Govt Engineering College Jhalawar

Department of management Studies

Class: BBA Ist Year

Subject : Fundamental of Accounting

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Model Question Paper With Answer

Q.1 What Do myou mean by Accounting . Explain the Accounting Concepts in Detail?

Ans: Accounting is a system meant for measuring business activities, processing of information into reports and making the findings available to decision-makers. The documents, which communicate these findings about the performance of an organisation in monetary terms, are called financial statements.

ACCOUNTING CONCEPTS :

1. Separate Business Entity Concept

In accounting we make a distinction between business and the owner. All the books of accounts records day to day financial transactions from the view point of the business rather than from that of the owner. The proprietor is considered as a creditor to the extent of the capital brought in business by him. For instance, when a person invests Rs. 10 lakh into a business, it will be treated that the business has borrowed that much money from the owner and it will be shown as a 'liability' in the books of accounts of business. Similarly, if the owner of a shop were to take cash from the cash box for meeting certain personal expenditure, the accounts would show that cash had been reduced even though it does not make any difference to the owner himself. Thus, in recording a transaction the important question is how does it affects the business?

For example, if the owner puts cash into the business, he has a claim against the business for capital brought in.

In so-far as a limited company is concerned, this distinction can be easily maintained because a company has a legal entity like a natural person it can engage itself in economic activities of buying, selling, producing, lending, borrowing and consuming of goods and services. However, it is difficult to show this distinction in the case of sole proprietorship and partnership. Nevertheless, accounting still maintains separation of business and owner. It may be noted that it is only for accounting purpose that partnerships and sole proprietorship are treated as separate from the owner (s), though law does not make such distinction. In fact, the business entity concept is applied to make it possible for the owners to assess the performance of their business and performance of those whose manage the enterprise. The managers are responsible for the proper use of funds supplied by owners, banks and others.

2. Money Measurement Concept

In accounting, only those business transactions are recorded which can be expressed in terms of money. In other words, a fact or transaction or happening which cannot be expressed in terms of money is not recorded in the accounting books. As money is accepted not only as a medium of exchange but also as a store of value, it has a very important advantage since a number of assets and equities, which are otherwise different, can be measured and expressed in terms of a common denominator.

We must realise that this concept imposes two severe limitations. Firstly, there are several facts which though very important to the business, cannot be recorded in the books of accounts because they cannot be expressed in money terms. For example, general health

condition of the Managing Director of the company, working conditions in which a worker has to work, sales policy pursued by the enterprise, quality of product introduced by the enterprise, though exert a great influence on the productivity and profitability of the enterprise, are not recorded in the books. Similarly, the fact that a strike is about to begin because employees are dissatisfied with the poor working conditions in the factory will not be recorded even though this event is of great concern to the business. You will agree that all these have a bearing on the future profitability of the company.

Secondly, use of money implies that we assume stable or constant value of rupee. Taking this assumption means that the changes in the money value in future dates are conveniently ignored. For example, a piece of land purchased in 1990 for Rs. 2 lakh and another bought for the same amount in 1998 are recorded at the same price, although the first purchased in 1990 may be worth two times higher than the value recorded in the books because of rise in land prices. In fact, most accountants know fully well that purchasing power of rupee does change but very few recognise this fact in accounting books and make allowance for changing price level.

3. Dual Aspect Concept

Financial accounting records all the transactions and events involving financial element. Each of such transactions requires two aspects to be recorded. The recognition of these two aspects of every transaction is known as a dual aspect analysis. According to this concept every business transactions has dual effect. For example, if a firm sells goods of Rs. 5,000 this transaction involves two aspects. One aspect is the delivery of goods and the other aspect is immediate receipt of cash (in the case of cash sales). In fact, the term ‘double entry’ book keeping has come into vogue and in this system the total amount debited always

equals the total amount credited. It follows from ‘dual aspect concept’ that at any point of time owners’ equity and liabilities for any accounting entity will be equal to assets owned by that entity. This idea is fundamental to accounting and could be expressed as the following equalities: Assets = Liabilities + Owners Equity …(1) Owners Equity = Assets- Liabilities …(2)

The above relationship is known as the ‘Accounting Equation’. The term ‘Owners Equity’ denotes the resources supplied by the owners of the entity while the term ‘liabilities’ denotes the claim of outside parties such as creditors, debenture-holders, bank against the assets of the business. Assets are the resources owned by a business. The total of assets will be equal to total of liabilities plus owners capital because all assets of the business are claimed by either owners or outsiders.

4. Going Concern Concept

Accounting assumes that the business entity will continue to operate for a long time in the future unless there is good evidence to the contrary. The enterprise is viewed as a going concern, that is, as continuing in operations, at least in the foreseeable future. In other words, there is neither the intention nor the necessity to liquidate the particular business venture in the predictable future. Because of this assumption, the accountant while valuing the assets does not take into account forced sale value of them. In fact, the assumption that the business is not expected to be liquidated in the foreseeable future establishes the basis for many of the valuations and allocations in accounting. For example, the accountant charges depreciation on fixed assets. It is this assumption which underlies the decision of investors to commit capi**tal** to enterprise. Only on the basis of this assumption accounting process can remain stable and achieve the objective of

correctly reporting and recording on the capital invested, the efficiency of management, and the position of the enterprise as a going concern.

However, if the accountant has good reasons to believe that the business, or some part of it is going to be liquidated or that it will cease to operate (say within six-month or a year), then the resources could be reported at their current values. If this concept is not followed, International Accounting Standard requires the disclosure of the fact in the financial statements together with reasons.

5. Accounting Period Concept

This concept requires that the life of the business should be divided into appropriate segments for studying the financial results shown by the enterprise after each segment. Although the results of operations of a specific enterprise can be known precisely only after the business has ceased to operate, its assets have been sold off and liabilities paid off, the knowledge of the results periodically is also necessary. Those who are interested in the operating results of business obviously cannot wait till the end. The requirements of these parties force the businessman ‘to stop’ and ‘see back’ how things are going on. Thus, the accountant must report for the changes in the wealth of a firm for short time periods. A year is the most common interval on account of prevailing practice, tradition and government requirements. Some firms adopt financial year of the government, some other calendar year. Although a twelve month period is adopted for external reporting, a shorter span of interval, say one month or three month is applied for internal reporting purposes.

This concept poses difficulty for the process of allocation of long term costs. All the revenues and all the cost relating to the year in operation have to be taken into account while matching the earnings and the cost of those earnings for the any accounting period. This holds good

irrespective of whether or not they have been received in cash or paid in cash. Despite the difficulties which stem from this concept, short term reports are of vital importance to owners, management, creditors and other interested parties. Hence, the accountants have no option but to resolve such difficulties.

6. Cost Concept

The term ‘assets’ denotes the resources land building, machinery etc. owned by a business. The money values that are assigned to assets are derived from the cost concept. According to this concept an asset is ordinarily entered on the accounting records at the price paid to acquire it. For example, if a business buys a plant for Rs. 5 lakh the asset would be recorded in the books at Rs. 5 lakh, even if its market value at that time happens to be Rs. 6 lakh. Thus, assets are recorded at their original purchase price and this cost is the basis for all subsequent accounting for the business. The assets shown in the financial statements do not necessarily indicate their present market values. The term ‘book value’ is used for amount shown in the accounting records.

The cost concept does not mean that all assets remain on the accounting records at their original cost for all times to come. The asset may systematically be reduced in its value by charging ‘depreciation’, which will be discussed in detail in a subsequent lesson. Depreciation has the effect of reducing profit of each period. The prime purpose of depreciation is to allocate the cost of an asset over its useful life and not to adjust its cost. However, a balance sheet based on this concept can be very misleading as it shows assets at cost even when there are wide difference between their costs and market values. Despite this limitation you will find that the cost concept meets all the three basic norms of relevance, objectivity and feasibility.

7. The Matching concept

This concept is based on the accounting period concept. In reality we match revenues and expenses during the accounting periods. Matching is the entire process of periodic earnings measurement, often described as a process of matching expenses with revenues. In other words, income made by the enterprise during a period can be measured only when the revenue earned during a period is compared with the expenditure incurred for earning that revenue. Broadly speaking revenue is the total amount realised from the sale of goods or provision of services together with earnings from interest, dividend, and other items of income. Expenses are cost incurred in connection with the earnings of revenues. Costs incurred do not become expenses until the goods or services in question are exchanged. Cost is not synonymous with expense since expense is sacrifice made, resource consumed in relation to revenues earned during an accounting period. Only costs that have expired during an accounting period are considered as expenses. For example, if a commission is paid in January, 2002, for services enjoyed in November, 2001, that commission should be taken as the cost for services rendered in November 2001. On account of this concept, adjustments are made for all prepaid expenses, outstanding expenses, accrued income, etc, while preparing periodic reports.

8. Accrual Concept

It is generally accepted in accounting that the basis of reporting income is accrual. Accrual concept makes a distinction between the receipt of cash and the right to receive it, and the payment of cash and the legal obligation to pay it. This concept provides a guideline to the accountant as to how he should treat the cash receipts and the right related thereto. Accrual principle tries to evaluate every transaction in terms of its impact on the owner’s equity. The essence of the accrual concept is that net income arises from events that change the owner's equity in a specified period and that these are not necessarily the same as change in the cash position of the business. Thus it helps in proper measurement of income.

9. Realisation Concept

Realisation is technically understood as the process of converting non-cash resources and rights into money. As accounting principle, it is used to identify precisely the amount of revenue to be recognised and the amount of expense to be matched to such revenue for the purpose of income measurement. According to realisation concept revenue is recognised when sale is made. Sale is considered to be made at the point when the property in goods passes to the buyer and he becomes legally liable to pay. This implies that revenue is generally realised when goods are delivered or services are rendered. The rationale is that delivery validates a claim against the customer. However, in case of long run construction contracts revenue is often recognised on the basis of a proportionate or partial completion method. Similarly, in case of long run instalment sales contracts, revenue is regarded as realised only in proportion to the actual cash collection. In fact, both these cases are the exceptions to the notion that an exchange is needed to justify the realisation of revenue.

Q.2 Explain the Types of ACCOUNTING?

Ans :- The financial literature classifies accounting into two broad categories, viz, Financial Accounting and Management Accounting. Financial accounting is primarily concerned with the preparation of financial statements whereas management accounting covers areas such as interpretation of financial statements, cost accounting, etc. Both these types of accounting are examined in the following paragraphs.

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1 Financial accounting

As mentioned earlier, financial accounting deals with the preparation of financial statements for the basic purpose of providing information to various interested groups like creditors, banks, shareholders, financial institutions, government, consumers, etc. Financial statements, i.e. the income statement and the balance sheet indicate the way in which the activities of the business have been conducted during a given period of time.

Financial accounting is charged with the primary responsibility of external reporting. The users of information generated by financial accounting, like bankers, financial institutions, regulatory authorities, government, investors, etc. want the accounting information to be consistent so as to facilitate comparison. Therefore, financial accounting is based on certain concepts and conventions which include separate business entity, going concern concept, money measurement concept, cost concept, dual aspect concept, accounting period concept, matching concept, realization concept and conventions of conservatism, disclosure, consistency, etc. All such concepts and conventions would be dealt with detail in subsequent lessons.

The significance of financial accounting lies in the fact that it aids the management in directing and controlling the activities of the firm and to frame relevant managerial policies related to areas like production, sales, financing, etc. However, it suffers from certain drawbacks which are discussed in the following paragraphs. • The information provided by financial accounting is consolidated in nature. It does not indicate a break-up for different departments, processes, products and jobs. As such, it becomes difficult to evaluate the performance of different sub-units of the organisation. • Financial accounting does not help in knowing the cost behaviour as it does not distinguish between fixed and variable costs. • The information provided by financial accounting is historical in nature and as such the predictability of such information is limited.

The management of a company has to solve certain ticklish questions like expansion of business, making or buying a component, adding or deleting a product line, deciding on alternative methods of production, etc. The financial accounting information is of little help in answering these questions.

The limitations of financial accounting, however, should not lead one to believe that it is of no use. It is the basic foundation on which other branches and tools of accounting analysis are based. It is the source of information, which can be further analysed and interpreted according to the tailor-made requirements of decision-makers.

2 Management accounting

Management accounting is 'tailor-made' accounting. It facilitates the management by providing accounting information in such a way so

that it is conducive for policy making and running the day-to-day operations of the business. Its basic purpose is to communicate the facts according to the specific needs of decision-makers by presenting the information in a systematic and meaningful manner. Management accounting, therefore, specifically helps in planning and control. It helps in setting standards and in case of variances between planned and actual performances, it helps in deciding the corrective action.

An important characteristic of management accounting is that it is forward looking. Its basic focus is one future activity to be performed and not what has already happened in the past.

Since management accounting caters to the specific decision needs, it does not rest upon any well-defined and set principles. The reports generated by a management accountant can be of any duration– short or long, depending on purpose. Further, the reports can be prepared for the organisation as a whole as well as its segments.

3 Cost accounting

One important variant of management accounting is the cost analysis. Cost accounting makes elaborate cost records regarding various products, operations and functions. It is the process of determining and accumulating the cost of a particular product or activity. Any product, function, job or process for which costs are determined and accumulated, are called cost centres.

The basic purpose of cost accounting is to provide a detailed breakup of cost of different departments, processes, jobs, products, sales territories, etc., so that effective cost control can be exercised.

Cost accounting also helps in making revenue decisions such as those related to pricing, product-mix, profit-volume decisions, expansion of business, replacement decisions, etc.

The objectives of cost accounting, therefore, can be summarized in the form of three important statements, viz, to determine costs, to facilitate planning and control of business activities and to supply information for short- and long-term decision. Cost accounting has certain distinct advantages over financial accounting. Some of them have been discussed succeedingly. The cost accounting system provides data about profitable and non-profitable products and activities, thus prompting corrective measures. It is easier to segregate and analyse individual cost items and to minimize losses and wastages arising from the manufacturing process. Production methods can be varied so as to minimize costs and increase profits. Cost accounting helps in making realistic pricing decisions in times of low demand, competitive conditions, technology changes, etc.

Various alternative courses of action can be properly evaluated with the help of data generated by cost accounting. It would not be an exaggeration if it is said that a cost accounting system ensures maximum utilization of physical and human resources. It checks frauds and manipulations and directs the employer and employees towards achieving the organisational goal.

Q.3 State with reasons whether the following events are transactions or not to Mr. K. Mondal,

. (i) Mr. Mondal started business with capital (brought in cash)Rs. 40,000.

(ii) Paid salaries to staff Rs. 5,000.

(iii) Purchased machinery for Rs. 20,000 in cash.

(iv) Placed an order with Sen & Co. for goods for Rs. 5,000.

(v) Opened a Bank account by depositing Rs. 4,000.

(vi) Received pass book from bank.

(vii) Appointed Sohan as Manager on a salary of Rs. 4,000 per month.

(viii) Received interest from bank Rs. 500.

(ix) Received a price list from Lalit.

Ans:- Here, each event is to be considered from the view point of Mr. Mondal's business. Those events which will change the financial position of the business of Mr. Mondal, should be regarded as transaction. (i) It is a transaction, because it changes the financial position of Mr. Mondal's business. Cash will increase by Rs. 40,000 and Capital will increase by Rs. 40,000.

(ii) It is a transaction, because it changes the financial position of Mr. Mondal's business. Cash will decrease by Rs. 5,000 and Salaries (expenses) will increase by Rs. 5,000

(iii) It is a transaction, because it changes the financial position of Mr. Mondal's business. Machinery comes in and cash goes out.

(iv) It is not a transaction, because it does not change the financial position of the business.

(v) It is a transaction, because it changes the financial position of the business. Bank balance will increase by Rs. 4,000 and cash will decrease by Rs. 4,000.

(vi) It is also not a transaction, because it does not change the financial position of Mr. Monal.

(vii) It is also not a transaction, because it does not change the financial position of Mr. Monal.

(viii) It is a transaction, because it changes the financial position of Mr. Mondal's business. Bank interest will increase by Rs. 500 and cash will increase by the same amount.

(ix) It is not a transaction, because it does not change the financial position of the business of Mr. Mondal.

Q.4 What Do You Mean by Journal. Explain the Advantages of Journal?

Ans:- Journal is a historical record of business transaction or events. The word journal comes from the French word "Jour" meaning "day". It is a book of original or prime entry. Journal is a primary book for recording the day to day transactions in a chronological order i.e. the order in which they occur. The journal is a form of diary for business transactions. This is called the book of first entry since every transaction is recorded firstly in the journal.

Journal Entry

Journal entry means recording the business transactions in the journal. For each transaction, a separate entry is recorded. Before recording, the transaction is analysed to determine which account is to be debited and which account is to be credited.

Advantages of Using Journal

Journal is used because of the following advantages:

• A journal contains a permanent record of all the business transactions.

• The journal provides a complete chronological (in order of the time of occurrence) history of all business transactions and the task of later tracing of some transactions is facilitated.

• A complete information relating to one single business transaction is available in one place with all its aspects.

• The transaction is provided with an explanation technically called a narration.

• Use of the journal reduces the possibility of an error when transactions are first recorded in this book.

• The journal establishes the quality of debits and credits for a transaction and reconciles any problems. If a business purchases a bicycle, it is necessary to decide whether the bicycle represents ordinary goods or machinery. Further any amount paid is debited to bicycle account and credited to cash account.

• The use of journals avoids omission or duplication of transactions or parts of transaction. Without the journal the accountant would be forced to got to the individual account to enter debits and credits. Therefore it is possible for accountant to miss part of a transaction, duplicate all or part of a transaction or incorrectly record debits and credits. Even with the Journal, it is still possible to omit transactions and make other errors. However, the Journal reduces these problems.

• Once a transaction is recorded in the journal, it is not necessary to post it immediately in the ledger accounts. In this, way, the journal allows the delayed posting.

In connection with the journal, the following points are to be remembered:

• For each transaction, the exact accounts should be debited and credited. For that, the two accounts involved must be identified to pass a proper journal entry.

• Sometimes, a journal entry may have more than one debit or more than one credit. This type of journal entry is called compound journal entry. Regardless of how many debits or credits are contained in a compound journal entry, all the debits are entered before any credits are entered. The aggregate amount of debits should be equal to the aggregate amount of credits.

• For a business, journal entries generally extend to several pages. Therefore, the total are cast at the end of each page, against the debit and credit columns, the following words and written in the particular column, which indicates, carried forward (of the amount on the next page) "Total c/f".

The debits and credits totals of the page are then written on the next page in the amount columns; and opposite to that on the left, the following words are written in the particulars column to indicate brought forward (of the amount of the previous page) "Total b/f". This process is repeated on every page and on the last page, "Grand Total" is cast.

Q.5 Explain the Types of Account:

Ans:- Types of Account:

1. Personal Accounts

Accounts which are related with accounts of individuals, firms, companies are known as personal accounts. The personal accounts may further be classified into three categories: (i) Natural Personal Accounts: Accounts of individuals relating to natural persons such as Akhil's A/c, Rajesh's A/c, Sohan's A/c are natural personal accounts. (ii) Artificial Personal Accounts: Accounts of companies, institutions such as Reliance Industries Ltd; Lions Club, M/s Sham & Sons, National College account are artificial personal accounts. These exist only in the eyes of law.

(iii) Representative Personal Accounts: The accounts which represent some person such as wage outstanding account, prepaid insurance account, accrued interest account are considered as representative personal accounts.

2. Real Accounts

Real accounts are the accounts related to assets/properties. These may be classified into tangible real account and intangible real account. The accounts relating to tangible assets such as building, plant, machinery, cash, furniture etc. are classified as tangible real accounts. Intangible real accounts are the accounts related to intangible assets such as goodwill, trademarks, copyrights, franchisees, Patents etc.

3. Nominal Accounts

The accounts relating to income, expenses, losses and gains are classified as nominal accounts. For example Wages Account, Rent Account, Interest Account, Salary Account, Bad Debts Accounts

Q.6 Give journal Entry for following Transactions:

1	Ram start business with cash Rs.2,00,000
2	Goods purchase from shyam Rs.1,00,000
3	Goods sold Rs 1,25,000
4	Machinery purchase Rs. 20,000
5	Cash paid to shyam Rs. 50,000
6	Furniture purchase Rs. 30,000
7	Cash withdraw for personal use Rs. 20,000
8	Wages paid RS. 1,000
9	Commission Received Rs. 500
10.	Goods loss by fire Rs. 1,500

Ans:-

Cash A/c Dr. To capital	2,00,000 2,00,000
Purchase A/c Dr. To Shyam	1,00,000 1,00,000
Cash A/c Dr. To sales	1,25,000 1,25,000
Machinery A/c Dr. To cash	20,000 20,000
Shyam A/c Dr. To cash	50,000 50,000
Furniture A/c Dr. To cash	20,000 20,000
Drawings A/c Dr. To Cash	30,000 30,000
Wages A/c Dr. To cash	1,000 1,000
Cash A/c Dr. To Commission	500 500
Loss by fire A/c Dr. To Purchase	1,500 1,500