Cash and Bank Balances and ends with closing Cash and Bank Balances.	It does not record such balances, rather its final balance shows a surplus or a deficit for the period.
Its closing balance is carried forward to the same account of the next accounting Period.	Its closing balance is transferred to Capital Fund or General Fund or Accumulated Fund in the same period's Balance Sheet.
It helps to prepare an Income & Expenditure Account.	It helps to prepare a Balance Sheet.

27. Distinction between Profit and Loss Account & Income andExpenditure Account

Profit and Loss Account	Income and Expenditure Account
It is prepared by business undertaking.	It is prepared by non-trading organizations
The credit balance of Profit and Loss Account is known as "net profit" and added to opening capital.	Credit balance of Income and Expenditure Account is known as excess of income over expenditure or surplus and added to opening capital fund.
Transactions are recorded on Cash basis.	Transactions are recorded on Accrual Basis
The debit balance of this Profit and Loss Account is known as "net loss" and deducted from opening capital.	Debit balance of this Income and Expenditure Account is known as "excess of expenditure over income' or deficit and deducted from opening capital fund.
To check correctness of accounts trial balance is prepared before preparing this account.	To check correctness of accounts, receipts and payments account is prepared before preparing this account.

28. What are the uses of Average Due Date?

It is the equated date on which a single total payment may be made in lieu of different payments on different dates without any loss to either party. Where payment is not made on the average due date, the party receiving the amount charges interest for as many days as the payment is delayed from the average due date.

Average Due Date is used in:

- For calculating interest on drawings of partners;
- For settling accounts between principle and agent;
- For settling contra accounts e.g. where parties sell goods to each other;
- For making lump sum payment against various bills drawn on differentdates with different due dates

29. Distinction between Bills of Exchange and Promissory Note

BASIS	BILL OF EXCHANGE	PROMISSORY NOTE
No. of parties	Includes three parties: Drawer, Drawee andPayee.	It include two parties: Maker and Payee.
Payer and Payee	Drawer and payee may be a same person.	The maker and payee cannot be the sameperson.

Promise/order	It contains an unconditional order given by acreditor to the debtor.	It contains unconditional promise given bydebtor to creditor.
Nature of liability	Liability of drawer is secondary andconditional.	The liability of the maker is primary andabsolute.
Notice of dishonor .	Notice must be given to all persons (includedrawer) liable to pay.	Notice not required to be given.

30. Short Note on Adjusted Cash Book

Adjusting the cash-book before preparing the bank reconciliation statement is completely optional, if reconciliation is done during different months. But if reconciliation is done at the end of the accounting year or financial year, the cash-book must be adjusted so as to reflect the correct bank balance in the balance sheet.

While adjusting the cash-book all the errors (like wrong amount recorded in the cash-book, entry posted twice in the cash-book, over/under casting of the balance etc.) and omissions (like bank charges recorded in the pass-book only, interest debited by the bank, direct receipt or payment by the bank, dishonour of cheques/bills etc.) by the cash-book are taken into care but delay in recordingin the pass-book due to difference in timing (like cheque issued but not presented for payment, cheque deposited but not collected) is taken to bank reconciliation statement. This adjusted cash-book balance is taken to bank reconciliation statement.
Errors occurred in the pass-book are not to be adjusted in the cash book. All the adjustments considered in the adjusted cash-book are not carried again to the bank reconciliation statement.

31. Distinguish between Consignment and Sale

Consignment	Sale
Ownership remains with the Consignor even if the goods are transferred to Consignee	Ownership of the goods transfers with the transfer of goods from seller tobuyer
Consignor bears the loss of goods heldby consignee	It is the buyer of the goods who has to bear the loss after the delivery ofgoods
Expenses done by consignee to receivethe goods and to keep it safely is borne by consignor.	Expenses incurred by buyer after delivery of goods are to be borne by buyer himself
The relationship between the consignor and consignee is that of principal and agent	The relationship between the buyerand seller is that of debtor and creditor.

32. Distinguish between Periodical Inventory System and PerpetualInventory System

Synod	Periodic Inventory System	Perpetual Inventory System
1.	This system is based on physical verification.	It is based on book records.
2.	This system provides information about inventory and cost of goods sold at a particular date.	It provides continuousinformation about inventory and cost of sales.
3.	This system determines inventory and takes cost of goods sold as residual figure.	It directly determines cost of goods sold and computes inventory as balancing figure.
4.	Cost of goods sold includes loss of goods as goods not in inventory are assumed to be sold.	Closing inventory includes loss of goods as all unsold goods are assumed to be in Inventory.
5.	Under this method, inventory control is not possible.	Inventory control can be exercised under this system.
6.	This system is simple and less expensive.	It is costlier method.
7.	Periodic system requires closure of business for counting of inventory.	Inventory can be determined without affecting the operations of the business.

33. Which cost are excluded from Inventory valuation?

Following expenses are generally not included in the costs of inventories:
- Abnormal amounts of wasted materials, labour or other production overheads;
- Storage costs, unless those costs are necessary in the production process prior to further production stage;
- Administrative overheads that do not contribute to bringing the inventories totheir present location and condition; and
- Selling and distribution costs
- Any discounts/rebates given by the seller is reduced from the cost

34. Explain accounting errors.

Errors refers to mistakes committed during the accounting process. It is not intentional.

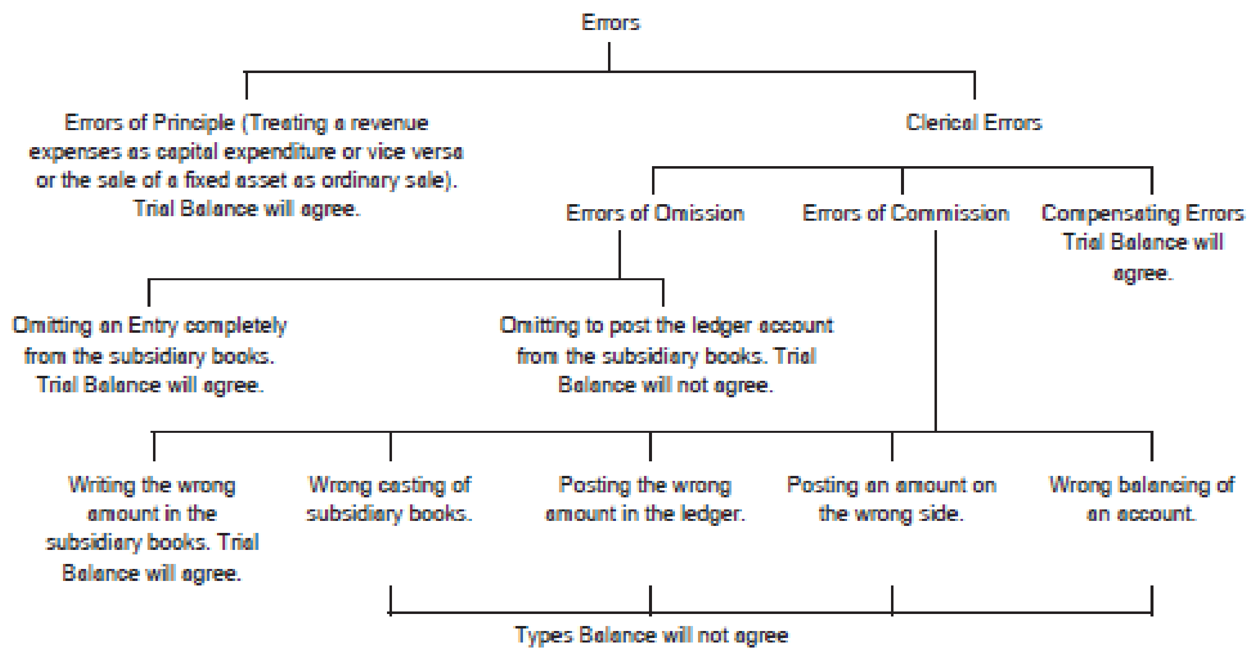
Fraud refers to mistakes/discrepancy committed during the accounting process andis deliberate. It is intentional.

Errors of Principle: It arises when a financial transaction is recorded in the books inan **incorrect manner**. I.e. Journal Entry is **not as per the Accounting Principles**.

Errors of Omission: Error of Omission means that a transaction is not recorded / posted/ transferred either wholly or partially, in the books of accounts.

Errors of Commission: A transaction is recorded **wrongly** or **incorrectly** in the books.It also includes all clerical errors during the Accounting Process.

Compensating Errors: One set of errors on the debit side for a specified amount is counter-balanced by another set of errors for the same on the credit side. Due to this,the Trial Balance is not affected.



35. Define Common Seal

Common Seal is the official signature of a Company. The Company's name is engraved on the Seal.

The Articles of Association may provide for the documents that require the signature of the Company, i.e. the Common Seal. Where any document is affixed with the Common seal, it amounts to being signed by the Company

36. Short Notes on Current Assets & Current Liabilities

Current Assets: An asset is classified as Current when it satisfies any of the followingcriteria -

- It is expected to be realized in, or is intended for sale or consumption in the company's normal Operating Cycle,
- It is held primarily for the purpose of being traded,
- It is expected to be realized within 12 months after the Reporting Date,
- It is Cash or Cash Equivalent unless it is restricted from being exchanged or usedto settle a liability for at least 12 months after the Reporting Date,

Non-Current Assets: All other Assets shall be classified as Non-Current

Current Liabilities: A Liability is classified as Current when it satisfies any or thefollowing -

- It is expected to be settled in the Company's normal Operating Cycle,
- It is held primarily for the purpose of being traded,
- It is due to be settled within 12 months after the Reporting Dale, or
- The Company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date (Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.)

Non-Current Liabilities: All other Liabilities shall be classified as Non-Current

37. Distinguish between Equity and Preference Shares

Basis	Preference Shares	Equity Shares
Definition	Shares that carry a Preferential Right as to payment of - (a) Dividend, and (b) Repayment of Capital	Shares that are not Preference Shares are called Equity Shares
Return	Fixed Rate or Fixed Amount	Based on profits available for distribution
Dividend	Priority over Equity Dividend, i.e. paid first	After payment of Preference Dividend
Repayment of Capital	Paid before repayment of Equity Capital	Paid after entire Preference Capital is repaid
Arrears of Dividend	Generally accumulates unless specifically said to be non-cumulative	No accumulation of Unpaid Dividend. No Profits means no Dividend
Redemption	Redeemable as per terms of issueand provisions of Act	Not Redeemable till winding-up.Even in winding-up, will be repaid after Pref. Shares
Voting Rights	Generally restricted. Carries right to vote on all matters if dividend remains unpaid for the prescribed period	Unrestricted, i.e. Holder can vote at any matter at any Meeting, or the Shares may be issued with varying voting rights

Further Issue of Shares	Principles relating to right and bonus issue is not applicable	Fresh Issue to be offered first to existing holders, i.e. Rights Issue and fully paid Bonus Shares offered to all members
Control/ Management	No right to take part in Management	Equity Shareholders are the real owners, hence have a right to control the Management of Company

38. Can Shares be issued at discount?

- A company shall not issue shares at a discount except as Sweat Equity Shares u/s54.
- Any share issued by a Company at a discounted price shall be void (except for Sweat Equity Shares)

Effect of default:

(a) Company is punishable with a fine of Minimum ₹1,00,000 and Maximum ₹5,00,000

(b) Every officer in default is punishable with
- Imprisonment of maximum 6 months, or
- Fine of Minimum ₹1,00,000 and Maximum ₹5,00,000, or
- Both

39. Short Notes on Calls in Advance and Calls in Arrears

CALLS IN ADVANCE

Meaning: Call in advance is the surplus money received by the Company from the allottees, i.e. the Shareholders

A Company, if permitted by its Articles, may accept from members either the whole orpart of the amount remaining unpaid on any shares held by him as Calls in Advance. No Voting Rights: The Member shall not be entitled to any voting rights on Calls in Advance, until the same becomes presently payable and duly appropriated.

Disclosure: Calls in Advance will always have a Credit Balance and will be shown underthe Liabilities side. It is not added to the amount of Paid-Up Capital.

Interest: The Company is liable to pay interest on the amount of Calls in Advance fromthe date of receipt till the date when the Call is due for payment, at the Maximum rateof 12% p.a. if the amount received in advance of calls is not refundable.

Dividend [Sec. 51]: A Company, if so authorised by its Articles, can pay dividends on advance money received on calls

Priority: In the event of winding up the shareholder ranks after the creditors but Callsin advance must be paid along with the interest if any before the other shareholders are paid off

/nirajacademy Ask /nirajagarwal_nae /nirajagarwalNAE /nirajagarwal Download g.page/Niraj_Agarwal-NAE

CALLS IN ARREARS

Meaning: Calls in Arrears is the money remaining unpaid by the shareholder on the calls raised by the Company in respect of the shares held by him.
Disclosure: Calls in Arrears always have a Debit Balance and are shown as a deductionfrom Share Capital in the Liabilities Side of the Balance Sheet.
Interest: The Company can recover interest on the amount of calls in arrears from the date it became due till date when the call is received at the rate not exceeding 10% p.a. (if Table F is adopted as Articles of Association).
Waiver of Interest: The Directors may also be empowered to waive the Interest on Calls an Arrears, subject to certain conditions laid down in the Articles

40. Short Notes on Forfeiture of Shares and Re issue of forfeited shares

FORFEITURE OF SHARES

Meaning: Forfeit =Taking away of property, on breach (non-fulfillment) of a condition.In the context of Shares, Forfeiture of Shares refers to the action taken by the Company, to cancel the Shares.
Situation: When Shareholders fail to pay Allotment or Call Money due, the directors may forfeit the shares in bonafide interests of the Company, and in accordance with the Articles of Association. Proper Notice should be served to the defaulting Shareholder, before forfeiture.
Effect: When Shares are forfeited, the title of such Shareholder is extinguished, but theamount paid by him till such forfeiture, is not refunded to him. The Shareholder has no further claim on the Company. The amount actually received from the Shareholderis transferred to 'Shares Forfeited A/c".
Treatment: Till Forfeited Shares are reissued, the amount is shown as an addition to Share Capital, on the Liabilities Side of the Balance Sheet.

REISSUE OF FORFEITED SHARES:

A forfeited share is merely a share available to the company for sale and remains vestedin 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 of 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.

41. Distinguish between Debentures and Shares

Debentures	Shares
1. Debenture holders are the creditors of the company.	1. Shareholders are the owners of the company.
2. Debenture holders have no voting rights and consequently do not pose any threat to the existing control of the company.	2. Shareholders have voting rights and consequently control the total affairs of the company.
3. Debenture interest is paid at a pre-determined fixed rate. It is payable, whether there is any profit or not. Debentures rank ahead of all types of shares for payment of the interest due on them.	3. Dividend on equity shares is paid at a variable rate which is vastly affected by the profits of the company (however,dividend on preference shares is paid at a fixed rate).
4. Interest on debentures are the charges against profits and they are deductible as an expense in determining taxable profit of the company.	4. Dividends are appropriation of profits and these are not deductible in determining taxable profit of the company.
5. There are different kinds of debentures, such as Secured/Unsecured; Redeemable/ Irredeemable; Registered/Bearer; Convertible / Non-convertible, etc.	5. There are only two kinds of shares– Equity Shares and Preference Shares.
6. In the Company's Balance Sheet, Debentures are shown under "Long Term Borrowings".	6. In the Company's Balance Sheet, shares are shown under "Shareholder's Fund" detailed in 'Share Capital' of Notes to Accounts.
7. Debentures can be converted into debentures shares as per the terms of issue of debentures.	7. Shares cannot be converted into in any circumstances.
8. Debentures cannot be forfeited for non-payment of call moneys.	8. Shares can be forfeited for non-payment of allotment and call moneys.
9. At maturity, debenture holders get back their money as per the terms and conditions of redemption.	9. Equity shareholders cannot get back their money before the liquidation of the company (however, preference shareholders can get back their money before liquidation).
10. At the time of liquidation, debenture holders are paid-off before the shareholders.	10. At the time of liquidation shareholders are paid at last, after paying debenture holders, Trade payable, etc.

/nirajacademy Ask /nirajagarwal_nae /nirajagarwalNAE /nirajagarwal Download g.page/Niraj_Agarwal-NAE

42. Short Notes on Types of Debentures

1. Security

(a) **Secured Debentures** : These debentures are secured by a charge upon someor all assets of the company. There are two types of charges: (i) Fixed charge; and
(ii) Floating charge. A fixed charge is a mortgage on specific assets. These assetscannot be sold without the consent of the debenture

holders. The sale proceeds of these assets are utilized first for repaying debenture holders. A floating charge generally covers all the assets of the company including future one.

(b) **Unsecured or "Naked" Debentures** : These debentures are not secured by any charge upon any assets. A company merely promises to pay interest on duedates and to repay the amount due on maturity date. These types of debenturesare very risky from the view point of investors.

2. Convertibility

(a) **Convertible Debentures :** These are debentures which will be converted into equity shares (either at par or premium or discount) after a certain period of time from the date of its issue. These debentures may be fully or partly convertible. In future, these debenture holders get a chance to become the shareholders of the company.

(b) **Non-Convertible Debentures :** These are debentures which cannot be converted into shares in future. As per the terms of issue, these debentures are repaid.

3. Permanence

(a) **Redeemable Debentures :** These debentures are repayable as per the termsof issue, for example, after 8 years from the date of issue.

(b) **Irredeemable Debentures :** These debentures are not repayable during thelife time of the company. These are also called perpetual debentures. These are repaid only at the time of liquidation.

NIRAJ ACADEMY FOR EXCELLENCE YOUR SUCCESS IS OUR GOAL

4. Negotiability

(a) **Registered Debentures :** These debentures are payable to a registered holderwhose name, address and particulars of holding is recorded in the Register of Debenture holders. They are not easily transferable. The provisions of the Companies Act, 2013 are to be complied with for effecting transfer of thesedebentures. Debenture interest is paid either to the order of registered holder as expressed in the warrant issued by the company or the bearer of the interest coupons.

(b) **Bearer Debentures**: These debentures are transferable by delivery. These are negotiable instruments payable to the bearer. No kind of record is kept by the company in respect of the holders of such debentures. Therefore, the interest onit is paid to the holder irrespective of any identity. No transfer deed is required for transfer of such debentures.

5. Priority

(a) **First Mortgage Debentures :** These debentures are payable first out of theproperty charged.

(b) **Second Mortgage Debentures:** These debentures are payable after satisfyingthe first mortgage debentures

43. Can Debentures be issued at discount?

The Companies Act does not impose any restriction on the price at which debentures can be issued. Unlike shares, there is no limit for discount on issue of debentures. Thisis why it is very common for debentures to be issued at a discount.

The company issues debentures at a discount when the market rate of interest is higher than the debenture interest rate. Like shares, Debentures Account is credited with the nominal value. The difference between the nominal value of debentures andcash received is transferred to "Discount on Issue of Debentures Account. In the subsequent years, Discount on Issue of Debentures is written-off proportionately by charging to the Statement of Profit and Loss. It is considered a normal practice to amortize discount on issue of debentures over the period of benefit, i.e., normally 3 to 5 years.

TREATMENT OF DISCOUNT/LOSS ON ISSUE OF DEBENTURES

The discount on issue of debentures is amortised over a period between the issuance date and redemption date. It should be written-off in the following manner depending upon the terms of redemption:

(a) If the debentures are redeemable after a certain period of time, say at the end of 5 years, the total amount of discount should be written-off equally throughout the life of the debentures (applying the straight line method). The main advantage of this method is that it spreads the burden of discountequally over the years.

(b) If the debentures are redeemable at different dates, the total amount of discount should be written-off in the ratio of benefit derived from debenture loan in any particular year (applying the sum of the year's digit method). This method is suitable when debentures are redeemed by unequal instalments.

44. Short notes on types of Share Capital

Type	Description
Authorised Share Capital [Sec 2(8)]	• It is the maximum amount of Share Capital which can be raised bythe Company. • The Authorised Share Capital is also known as the "Registered Capital" or "Nominal Capital" and is authorised by Memorandum of Association of Company.

	• Authorised Capital is shown in the Balance Sheet at Nominal Value(Face Value). • Example: Authorised Capital = 10,000 Shares of Z 100 each, Total=Z 10,00,000.
Issued Share Capital [Sec 2(50)]	• It represents that part of Authorised Share Capital which has beengiven or issued or offered to Shareholders. • Issued Capital includes Shares issued for — (i) Cash, and (ii) Consideration other than cash, to Promoters and Others. • Issued Share Capital is shown in the Balance Sheet at NominalValue (Face Value). • Example: Issued Capital = 9,000 Shares of ₹100 each, Total= ₹9,00,000. Note: The remaining portion of Authorised Capital, which is not issued for cash or other consideration, is called as Unissued Capital. It is not shown in the Balance Sheet.
Subscribed Share Capital [Sec 2(86)]	• Subscribed Capital is the part of Issued Share Capital which has been subscribed (i.e. applied for) by the Public / Shareholders, andallotted by the Company. • Example: Out of 9,000 Shares issued 8,000 Shares are subscribed by public. Note: The remaining portion of Issued Capital, which is not subscribed, is not shown in the Balance Sheet.
Called-Up Share Capital [Sec 2(15)]	• Companies generally receive the issue price of Shares in Installments e.g. application stage, allotment stage, First Call, Second Call, etc. • The portion of the Face Value of Shares which a Company has demanded or called from Shareholders is known as "Called—Up Capital". • The balance portion which the Company has decided to call / demand in future is called as Uncalled Capital. • Example: Out of ₹100 per Share, the Company has called up ₹70 per Share. In such case, the uncalled capital is ₹30 per Share
Paid-Up Share Capital [Sec 2(64)]	• It is that portion of Called Capital which has been actually paid bythe Shareholders • The unpaid portion is called 'Unpaid Calls' or 'Calls in Arrears' • So Paid up Capital = Called-up Capital – Calls in Arrears
Reserve Capital [Sec 65]	• Companies may decide by passing a special resolution that a certain portion of Subscribed Uncalled Capital can be called up only in the event of winding-up/liquidation • That portion is called reserve capital. It is not shown in the BalanceSheet

45. What are the rules in absence of Partnership deed?

- No partner has the right to a salary,
- No interest is to be allowed on capital,
- No interest is to be charged on the drawings,
- Interest at the rate of 6%.p.a is to be allowed on a partner's loan to the firm, and
- Prots and losses are to be shared equally.
- In the absence of an agreement, the interest and salary payable to a partner willbe paid only if there is profit

46. Short Note on fixed and fluctuating capital method

In Fixed Capital method, generally initial capital contributions by partners are creditedto partner's capital account and all subsequent transactions and events are recorded through partner's current account. On the contrary, under fluctuating capital method, no current account is maintained. All such transactions and events are recorded in capital account itself. So the balance of partner's capital keeps on fluctuating hence the name of the method.

47. What are the provisions of Partnership Act in case of Death of a partner ?

The procedure is same as in the case of retirement of a partner.

- Assets and liabilities are revaluated and profit or loss on revaluation is transferredto all partners.
- Goodwill of the firm is valued and share of goodwill of deceased partner is given tohis legal representative.
- The only additional point is that as death may occur on any day, the representativesof the deceased partner will be entitled to partner's share of profit from the beginning of the year to the date of death.
- The amount due to the deceased partner carries interest at the mutually agreed upon rate. In the absence of agreement, the representative of deceased partner can receive, at their option, interest at the rate of 6% p.a. or share of profits earned with the use of the amount due to the deceased partner (Section 37) - (In capital ratioand not profit sharing ratio).

48. Accounting Treatment when Sale of Goods on Approval or Return basisare frequently done

When Sale or Return transactions are very frequent, but not numerous, a separate Register called "Sale or Return Journal". The format of this register is as under –

Goods sent on approval				Goods returned				Goods approved				Balance
1	2	3	4	5	6	7	8	9	10	11	12	13
Date	Particulars	Fol.	Amt.	Date	Particulars	Fol.	Amt.	Date	Particulars	Fol.	Amt.	Amt.

No Entry in Financial Books	No Entry in Financial Books	Recorded as Sales in FB	Treated as Stock - FB

Transaction	Treatment
1. Goods despatched to Customers	• No entry in Financial Books • Record the despatch in Column 1to 4 of the above Journal
2. Goods returned by Customers	• No entry in the Financial Books • Record the return in Column 5 to8 of the above Journal
3. Goods approved by Customers	• Pass following entry in Financial Books: Sundry Debtors A/c Dr. (Selling Price) To Sales A/c • Record the approval in Columns 9to 12 of the above Journal
4. Stock at end of the period	• Pass following entry in Financial Books: Stock with Customers A/c Dr. To Trading A/c (At lower of Cost or NRV)

49. Accounting Treatment when Sale of Goods on Approval or Return basisare frequent and numerous

When Sale on Approval or Return transactions are frequent and numerous, there isneed to ensure proper control over the Sale or Return transactions. The firm maintains –

(a) Sale or Return Day Book

Goods sent on approval				Goods returned				Goods approved				Balance
1	2	3	4	5	6	7	8	9	10	11	12	13
Date	Particulars	Fol.	Amt.	Date	Particulars	Fol.	Amt.	Date	Particulars	Fol.	Amt.	Amt.

(b) Sale or Return Ledger Containing the Ledger accounts of Customers to whom goodsare sent

The Day Book and ledger are memorandum Books. They do not form part of regularfinancial books

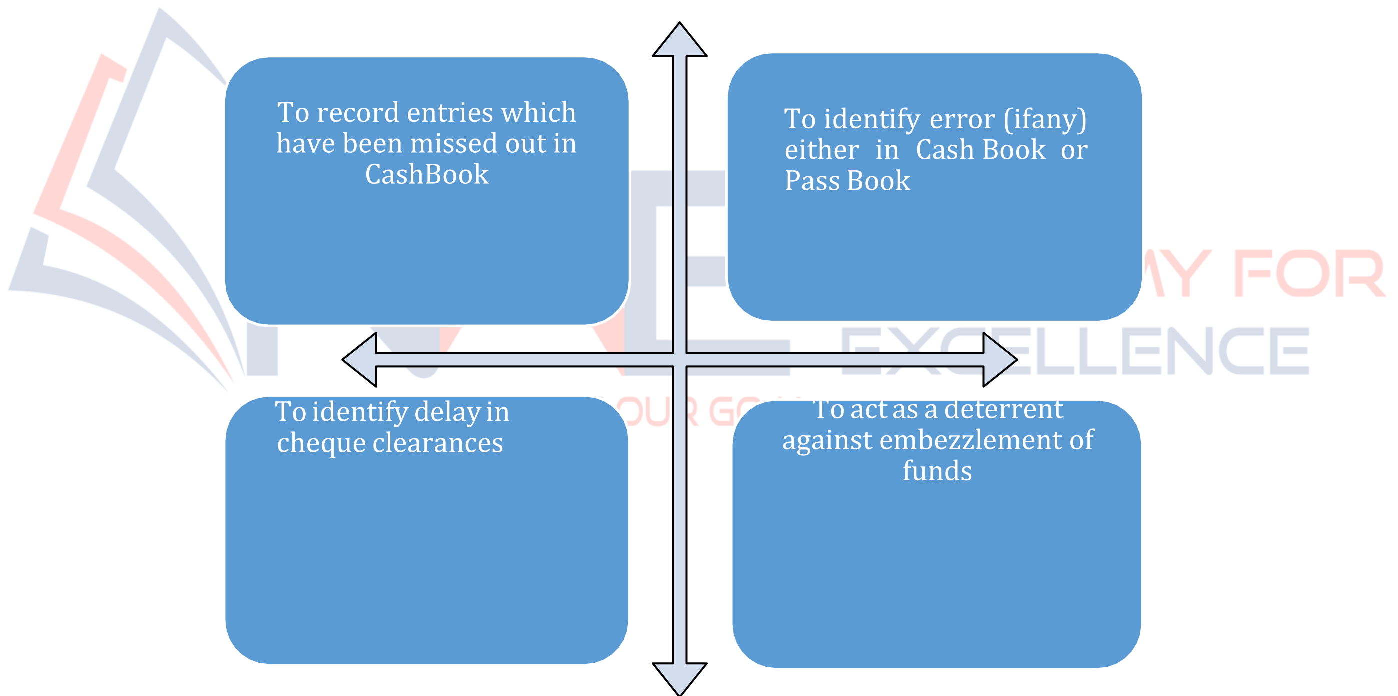
Transaction	Entry in		
	Sale or Return Day Book	**Sale or Return Ledger**	**Financial Books, i.e. Regular General Ledger**
1. Goods despatched to Customers	Record the despatch in Column 1 to 4 of the Sale or Return Day Book	Customer A/c Dr. To Sale or Return A/c (Entry made at Selling Price)	No entry in Financial Books
2. Goods returned by Customers	Record the returnin Column 5 to 8 of the Sale or Return Day Book	Sale or Return A/c Dr. To Customer A/c (Entry made at Selling Price)	No entry in Financial Books
3. Goods approved by Customers	Record the approval in Columns 9 to 12 of Sale or Return Day Book	Sale or Return A/c Dr. To Customer A/c (Entry made at Selling Price)	Customer A/c Dr. To Sales A/c (Entry made at Selling Price)
4. Stock at end of the period	Column 13 denotes stock at Sale Price.	Balance in Sale orReturn A/c is the value of Stock withCustomers, at Sale Price	Stock with Customers A/cDr. To Trading A/c (Entry made at cost or NRV whichever is lower)

50. When an Account Current is prepared?

Account Current is prepared when:

- When frequent transactions regularly take place between two parties. An example is of a manufacturer who sells goods frequently to a merchant on credit and receives payments from him in instalments at different intervals andcharges interest on the amount which remains outstanding.
- A consignee of goods can also prepare an Account Current, if the latter is to settle the account at the end of the consignment & interest is chargeable on outstanding balance.
- An Account Current also is frequently prepared to set out the transactions taking place between a banker and his customer.
- It is prepared when two or more persons are in joint venture and each co-venture is entitled to interest on their investment.

51. Importance of Bank Reconciliation Statement?



52. Reasons for differences in Bank Reconciliation Statement?

1.Cheques issued but not presented for payment
2.Cheques paid into the bank but not cleared 3.Interest allowed by bank:
4.Interest and expenses charged by the bank
5.Interest and dividends collected by the bank
6.Direct payments by the bank
7.Direct payment into the bank by a customer
8.Dishonour of a bill discounted with the bank 9.Bills collected by the bank on behalf of the customer
10.Differences arising due to errors in Recording the Entries

53. Methods of Preparing Bank Reconciliation Statement?

1. BANK RECONCILIATION STATEMENT WITHOUT PREPARATION OF ADJUSTEDCASH-BOOK
2. BANK RECONCILIATION STATEMENT AFTER THE PREPARATION OF ADJUSTEDCASH-BOOK

Adjusting the cash-book before preparing the bank reconciliation statement is completely optional, if reconciliation is done during different months. But if reconciliation is done at the end of the accounting year or financial year, the cash-book must be adjusted so as to reflect the correct bank balance in the balance sheet.

While adjusting the cash-book all the errors (like wrong amount recorded in the cash-book, entry posted twice in the cash-book, over/under casting of the balance etc.) and omissions (like bank charges recorded in the pass-book only, interest debited by the bank, direct receipt or payment by the bank, dishonour of cheques/bills etc.) by the cash-book are taken into care but delay in recording in the pass-book due to difference in timing (like cheque issued but not presented for payment, cheque deposited but not collected) is taken to bank reconciliation statement. This adjusted cash-book balance is taken to bank reconciliation statement.

Errors occurred in the pass-book are not to be adjusted in the cash book. All the adjustments considered in the adjusted cash-book are not carried again to the bank reconciliation statement.

54. What are the objectives for providing depreciation?

- Correct income measurement
- True position statement
- Funds for replacement
- Ascertainment of true cost of production.

55. Short note on change in method of depreciation and revision of estimated useful life

The depreciation method applied to an asset should be reviewed at least at eachfinancial year-end and, if there has been a significant change in the expected pattern

of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Whenever any change indepreciation method is made. Such change in method is treated as change in accounting estimate as per Accounting Standards. Its effect needs to be quantified anddisclosed. A change in an accounting estimate may affect the current period only or both the current period and future periods.

There should be a periodical review of the useful life of depreciable assets. Whenever there is a revision in the estimated useful life of the asset, the unamortized depreciable amount should be charged to the asset over the revised remaining estimated useful lifeof the asset.

56. Short note on Valuation of Inventories

Cost of inventories should comprise

- all cost of purchase,
- costs of conversion (primarily for finished goods and work - in progress) and
- other costs incurred in bringing the inventories to their present location and condition

Valuation of Inventory

LOWER Of

COST INCLUDES	NET REALISABLE VALUE
• Purchase Price • Loading, unloading charges, transit insurance • Non Refundable Duties & Taxes • Freight Inwards • Administrative overheads incurred to bring the inventory into present location and condition	• Estimated Selling Price – Selling cost • Selling cost includes estimated costs necessary to make the sale • Normally, Damaged Goods are valued at NRV.

Exclusions from cost of Inventories:

Following expenses are generally not included in the costs of inventories:

- abnormal amounts of wasted materials, labour or other production overheads;
- storage costs, unless those costs are necessary inthe production process prior to further production stage;
- administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- selling and distribution costs
- any discounts/rebates given by the seller is reduced from the cost

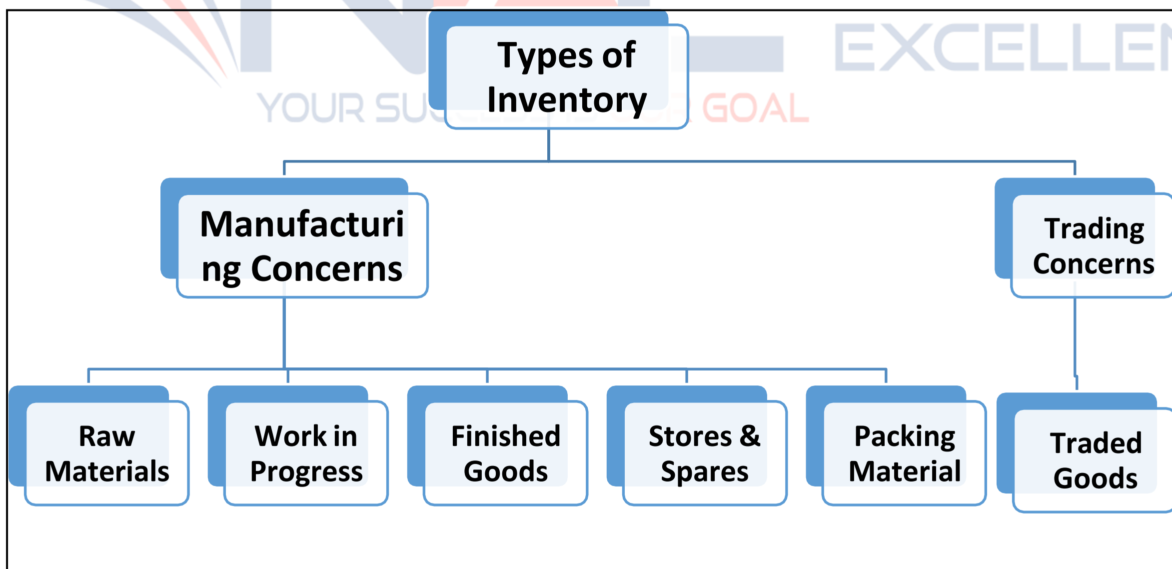
57. Define Inventory

Inventory can be defined as

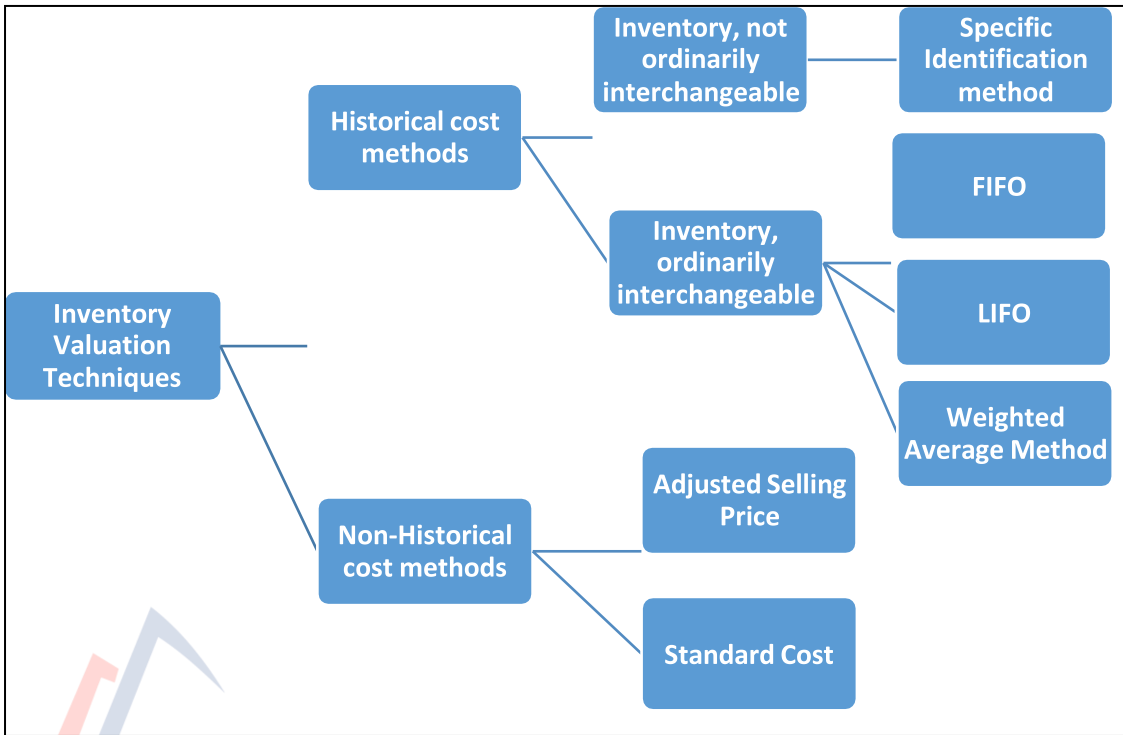
- Assets held for sale in the ordinary course of business, or
- in the process of production for such sale, or
- for consumption in the production of goods or services for sale, including maintenance

supplies and consumables other than machinery spares, servicing equipmentand standby equipment.

58. Short Note on Types of Inventory

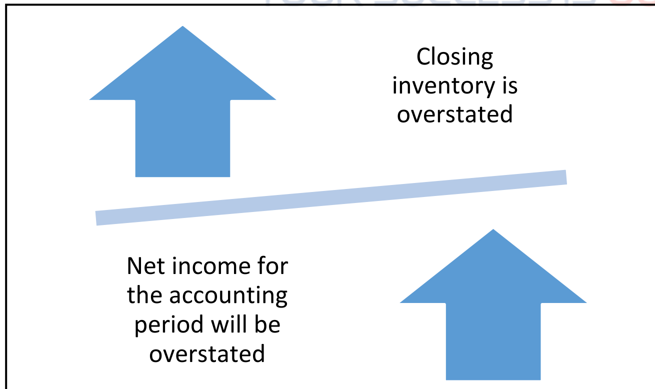


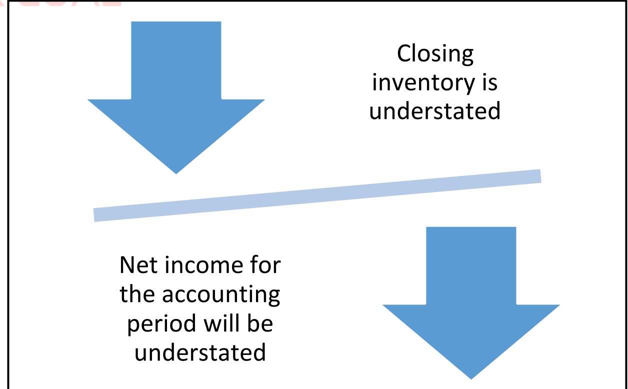
59. Short Note on Determination of Inventory Cost

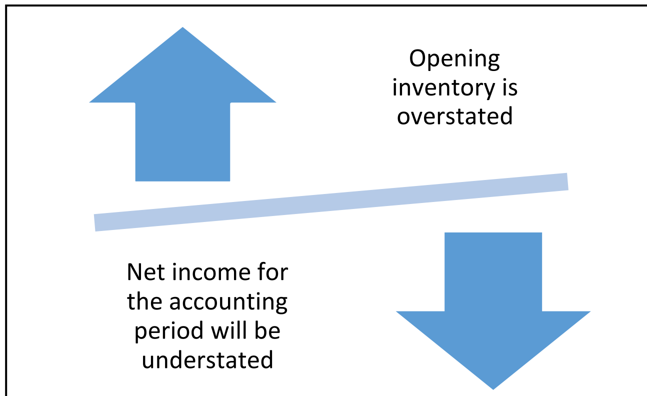


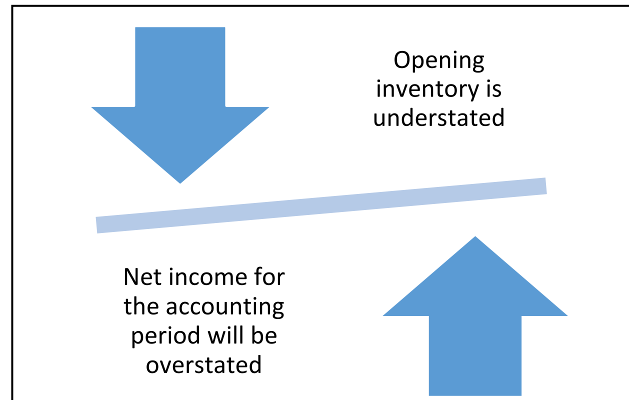
Cost of Goods Sold = Opening Inventory + Purchases + Direct Expenses - Closing Inventory

60. Short Note on Inventory Valuation and Determination of Income









60. Write short notes on the following:
(i) Fundamental Accounting Assumptions.
(ii) Objectives of preparing Trial Balance.
(iii) Accounting conventions.
(iv) Machine Hour Rate method of calculating depreciation.

(i) **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 towhich 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 materiallythe scale of the operations.

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

3. **Accrual**: Guidance Note on 'Terms used in Financial Statements' defines accrual basis 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 preparedon 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 inmaking economic decisions. Accrual basis is also referred to as mercantile basis of accounting.

(ii) Objectives of preparing Trial Balance

The preparation of trial balance has the following objectives:

1 **Checking of the arithmetical accuracy of the accounting entries:** 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 the arithmetical accuracy of the books.

2. **Basis for preparation of financial statements:** Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet.The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period. In case, the Trial Balance is not prepared, itwill be almost impossible to prepare the financial statements to know the profit or loss made by the business during a particular period or its financial position on a particular date.

3. **Summarized ledger:** Trial Balance contains the ledger balances on a particular date. Thus, the entire ledger is summarized in the form of a Trial Balance. The position of a particular account can be judged simply by looking at the Trial Balance.
The ledger may be seen only when details regarding the accountsare required.

(iii) 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.

(iv) **Machine Hour Rate method of calculating depreciation**: Where it is practicableto 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 mayhave 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.

61. Classify the following expenditures as capital or revenue expenditure:
(i) Money spent to reduce working expenses.
(ii) Amount spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land.
(iii) Rings and Pistons of an engine were changed at a cost of ` 5,000 to get fuel efficiency.
(iv) Compensation of ` 2.5 crores paid to workers, who opted for voluntary retirement.

Answer:
(i) Capital expenditure.
(ii) Revenue expenditure.
(iii) Capital expenditure.
(iv) Revenue expenditure.

62. FACTORS IN THE MEASUREMENT OF DEPRECIATION

Answer:
- Cost of asset
- Estimated useful life of the asset
- Estimated scrap value (if any) at the end of useful life of the asset

63. What are the qualitative features of a Financial Statement

Answer:

Qualitative Features of Financial Statements:
Financial Statements are prepared to ascertain the operating results and the financial position of the business. They should have the following features:

1. Relevance	Information must be relevant for users to make decisions.
2. Reliability	Information in Financial Statements must be reliable, i.e.: • Free from material error and bias • Can be dependent upon by the user to faithfully represent the correct position
3. Understandability	Financial Statements must be understandable to users. However complex information must not be excluded on this ground, if the information is essential.
4. Comparability	Information in financial statements must be comparable both Intra firm and Inter firm. Consistency concept should be applied and accounting policies & changes therein must be properly disclosed.
5. Materiality	All the material information should be disclosed in the Financial Statements. Information is material if its misstatement could influence the economic decision of the user
6. Faithful Representation	Information must faithfully represent the transactions and events. It should represent the balances of assets and liabilities, which should be used for analysis in good faith.
7. Substance over form	The financial statements should reflect the substance of the transactions and not mere the legal form.

8. Neutrality	Information in Financial Statements must be free from bias, i.e. it should not influence the decision or judgement of the user.
9. Prudence	Prudence is the degree of caution in the exercise of the judgements needed in making the estimates required under condition of uncertainty. Hence Assets and Incomes should not be over-stated and Liabilities and Expenses should not be under-stated.
10. Disclosure	All material items must be fully, fairly and adequately disclosed in the Financial Statements. • Financial means nothing material should be omitted. • Fairness implies true and fair view of the Financial Statements. Adequacy implies disclosure of proper details and in a sensible manner.
11. Completeness	Information in Financial Statements must be complete within the limitations set by materiality and cost. An omission can cause information to be misleading, unreliable and irrelevant.

64. Explain Accounting as a Measurement Discipline

Answer:

Accounting as Measurement Discipline

The three elements of Measurement Discipline and how accounting satisfies these elements as under:

Element/ Condition	Does Accounting Satisfy the Condition?
1. Identification of objects or events to be measured	Financial Transactions and Events are measured in Accounting. Non-financial transactions, however significant, are not considered.
2. Selection of standard or scale to be used	The ruling currency of the country is used as the basis of money measurement in Accounting, however –
	• Money is not a stable scale having universal applicability • Exchange Rates between different currencies are not constant
3. Evaluation of dimension of measurement standard	Money, as a valuation base, loses its value over the period of time. Hence it is not stable in the dimension.

However, Accounting is not an exact measurement discipline because accounting measures information mostly in money terms which is –

- not a stable scale
- not having universal applicability
- not stable in dimension for comparison over time

65. What are measurement bases in Accounting?

Answer:
Measurement Bases in Accounting

The measurement bases or valuation principles used in Accounting are:

Base	Valuation Rule	
	Assets	Liabilities
1. Historical Cost	Cash and Cash Equivalents paid or Fair Value of the asset at the time of acquisition	Proceeds received in exchange of the obligation, or the amount of cash or cash equivalent expected to be paid to satisfy it in the normal course of business
2. Current Cost	Cash and Cash Equivalents which is to be paid if the same or an equivalent asset was acquired currently. (From view point of purchase)	Undiscounted amount of Cash and Cash Equivalent that would be required to settle the obligation currently
3. Realisable Value	Cash and Cash Equivalents that could currently be obtained by selling the assets in an orderly disposal. (From view point of sale)	Undiscounted amount of Cash and Cash Equivalents that would be required to settle the obligation in the normal course of business
4. Present Value	Present Discounted Value of Cash inflows expected to be derived from such assets over its useful life.	Present discounted value of cash outflows expected to be required to settle the liabilities in the normal course of business.

Different measurement bases, like historical cost/ current cost, net realisable value / present value, are used according to suitability (i.e. suitability needs) to depict true and fair view of the financial position of the reporting entity.

66. Define Accounting Policies

Answers:

Accounting Policies

Inventory is valued at lower of Cost or NRV – this is **accounting principle** & Cost can be determined by FIFO or Weighted Average is the **method**

Accounting Policies refers to:

- the specific accounting principles and
- the methods of applying those principles,

adopted by the enterprise in the preparation and presentation of Financial Statements.

E.g. Methods of depreciation, amortisation or depletion, valuation of inventories, fixed assets, investments, etc.

67. What are the Principles for selecting Accounting Policies?

Answer:
Principles for Selecting Accounting Policy

1. **True and Fair View:** The primary consideration in the selection of accounting policy by an enterprise is that the Financial Statements prepared and presented should represent a **true and fair view** as under –

In the case of Balance Sheet	Of the State of Affairs as on certain date
In the case of Profit & Loss Account	Of the Profit or Loss for the period ended on that date

2. **Factors:** To select and apply an accounting policy, the following points are considered
   - Prudence
   - Substance over Form
   - Materiality

3. **Change in Accounting Policy:** An enterprise should change its accounting policy in anyof the following circumstances only:
   - To bring the books of accounts in accordance with the issued Accounting Standards.
   - To compliance with the provision of law.
   - When under changed circumstances it is felt that new method will reflect more trueand fair picture in the financial statement.

68. What are the disclosure requirements of an Accounting Policy?

Answer:
Disclosure of Accounting Policies
- Accounting Policies have to be disclosed in Notes to Accounts.
- Changes in Accounting Policies must be disclosed, when such changes have material affect in current period or expected to have material affect in later periods. Impact on Profit and Loss Account and Balance Sheet should be quantified, to the extent ascertainable.
- If fundamental accounting assumptions (Going Concern, Consistency & Accrual) are not followed, then the fact should be disclosed
- Disclosure of Accounting Policies or of changes therein cannot remedy a wrong or inappropriate treatment of the items in the accounts.

69. Accounting Estimates vs Accounting Policies

Answer:

Accounting Estimates

It means an approximation of the amount of an item in the absence of a precise means of measurement.

E.g. Rates of Depreciation, Provision for Bad Debts, Provision for Taxation, etc.

Accounting Estimates Vs Accounting Policies

Particulars	Accounting Estimates	Accounting Policies
Meaning	Accounting estimates refer to Financial Statement items, which cannot be measured with precision, but can be estimated based on informed judgement.	A policy refers to accounting principle and the method of applying that principle.
Frequency	Accounting Estimates are changed frequently, E.g. PBDD	Accounting Policies are permanent change in basis of accounting and are infrequent. E.g. Methods of Depreciation
Causes/Reasons	Change in Accounting Estimates arises due to: • Change in circumstances on which the estimate was based or • Availability of new information	Change in Accounting Policies arises when: • Required by statute • Required by AS • For better presentation of financial statements
Materiality	Changes in Accounting estimates do not have material impact, generally.	Changes in Accounting policies do have material and long term impact, generally.
Disclosure	The nature and amount of change in Accounting Estimate which has a material effect should be disclosed.	A change in accounting Policy which has a material effect should be disclosed.

70. Fundamental Accounting Assumptions Vs Accounting Policy

Answer:

Particulars	Fundamental Accounting Assumption	Accounting Policy
Number	3	No Specified list
Disclosure	To be disclosed, if not followed	Required to be disclosed
If not followed/ changed	The fact to be disclosed with reasons	The fact of change in the accounting policy along with the effect of change to be disclosed
Choices	Mandatory	The entity has an option to choose from. E.g. WDV or Straight Line method of Depreciation.

71. Meaning & Applicability of Accounting Standards

Accounting Standards

Meaning	"Accounting Standards (AS)" represents the statements issued by the Institute of Chartered Accountants of India (ICAI), which contain basic principles for Accounting / disclosure of specific items in the Financial Statements.
Applicability	The Accounting standards deals issues with respect to: • **Recognition** of transactions and events in the Financial Statements • **Measurements** of these transactions and events • **Presentation** of these transactions and events in Financial Statements • **Disclosure Requirements** in Financial Statements
Procedure	The Accounting Standard Board (ASB) of the ICAI is responsible for identification and issue of Accounting Standards.

72. Meaning of Ind As & IFRS and benefit of converging IndAs with IFRS

Answer:

Meaning of IFRS	International Financial Reporting Standards (IFRS) comprises of: • IFRS issued by International Accounting Standard Board (IASB) • International Accounting Standards (IAS) issued by International Accounting Standard Committee (IASC) • Interpretations issued by the Standards Interpretation Committee (SIC) and International Financial Reporting Interpretations (IFRIC) of the IASB
Meaning of Ind AS	• Indian Accounting Standards (Ind AS) are the IFRS converged standards (not adopted) issued by the Central Government of India under the supervision and control of Accounting Standard Board (ASB) of ICAI and in consultation with National Advisory Committee on Accounting Standards (NACAS) • National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India. • The Ind AS are named and numbered in the same way as the corresponding IFRS
Benefits of Convergence with IFRS	• To bring about **uniformity, rationalization, comparability, transparency and adaptability** of Financial Statements across the world. • Boosts **economy** as it encourages international investing and thereby leads to more foreign capital flows to the country. • Convergence with IFRS contributes to **investors'** understanding and confidence in high quality financial statements. • **Industry** would be able to raise capital from foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted accounting standards. The burden of financial reporting is lessened as it simplifies the process of preparing the financial statements using different sets of accounting standards.

73. Capital and Revenue Expenditures & Receipts

Revenue Expenditure	• Revenue expenditure is the expenditure which is incurred to carry out the normal day to day activities of the company. • They are incurred to maintain existing productivity or earning capacity of the company. • Revenue expenditure does not yield benefit beyond the current accounting period. Revenue expenditure appears generally as expense on the debit side of trading and profit and loss account. • Revenue expenditure is recurring in nature.
Examples of revenue expenditure	• Depreciation on asset. • Repairs of machine after it are put to use. • Rent, Interest, Salary, Commission
Revenue Receipts	• Revenue Receipts are the receipts which occur from activities which are a part of normal business operations. • They arise from the operating activities of the company that is why they occur again and again however its benefit can be enjoyed only in the current accounting year as its effect is short term. • The income received from the day to day activities of business includes all the operations that bring cash into the business.
Examples of revenue receipts	• Sale of goods and services. • Interest on investments. • Rent received. • Commission Received. • Insurance claim for stock damaged.
Capital Expenditure	• Capital expenditure is the expenditure which is incurred to acquire a fixed asset which increases the productivity or earning capacity of the company. • Such expenditure normally yields benefit beyond the current accounting period. • Capital expenditure is generally of a one kind but its benefit is derived over several accounting periods. • Capital expenditure appears generally as asset in the balance sheet. • Capital expenditure is non – recurring in nature.
Examples of Capital Expenditure	• Cost of machinery purchased. • Purchase of a patent right. • Customs duty on imported machinery. • Purchases of technical know – how. • Legal expenses to acquire a building.
Capital Receipt	• Capital receipts are the receipts which occur from activities which are not part of the normal trading activities of thecompany. • They do not arise from the operating activities of business. • Capital receipts are non-recurring in nature and generally appear as liabilities in the balance sheet.
Examples of Capital Receipt	• Money received from share-holders. • Money received from debentures holders.

	• Loans raised • Sale of plant & machinery • Sale of investments. • Insurance claim for machinery damaged.

74. Contingent Asset and Contingent Liabilities

Contingent	When something is contingent it means that the possibility of an event or situation depends on the happening of another.
Contingent Asset	A possible asset arises from past events and their existence will be confirmed only after occurrence or non-occurrence of one or more uncertain future events. It usually arises from unplanned or unexpected events that give rise to the possibility of an in-flow of economic benefits to the entity.
Examples	For example, a claim that an enterprise is pursuing through legal process, where the outcome is uncertain, is a contingent asset.
Recognition of contingent Assets	• As per the concept of prudence or conservatism as well as the present accounting standards, an enterprise should not recognise a contingent asset. • It is possible that recognition of contingent assets may result in recognition of income that may never be realised. • However, when the realisation of income is virtually certain, then the related asset no longer remains as contingent asset. • Contingent assets are assessed continually and if it has become virtually certain that an in-flow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs.
Disclosure	• A contingent asset need not be disclosed in the financial statements. • A contingent asset is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise), if an inflow of economic benefits is probable.
Contingent Liabilities	A possible obligation arising from past events and may arise in future depending on the occurrence or non- occurrence of one or more uncertain future events.
Examples	Guarantees given in the respect of third parties, Disputed income tax demand, Bills discounted
Recognition of Contingent Liabilities	• An enterprise should not recognise a contingent liability. • These liabilities are assessed continually to determine whether an out-ow of resources embodying economic benefits has become probable. • If it becomes probable that an out-flow or future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in financial statements of the period in which the change in probability occurs • However, it should not be recognised circumstances where no reliable estimate can be made.

Disclosure	A Contingent liability is required to be disclosed unless possibility of outflow of a resource embodying economic benefits is remote.
Liabilities vs Contingent Liabilities	A liability is defined as the present financial obligation of an enterprise, which arises from past events. The settlement of a liability results in an outflow from the enterprises of resources embodying economic benefits. In the case of contingent liability, either out-flow 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.

75. Provision Vs Contingent Liability

S No	Provision	Contingent liability
1	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 crystallize depending on the occurrence or non-occurrence of one or more uncertain future events.
2	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
3	Provision is recognised when (a) an enterprise has a present obligation arising 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 the recognition criteria because either it is not probable that settlement of those obligations will require out-ow of economic benefits, or the amount cannot be reliably estimated.
4	If the management estimates that it is probable that the settlement of an obligation will result in out-flow of economic benefits, it recognises a provision in the balance sheet.	If the management estimates, that it is less likely that any economic benefit will out-ow the firm to settle the obligation, it discloses the obligation as a contingent liability.

76. State with reasons whether the following are Capital or Revenue Expenditure:
(1) Expenses incurred in connection with obtaining a license for starting the factory for ₹10,000.
(2) ₹1,000 paid for removal of Inventory to a new site.
(3) Rings and Pistons of an engine were changed at a cost of ₹5,000 to get fuel efficiency.
(4) Money paid to Mahanagar Telephone Nigam Ltd. (MTNL) ₹8,000 for installing telephone inthe office.
(5) A factory shed was constructed at a cost of ₹1,00,000. A sum of ₹5,000 had been incurred in the construction of temporary huts for storing building material.

Ans
1) Money paid ₹10,000 for obtaining license to start a factory is a **capital expenditure**. This isan item of expenditure incurred to acquire the right to carry on business.
(2) ₹1,000 paid for removal of Inventory to a new site is **revenue expenditure**. This is neither bringing enduring benefit nor enhancing the value of the asset.
(3) ₹5,000 spent in changing Rings and Pistons of an engine to get fuel efficiency is **capital expenditure**. This is an expenditure on improvement of a fixed asset. It results in increasing profit-earning capacity of the business by cost reduction.
(4) Money deposited with MTNL for installation of telephone in office is **not expenditure**. This is treated as an asset and the same is adjusted over a period of time against actual telephone bills.
(5) Cost of construction of building including cost of temporary huts is **capital expenditure**. Building is fixed asset which will generate enduring benefit to the business over more than one accounting period. Construction of temporary huts is incidental to the main construction. Such cost is also capitalised with the cost of building.

77.
Good Pictures Ltd., constructs a cinema house and incurs the following expenditure during the first year ending 31st March, 2016.
(i) Second-hand furniture worth ₹9,000 was purchased; repainting of the furniture costs ₹1,000. The furniture was installed by own workmen, wages for this being ₹200.
(ii) Expenses in connection with obtaining a license for running the cinema worth ₹20,000. During the course of the year the cinema company was fined ₹1,000, for contravening rules. Renewal fee ₹2,000 for next year also paid.
(iii) Fire insurance, ₹1,000 was paid on 1st October, 2015 for one year.
(iv) Temporary huts were constructed costing ₹1,200. They were necessary for the construction of the cinema. They were demolished when the cinema was ready.
Point out how you would classify the above items.

Ans
(i) The total cost of the furniture should be treated as ₹10,200 i.e., all the amounts mentioned should be capitalised since without such expenditure the furniture would not be available for use. If ₹1,000 and ₹200 have been respectively debited to the Repairs Account and the Wages Account, these accounts will be credited to the Furniture Account.
(ii) License for running the cinema house is necessary, hence its cost should be capitalised. But the fine of ₹1,000 is revenue expenditure. The renewal fee for the next year is also revenue expenditure but pertains to the next year; hence, it is a prepaid expense.
(iii) Half of the insurance premium pertains to the year beginning on 1st April, 2016. Hence such amount should be treated as prepaid expense. The remaining amount is revenue expense for the current year.
(iv) Since the temporary huts were necessary for the construction, their cost should be added to the cost of the cinema hall and thus capitalised.

78. State with reasons, how you would classify the following items of expenditure:
1. Overhauling expenses of ₹25,000 for the engine of a motor car to get better fuel efficiency.
2. Inauguration expenses of ₹25 lacs incurred on the opening of a new manufacturing unit inan existing business.
3. Compensation of ₹2.5 crores paid to workers, who opted for voluntary retirement.

Ans
1. Overhauling expenses are incurred for the engine of a motor car to derive better fuel efficiency. These expenses will reduce the running cost in future and thus the benefit is in form of endurable long-term advantage. So, this expenditure should be capitalised.

2. Inauguration expenses incurred on the opening of a new unit may help to explore more customers. This expenditure is in the nature of revenue expenditure, as the expenditure may not generate any enduring benefit to the business over more than one accounting period.

3. The amount paid to workers on voluntary retirement is in the nature of revenue expenditure. Since the magnitude of the amount of expenditure is very significant, it may be better to defer it over future years.

79. Classify the following expenditures and receipts as capital or revenue:
(i) ₹10,000 spent as travelling expenses of the directors on trips abroad for purchase of capital assets.
(ii) Amount received from Trade receivables during the year.
(iii) Amount spent on demolition of building to construct a bigger building on the same site.
(iv) Insurance claim received on account of a machinery damaged by fire.

Ans
(i) Capital expenditure.
(ii) Revenue receipt.
(iii) Capital expenditure.
(iv) Capital receipt.

NIRAJ ACADEMY FOR EXCELLENCE YOUR SUCCESS IS OUR GOAL

80. Are the following expenditures capital in nature?
(i) M/s ABC & Co. run a restaurant. They renovate some of the old cabins. Because of this renovation some space was made free and number of cabins was increased from 10 to 13. The total expenditure was ₹20,000.
(ii) M/s New Delhi Financing Co. sold certain goods on installment payment basis. Five customers did not pay installments. To recover such outstanding installments, the firm spent ₹10,000 on account of legal expenses.
(iii) M/s Ballav & Co. of Delhi purchased a machinery from M/s Shah & Co. of Ahmedabad. M/s Ballav & Co. spent ₹40,000 for transportation of such machinery. The year ending is 31st Dec, 2015.

Ans
(i) Renovation of cabins increased the number of cabins. This has an effect on the future revenue generating capability of the business. Thus, the renovation expense is capital expenditure in nature.
(ii) Expense incurred to recover installments due from customer do not increase the revenue generating capability in future. It is a normal recurring expense of the business. Thus, the legal expenses incurred in this case is revenue expenditure in nature.
(iii) Expenses incurred on account of transportation of fixed asset is capital expenditure in

nature.

81. (a)Distinguish between Money measurement concept and matching concept.
(b) Change in accounting policy may have a material effect on the items of financial statements." Explain the statement with the help of an example

Ans:
(a) **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.

(b) Change in accounting policy may have a material effect on the items of financial statements. For example, 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

82. Write short notes on:
- **(i) Fundamental Accounting Assumptions.**
- **(ii) Retirement of bills of exchange.**
- **(iii) Noting Charges.**
- **(iv) Over-riding Commission.**

Ans:
(i) Fundamental Accounting Assumptions:
Fundamental accounting assumptions underline 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) 'Disclosure of Accounting Policies' according to which the following have been generally accepted as fundamental accounting assumptions:

(a) 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.

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

(c) Accrual: Revenues and costs are accrued, i.e. recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

(ii) 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.

/nirajacademy

Ask

/nirajagarwal_nae

/nirajagarwalNAE

/nirajagarwal

Download

g.page/Niraj_Agarwal-NAE

(iii) Noting Charges: It is necessary that the fact of dishonour and the causes of dishonour should be established. If there is a fear of dishonour, the bill will be given to the public official known as "Notary Public". These officials present the bill for payment and if the money is received, they will hand over the money to the original party. But, if the bill is dishonoured they will note the fact of dishonour, and the reasons given and give the bill back to their client. For this service, they charge a small fee. This fee is known as noting charges. The amount of noting charges is recoverable from the party who is responsible for dishonour.

(iv) Over-riding Commission: In the case of consignment accounts, the consignor pays a commission to the consignee in consideration of services rendered by the latter for selling the goods consigned. This commission may be either normal commission or special commission. Again, the special commission may be del- credere commission or over riding commission.
Over-riding commission is an extra commission allowed to the consignee in addition to the normal commission. Such additional commission is generally allowed:-
(i) To provide additional incentive to the consignee for the purpose of introducing and creating a market for a new product.
(ii) To provide incentive for supervising the performance of other agents in a particular area.
(iii) To provide incentive for ensuring that the goods are sold by the consignee at the highest possible price.

83. (a) Explain Cash and Mercantile system of accounting.
(b) State the advantages of setting Accounting Standards.

Ans:
(a)Cash and mercantile system:
Cash system of accounting is a system by which a transaction is recognized only if cash is received or paid. In cash system of accounting, entries are made only when cash is received or paid, no entry being made when a payment or receipt is merely due. Cash system is normally followed by professionals, educational institutions or non-profit making organizations.
On the other hand, mercantile system of accounting is a system of classifying and summarizing transactions into assets, liabilities, equity (owner's fund), costs, revenues and recording thereof. A transaction is recognized when either a liability is created/ impaired and an asset is created /impaired. A record is made on the basis of amounts having become due for payment or receipt irrespective of the fact whether payment is made or received actually.
Mercantile system of accounting is generally accepted accounting system by business entities

(b) **Advantages of setting Accounting Standards**
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.

(i) 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.

84. Write short notes on any three of the following:
(i) Double entry system.
(ii) Journal.
(iii) Importance of bank reconciliation to an industrial unit.
(iv) Bill of exchange and the various parties to it

Ans:

(i) 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.

(ii) 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.

(iii) Banks are essential to modern society, but for an industrial unit, it serves as a 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.

(iv) 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:
(i) The drawer, who draws the bill, that is, the creditor to whom the money is owing;
(ii) 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
(iii) The payee, the person who is to receive the payment. The drawer in many cases is also the payee

/nirajacademy

Ask

/nirajagarwal_nae

/nirajagarwalNAE

/nirajagarwal

Download

g.page/Niraj_Agarwal-NAE

85. (a) Distinguish between fundamental accounting assumption and accounting policies.
(b) Change in accounting policy may have a material effect on the items of financial statements." Explain the statement with the help of an example.

Ans. (a)

Fundamental Accounting Assumption	Accounting Policies
There are three fundamental accounting assumptions viz. Going Concern, Consistency and Accrual.	There is no single list of accounting policies which are applied in all circumstances. As aresult, there may be different accounting policies adopted by different enterprises.
No disclosures is required if all the fundamental assumptions have been followed.	Disclosure is required if a particular accounting policy has been followed.
If fundamental accounting assumption is not followed, it is to be disclosed in the financial statements together with thereasons.	If the policy is changed in subsequent year, the effect of such change should be disclosedin the financial statements.
There is no option to choose fundamental accounting assumptions.	The firm has an option to select a particular policy.

(b) Change in accounting policy may have a material effect on the items of financial statements. For example, 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

86. Write short notes on:
(i) Noting Charges.
(ii) Objective of Accounting Standards.
(iii) Retirement of bills of exchange.
(iv) Over-riding Commission.

Ans:

i) Noting Charges: It is necessary that the fact of dishonour and the causes of dishonour should be established. If there is a fear of dishonour, the bill will be given to the public official known as "Notary Public". These officials present the bill for payment and if the money is received, they will hand over the money to the original party. But, if the bill is dishonoured they will note the fact of dishonour, and the reasons given and give the bill back to their client. For this service, they charge a small fee. This fee is known as noting charges. The amount of noting charges is recoverable from the party who is responsible for dishonour.

(ii) 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.

(iii) 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.

(iv) Over-riding Commission: In the case of consignment accounts, the consignor pays a commission to the consignee in consideration of services rendered by the latter for selling the goods consigned. This commission may be either normal commission or special commission. Again, the special commission may be del- credere commission or over riding commission.
Over-riding commission is an extra commission allowed to the consignee in addition to the normal commission. Such additional commission is generally allowed:-
(i) To provide additional incentive to the consignee for the purpose of introducing and creating a market for a new product.
(ii) To provide incentive for supervising the performance of other agents in a particular area.
(iii) To provide incentive for ensuring that the goods are sold by the consignee at the highest possible price.

87. (a) Explain Cash and Mercantile system of accounting.
(b) Define revenue receipts and give examples. How are these receipts treated? Explain.

Ans :
(a) Cash and mercantile system: Cash system of accounting is a system by which a transaction is recognized only if cash is received or paid. In cash system of accounting, entries are made only when cash is received or paid, no entry being made when a payment or receipt is merely due. Cash system is normally followed by professionals, educational institutions or non-profit making organizations.

On the other hand, mercantile system of accounting is a system of classifying and summarizing transactions into assets, liabilities, equity (owner's fund), costs, revenues and recording thereof. A transaction is recognized when either a liability is created/ impaired and an asset is created /impaired. A record is made on the basis of amounts having become due for payment or receipt irrespective of the fact whether payment is made or received actually.
Mercantile system of accounting is generally accepted accounting system by business entities.

(b) 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.

88. Write short notes on the following:
(i) Going Concern concept.
(ii) Objectives of preparing Trial Balance.
(iii) Retirement of bills of exchange.
(iv) Over-riding Commission.
(v) Trade bill vs. Accommodation bill.

Ans:
(i) **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. Hence, it is assumed that the enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a

different basis and, if so, the basis used is disclosed.

(ii) **Objectives of preparing Trial Balance**

The preparation of trial balance has the following objectives:

1 Checking of the arithmetical accuracy of the accounting entries: 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 the arithmetical accuracy of the books.

2. Basis for preparation of financial statements: Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period. In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements to know the profit or loss made by the business during a particular period or its financial position on a particular date.

3. Summarized ledger: Trial Balance contains the ledger balances on a particular date. Thus, the entire ledger is summarized in the form of a Trial Balance. The position of a particular account can be judged simply by looking at the Trial Balance. The ledger may be seen only when details regarding the accounts are required.

(iii) **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

(iv) **Over-riding Commission:** In the case of consignment accounts, the consignor pays a commission to the consignee in consideration of services rendered by the latter for selling the goods consigned. This commission may be either normal commission or special commission. Again, the special commission may be del- credere commission or over riding commission.

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

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

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

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

(v) **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.

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

Ans

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.

90. (a) State the causes of difference between the balance shown by the pass book and the cash book.
(b)Which subsidiary books are normally used in a business?

Ans:

(a) 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.
(viii) Dishonour of a bill discounted with the bank.
(ix) Bills collected by the bank on behalf of the customer.
(x) An error committed by the bank etc.

(b) 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.

91. Change in accounting policy may have a material effect on the items of financial statements." Explain the statement with the help of an example.

Ans: Change in accounting policy may have a material effect on the items of financial statements. For

example, 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.

92. Write short notes on any two of the following:
(i) Double entry system.
(ii) Importance of bank reconciliation to an industrial unit.
(iii) Bill of exchange and the various parties to it.
(iv) Retirement of bills of exchange.

Ans:
(i) 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.

(ii) Banks are essential to modern society, but for an industrial unit, it serves as a 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.

(iii) A bill of exchange is an instrument in writing containing an unconditiona l 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:

(i) The drawer, who draws the bill, that is, the creditor to whom the money is owing;
(ii) 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
(iii) The payee, the person who is to receive the payment. The drawer in many cases is also the payee.

(iv) 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.

/nirajacademy

Ask

/nirajagarwal_nae

/nirajagarwalNAE

/nirajagarwal

Download

g.page/Niraj_Agarwal-NAE

93. Explain, in brief, the basic considerations for distinguishing between capital and revenue expenditures?

Ans:
The basic considerations in distinction between capital and revenue expenditures are:
(i) 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.
(ii) Recurring nature of expenditure: If the frequency of an expense is quite often in 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.
(iii) 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.
(iv) Materiality of the amount involved: Relative proportion of the amount involved is another important consideration in distinction between revenue and capital.

94. (a) Explain in brief objectives of preparing Trial Balance.
(b) What are the rules of posting of journal entries into the Ledger? Explain in brief.

Ans: (a) The preparation of trial balance has the following objectives:
1 Checking of the arithmetical accuracy of the accounting entries: 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 the arithmetical accuracy of the books.
2. Basis for preparation of financial statements: Trial Balance forms the basis for preparing financial statements such as the Income Statement and the Balance Sheet. The Trial Balance represents all transactions relating to different accounts in a summarized form for a particular period. In case, the Trial Balance is not prepared, it will be almost impossible to prepare the financial statements to know the profit or loss made by the business during a particular period or its financial position on a particular date.
3. Summarized ledger: Trial Balance contains the ledger balances on a particular position of a particular account can be judged simply by looking at the Trial Balance. The ledger may be seen only when details regarding the accounts are required

NIRAJ ACADEMY FOR EXCELLENCE YOUR SUCCESS IS OUR GOAL

(b) Rules regarding posting of entries in the ledger
1. Separate account is opened in ledger book for each account and entries from journal are posted to respective account accordingly.
2. It is a practice to use words 'To' and 'By' while posting transactions in the ledger.
3. The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.

95. Differentiate between provision and contingent liability.

Ans: Difference between Provision and Contingent liability

	Provision	Contingent liability
(1)	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.

/nirajacademy

Ask

/nirajagarwal_nae

/nirajagarwalNAE

/nirajagarwal

Download

g.page/Niraj_Agarwal-NAE

(2)	A provision meets the recognition criteria.	A contingent liability fails to meet the same.
(3)	Provision is recognized when (a) an enterprise has a present obligation arising 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 the recognition criteria because either it is not probable that settlement of those obligations will require outflow of economic benefits, or the amount cannot be reliably estimated.
(4)	If the management estimates that it is probable that the settlement of an obligation will result in outflow of economic 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.

96. What services can a Chartered Accountant provide to the society?

Ans: The practice of accountancy has crossed its usual domain of preparation of financial statements, interpretation of such statements and audit thereof. Chartered 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.

Some of the services rendered by chartered accountants to the society are briefly mentioned hereunder:

(i) Maintenance of books of accounts;
(ii) Statutory audit;
(iii) Internal Audit;
(iv) Taxation;
(v) Management accounting and consultancy services;
(vi) Financial advice and financial investigations etc.

Other services like secretarial work, share registration work, company formation receiverships, arbitrations etc.

97. Write short notes on:
(i) Adjusted Selling Price method of determining cost of stock.
(ii) Principal methods of ascertainment of cost of inventory.

Ans: (i) Adjusted selling method is also called retail 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.

(ii) 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

98. Explain Cash and Mercantile system of accounting

Ans: Cash and mercantile system: Cash system of accounting is a system by which a transaction is recognized only if cash is received or paid. In cash system of accounting, entries are made only when cash is received or paid, no entry being made when a payment or receipt is merely due. Cash system is normally followed by professionals, educational institutions or non-profit making organizations.

On the other hand, mercantile system of accounting is a system of classifying and summarizing trandsactions into assets, liabilities, equity (owner's fund), costs, revenues and recording thereof. A transaction is recognized when either a liability is created/ impaired and an asset is created/impaired. A record is made on

/nirajacademy

Ask

/nirajagarwal_nae

/nirajagarwalNAE

/nirajagarwal

Download

g.page/Niraj_Agarwal-NAE

the basis of amounts having become due for payment or receipt irrespective of the fact whether payment is made or received actually.
Mercantile system of accounting is generally accepted accounting system by business entities

99. Explain in brief objective and advantages of setting Accounting Standards

Ans: Objective and Advantages of Accounting Standards: An Accounting Standard is a selected set of accounting policies or broad guidelines regarding the principles and methods to be chosen out of several alternatives. The Accounting Standards Board formulates Accounting Standards to be established by the Council of the Institute of Chartered Accountants of India.
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 standards. 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.
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 as follows:
(i) Reduction in variations.
(ii) Disclosure beyond that required by law.
(iii) Facilities comparison.

100. Define the following terms:
(i) Capital Commitment
(ii) Expired Cost
(iii) Floating Charge
(iv) Obsolescence

Ans
(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.

101. Discuss the rules if there is no Partnership Agreement.

Ans: As per the Indian Partnership Act, 1932, in the absence of any agreement among the partners,
1. No partner has the right to a salary,
2. No interest is to be allowed on capital,
3. No interest is to be charged on the drawings,
4. Interest at the rate of 6%.p.a is to be allowed on a partner's loan to the firm, and
5. Profits and losses are to be shared equally.

102. Discuss the basic considerations in distinguishing between capital and revenue expenditure.

Ans: 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 often in 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 help to 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.

NIRAJ ACADEMY FOR EXCELLENCE
YOUR SUCCESS IS OUR GOAL

103. What are the advantages of Subsidiary Books ?

Ans Advantages of Subsidiary Books

The use of subsidiary books affords the under mentioned advantages:

(i) Division of work: Since in the place of one journal there will be so many subsidiary books, the accounting work may be divided amongst a number of clerks.

(ii) Specialization and efficiency: When the same work is allotted to a particular person over a period of time, he acquires full knowledge of it and becomes efficient in handling it. Thus the accounting work will be done efficiently.

(iii) Saving of the time: Various accounting processes can be undertaken simultaneously because of the use of a number of books. This will lead to the work being completed quickly.

(iv) Availability of information: Since a separate register or book is kept for each class of transactions, the information relating to each transactions will be available at one place.

(v) Facility in checking: When the trial balance does not agree, the location of the error or errors is facilitated by the existence of separate books. Even the commission of errors and frauds will be checked by the use of various subsidiary books

/nirajacademy Ask /nirajagarwal_nae /nirajagarwalNAE /nirajagarwal Download g.page/Niraj_Agarwal-NAE

104. Explain the followings:
(i) Accrual Basis of Accounting
(ii) Amortisation
(iii) Contingent Assets
(iv) Contingent Liabilities

Ans:
1. Accrual Basis of Accounting
The method of recording transactions by which revenues, costs, assets and liabilities are reflected in the accounts in the period in which they accrue.

2. Amortisation
The gradual and systematic writing off of an asset or an account over an appropriate period.
3. Contingent Asset
An asset the existence, ownership or value of which may be known or determined only on the occurrence or non-occurrence of one or more uncertain future events.
4. Contingent Liability
An obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events.

105. Discuss the following:
(i) What do you mean by principal books of accounts?
(ii) What are the rules of posting of journal entries into the Leger?

Ans
(i) Ledger is known as principal books of accounts as 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)

(ii) Rules regarding posting of entries in the ledger:

1. Separate account is opened in ledger book for each account and entries from journal are posted to respective ledger account accordingly.
2. 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.
3. The concerned account debited in the journal should also be debited in the ledger but reference should be of the respective credit account.