Biyani's Think Tank

Concept based notes

Fundamental of Accounting

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[BBA Part-I & BCA Part-I]

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Preface

I am glad to present this book, especially designed to serve the needs of the students. The book has been written keeping in mind the general weakness in understanding the fundamental concepts of the topics. The book is self-explanatory and adopts the "Teach Yourself" style. It is based on question-answer pattern. The language of book is quite easy and understandable based on scientific approach.

This book covers basic concepts related to the microbial understandings about diversity, structure, economic aspects, bacterial and viral reproduction etc.

Any further improvement in the contents of the book by making corrections, omission and inclusion is keen to be achieved based on suggestions from the readers for which the author shall be obliged.

I acknowledge special thanks to Mr. Rajeev Biyani, *Chairman* & Dr. Sanjay Biyani, *Director* (*Acad.*) Biyani Group of Colleges, who are the backbones and main concept provider and also have been constant source of motivation throughout this Endeavour. They played an active role in coordinating the various stages of this Endeavour and spearheaded the publishing work.

I look forward to receiving valuable suggestions from professors of various educational institutions, other faculty members and students for improvement of the quality of the book. The reader may feel free to send in their comments and suggestions to the under mentioned address.

Author

Content

1
Accounting: An Introduction

Very Short: Question-Answer

Q.1. What is meant by Accounting? Give two objectives of Accounting.

Ans. According to the American Institute of Certified Public Accountants (AICPA) in their Accounting Terminology Bulletin No. 1, "Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof."

Two objectives of Accounting are:—

(i) **To keep systematic records:** Its main objective is to keep complete record of business transactions. It avoids the possibility of omission and fraud.

(ii) **To calculate profit or loss:** Accounting helps to ascertain the net profit earned or loss suffered on account of business transactions during a particular period. To ascertain profit or loss at the end of each accounting period Trading and Profits & Loss of the business is prepared.

Q.2. What do you mean by Accounting Concepts?

Ans. Accounting Concepts provide a base for accounting process every enterprise has to consider basic concepts at the time of preparing its financial statements.

According to Kohler concept as, "A series of assumptions constituting the supposed basis of a system of thought or an organized field of an endeavour.

Q.3. What is separate entity concept?

Ans. According to this concept, the business and businessman are two separate and distinct entities. Business is treated as a unit separate and distinct from its owners, managers and others. Therefore, proprietor is treated as a creditor of the business to the extent of capital invested by him in the business. It is applicable to all forms of business organizations, i.e., sole proprietorship, partnership or a company.

Q.4. What do you understand by going concern concept?

Ans. According to this concept it is assumed that the business will continue to exist for a long period in the future. According to this concept we record fixed assets at their original cost and full cost of the asset would not be treated an expense in the year of its purchase itself.

Q.5. What do you understand by convention of consistency?

Ans. According to this convention accounting principles and methods should remain consistent from one year to another. The rationale for this concept is that changes in accounting treatment would make the Profit & Loss and Balance Sheet unreliable for end users. For example there are several methods of providing depreciation on fixed assets i.e. fixed installment method, diminishing balance method etc., But it is expected that the business entity should be consistent to follow accounting method.

Q.6. Explain Accounting Equation.

Ans. Accounting equation is also termed as balance sheet equation. It signified that the assets of a business are always equal to the total of capital and liabilities.

It can be represented as:

Assets = Liabilities + Capital

Capital = Assets + Liabilities

Short: Question-Answer

Q.1. Give advantages of Accounting.

Ans. Advantages of accounting are:—

(i) **Provides Complete and Systematic Record:** In business there are so many transactions therefore it is not possible to remember all transactions. Accounting keeps a systematic record of all the business transactions and summarized into financial statements.

(ii) **Information Regarding Financial Position:** Accounting provides information about the financial position of the business by preparing a balance sheet at the end of each accounting period.

(iii) **Helpful in Assessment of Tax Liability:** Accounting helps in maintaining proper records. With the help of these records a firm can assessed income tax of sales tax. Such records are trusted by income tax and sales tax authorities.

(iv) **Information Regarding Profit or Loss:** Profit & Loss Account is prepared at the end of each accounting period to know the net profit earned or net loss suffered at the end of each accounting period.

Q.2. Give limitations of Accounting.

Ans. Limitations of Accounting are:—

(i) **Possibilities of Manipulation:** Accounts can be manipulated, so that the financial statements may disclose a more favourable position then the actual position for example closing stock may be overvalued in accounts.

(ii) **It includes only Economic Activities:** Non-monetary transactions are not recorded in accounts. Transactions which can not be expressed in money cannot find place in accounts. Qualitative aspects of business units like management labour relations, efficiency of management etc. are wholly omitted from the books of accounts.

(iii) **Price Level Changes not Considered:** Fixed assets are recorded in accounts at their original cost. Sometimes assets remain undervalued particularly land and building. Effect of price level changes is not considered at the time of preparing accounts.

(iv) **Influenced by Personal Judgments:** An accountant has to use his personal judgment in respect of many items. For example, it is very difficult to predict the useful life of an asset.

2

Journal and Ledger

Very Short: Question-Answer

Q.1. What is Journal?

Ans. A Journal is a book of original entry in which transactions are recorded in the order in which they occur i.e., in chronological order.

It is a basic book of original entry in which transactions are analyzed before they are posted in the ledger.

Q.2. Give four advantages of Journal.

Ans. Advantages of Journal:—

(i) As transactions in journal are entered as and when they take place, the possibility of omission of a transaction in the books of accounts is minimized.

(ii) Journal provides a chronological record of all transactions.

(iii) Along with the entry in the journal, a complete explanation is written so that it is possible to understand the entry properly later.

(iv) Journal facilitates cross checking of ledger accounts in cae a trial balance does not agree.

Q.3. Give two limitations of Journal.

Ans. Limitations of Journal:—

(i) When the number of transactions is large, it is not possible to record all the transactions in journal. Therefore, the usual practice is to have separate journals or books for different classes of transactions.

(ii) Cash transactions are generally recorded in a separate book called Cash Book. Thus cash transactions need not be recorded in Journal.

Q.4. What is Double Entry System of Book-Keeping?

Ans. According to William Pickles, "The Double Entry System seeks to record every transaction in money or money's worth in its double aspect-The receipt of a benefit by one account and the surrender of a like benefit by another account, the former entry being to the debit of the account receiving and the latter to the credit of that account surrendering."

Q.5. Give two advantages of Ledger.

Ans. Advantages of Ledger:—

(i) It is difficult to prepare the final accounts in the absence of a ledger as it provides necessary information regarding various accounts.

(ii) All the transactions related to an account are collected at one place, which will provide a complete information of all the transactions related to a particular account.

Q.6. Differentiate between Journal and Ledger.

Ans. (i) Journal is the book of original entry while a ledger is the book of secondary entry because all transactions are recorded first in the journal and then posted to the ledger.

(ii) The process of recording transactions in a journal is termed 'Journalizing' while the process of recording transactions in a ledger is called a posting'.

Q.7. Distinguish between Cash Discount and Trade Discount.

Ans. Difference between Cash Discount and Trade Discount are:—

Basic of Difference	Cash Discount	Trade Discount
1. Meaning	Cash discount is allowed when payment is received and cash discount is received when payment is made.	Trade discount is allowed at the time of sale to the customers at a fixed percentage on the marked price.
2. Purpose	The purpose is to encourage prompt payment from customers.	The purpose is to increase sales and to enable retailers to sell the goods to their customers at list price.
3. Recording in the books	It is recorded in the books of accounts.	It is not recorded in the books of accounts.
4. Deduction from Invoice	This discount is not deducted from the invoice.	It is deducted from the invoice.

3

Subsidiary Books

Very Short: Question-Answer

Q.1. Define subsidiary books and give names of subsidiary books.

Ans. Subsidiary book is meant for recording all the transactions of a similar nature. They are also known as special journals.

It may be defined as books where the transactions are entered first and then ledger accounts are prepared on their basis.

Journal is divided into a number of subsidiary books. These are:—

(i)	Cash Book	(ii)	Purchase Book
(ii)	Sales Book	(iii)	Purchase Return Book
(iv)	Sales Return Book	(iv)	Bills Receivable Book
(v)	Bills Payable Book	(vi)	Journal Proper

Q.2. Why Cash Book is called a book of original entry?

Ans. The number of cash transactions in a firm is generally larger, therefore, it becomes inconvenient to record all cash transactions in the journal. Since all cash transactions are recorded for the first time in the cash book, it is therefore called a book of original entry. Only cash transactions are recorded in the cash book.

Q.3. Give four advantages of Petty Cash Book.

Ans.
(i) It saves the time of chief cashier.
(ii) Maintenance of petty cash book does not require any specialized knowledge of accounting.
(iii) It provides control over small payments.
(iv) It minimizes the chances of fraud.

Q.4. What is a purchase book?

Ans. It is a subsidiary book which records transactions of credit purchases of goods. Cash purchases are not recorded in the purchases book since they are recorded in the cash book.

Q.5. What is a sales book?

Ans. It is a subsidiary book which records transactions of credit sales of goods. Cash sales will be recorded in the cash book and not in the sales book. Sale of assets is not recorded in the sales books.

Q.6. Define purchase return book.

Ans. Purchase return or return outward book is maintained to record the goods or materials returned to the suppliers that have been purchased on credit. When the goods are returned, a debit note is prepared and is sent to the supplier with the returned goods.

Q.7. What is a credit note?

Ans. When the goods are received back, a credit note is prepared in duplicate and the original copy of the same is sent to the party from whom goods were received. A credit note contains details relating to the name of the customer, details of the goods received back and the amount of return.

Short: Question-Answer

Q.1. State the four advantages of sub-dividing a Journal.

Ans. Advantages of sub-dividing a Journal are:—

(i) **Division of Work:** There are eight subsidiary books, in place of one journal, accounting work can be divided among a number of persons. Different persons do the accounting work in different books, therefore, the work will be completed in a very short time.

(ii) **Time Saving:** Various accounting processes can be undertaken simultaneously because of the use of number of books. This leads to the work being completed quickly.

(iii) **Increase in Efficiency:** Work of a particular book is handled by a particular person, therefore he acquires full knowledge of it and becomes efficient in handling it.

(iv) **Flexible:** Maintenance of all the eight books is not necessary for every business firm. Any business firm can increase or decrease the number of books according to the needs of the business.

Q.2. Explain the meaning of Imprest System of Petty Cash Book.

Ans. Under this system, a definite sum of money is given to the petty cashier at the beginning of a period. The petty cashier goes on paying all petty expenses like expenses on telegram, newspaper, taxi fare etc. Out of this amount and records them in the petty cash book maintained by him. At the end of the certain period, the petty casher submits the account to the chief cashier who, after having examined the petty cash book, reimburses the amount actually spent by the petty cashier. Thus, petty cashier will again have the fixed amount at the beginning of the new period. Such a system is known as the ‘Imprest System of Petty Cash’.

Q.3. What is Journal Proper?

Ans. In journal proper only those transactions are recorded which cannot be recorded in any other subsidiary book. For example, if fixed asset is purchased on credit, it can neither be recorded in cash book nor in purchase book, it will be recorded in the journal proper.

Following types of transactions are recorded in journal proper:

(i) Opening Entry

(ii) Closing Entries

(iii) Adjustment Entries

(iv) Transfer Entries

(v) Rectifying Entries

(vi) Entries for dishonour of bills (not discounted with the bank)

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4
Trial Balance

Very Short: Question-Answer

Q.1. What is Trial Balance?

Ans. It is a statement of accounts which appears in the ledger showing either the balances or the total amounts of debit and credit items. It can be prepared on any date. It is neither a part of double entry system, nor does it appear in the actual books of accounts. It is only a working paper.

Q.2. Give four objectives of Trial Balance.

Ans. (i) To ascertain the arithmetical accuracy of the ledger accounts.

(ii) To help in locating errors.

(iii) To provide help for the preparation of Final Accounts.

(iv) To obtain a summary of the ledger accounts.

Q.3. Give the name of errors which does not affect the Trial Balance.

Ans. (i) Errors of Omission.

(ii) Errors of Commission.

(v) Compensating Errors.

(vi) Errors of Principle.

Q.4. What do you mean by errors of Omission?

Ans. If transaction is completely or partially omitted from being recorded in the books of account, constitutes an error of omission. For example, Goods for Rs. 5000.00 have been purchased from Mohan on credit and the transaction was omitted to be recorded in the books.

Q.5. Define errors of Commission.

Ans. Errors which arise due to wrong recording, wring carrying forward, wrong balancing, wrong posting etc. are known as errors of commission. Errors od commission does not affect Trial Balance because the same amount (though wrong) will be posted in both the accounts affected by the transaction.

Q.6. What do you mean by compensatory error?

Ans. If the effect of one error is nullified by the effect of some other error, such errors are called compensating errors. For example: Reena's Account was debited with Rs. 30 instead of Rs. 300 while Anju's Account was debited with Rs. 300 instead of Rs. 30. These two mistakes will neutralize the effect of each other.

Q.7. What do you mean by errors of principle?

Ans. When a transaction is recorded in violation of accounting principles, it is known as an error of principle. For example, purchase of plant and machinery is treated as an ordinary purchase and is thus debited to purchase account instead of plant and machinery.

Short: Question-Answer

Q.1. Explain any three major differences between Trial Balance and Balance Sheet.

Ans. Three major differences between Trial Balance and Balance Sheet:—

Basis of Difference	Trial Balance	Balance Sheet
(i) Object	It is prepared to check the arithmetical accuracy of the books of accounts.	It is prepared to know the true financial position of the firm.
(ii) Period	It is prepared whenever needed.	Normally, it is prepared at the end of the accounting period.
(iii) Types of Accounts	It includes all types of accounts, whether personal, real and nominal accounts.	It includes only personal and real accounts.

Q.2. Define the two methods of preparing Trial Balance.

Ans. The two methods are:—

(i) **Balance Method:** It is the commonly used method of preparing a Trial Balance. It shows the balances of all the accounts in the ledger. Under this method, accounts showing debit balances in the ledger are put on the debit side of the Trial Balance and the accounts showing credit balances are put on its credit side.

(ii) **Total Method:** It shows the total amounts of the debit and credit sides in each ledger account. Under this method, trial balance can be prepared immediately after the completion of posting to the ledger. It considers all accounts of the ledger.

Q.3. What is suspense account? When and why it is prepared?

Ans. In-spite of the best efforts if the both sides of trial balance do not tally, then the amount of difference of both side s put to a specific account which is known as suspense account. If the debit side of the Trial Balance exceeds the credit side, the difference will be put on the credit side of the suspense account and vice-versa. When all the errors have been located and rectified, the suspense account will automatically stand closed. If suspense account shows a credit balance then it will be shown on the Assets side of the Balance Sheet and in the case of credit balance then it will be shown on the Liabilities side of the Balance Sheet.

It is prepared to avoid the delay in the preparation of final accounts.

5

Bill of Exchange

Very Short: Question-Answer

Q.1. What is bill of exchange?

Ans. According to Indian Negotiable Instrument Act, 1881, "A bill of exchange is an instrument in writing, an unconditional order signed by the maker directing to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument."

Q.2. Give four characteristics of Bills of Exchanges.

Ans. (i) It is unconditional order.

(ii) It must be in writing.

(iii) The amount of bill of exchange must be definite.

(iv) It must be signed by the drawer of the bill.

Q.3. What are the parties to a bill of exchange?

Ans. (i) **Drawer:** He is the creditor who is entitled to receive money from acceptor. He draws the bill and is known as drawer.

(ii) **Drawee:** He is the debtor on whom the bill is drawn. He accepts to pay the amount by writing the word "Accepted" on the bill and then signs it.

(vii) **Payee:** The drawer or the payee may be the same person. The party to whom the amount has to be paid is known as the payee.

Q.4. What is a promissory note?

Ans. According to Section 4 of the Negotiable Instruments Act, 1881, "A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument."

Q.5. Give the four features of a promissory note.

Ans. (i) It must be in writing.

(ii) The amount to be paid must be definite.

(iii) The maker must also be a definite person.

(iv) It must be properly stamped.

Q.6. Differentiate between Bills of Exchange and Promissory Note.

Ans.

Basis of Difference	Bill of Exchange	Promissory Note
(i) Parties	It has three parties the drawer, the drawee and the payee.	It has two parties the maker and the payee.
(ii) Payee	Drawer can be the payee of the bill.	Maker cannot be the payee of it.

Q.7. What are days of grace?

Ans. It is a practice to add three extra days to the period of the bill. These extra days are called days of grace. For example, If a bill is drawn on 1st June, 2006 and is payable 1 month after date, its maturity date will be 4th July, 2006.

Q.8. Define Discounting of bill.

Ans. Discounting means encashing the bill before the date of its maturity o borrowing from the bank on the security of the bill. The bank charges an amount as interest for discounting the bill.

Q.9. Define Endorsement of a Bill.

Ans. The holder of a bill receivable can endorse the bill to another person by putting his signature at the back of the bill. Endorsement means signing the bill of exchange for the purpose of transferring it to another. Instruments payable to the bearer can be negotiated or endorsed by mere delivery.

Q.10. Define dishonour of a bill.

Ans. When the acceptor of the bill refuses to pay the amount of the bill on the date of maturity or becomes insolvent, it is called dishonour of the bill. In such a case, the holder of the bill can recover the amount from any of the previous endorsers or the drawer.

Short: Question-Answer

Q.1. Distinguish between an accommodation bill and a trade bill.

Ans. Major difference between accommodation bills and trade bill are:—

Basis of Difference	Trade Bill	Accommodation Bill
(i) Object	These bills are drawn against trade transactions of sale and purchase.	These bills are drawn for financial assistance.
(ii) Consideration	There is a definite consideration for which the bill is accepted.	The acceptor may not receive consideration for his acceptance.
(iii) Recovery	If these bills are dishonoured, the amount may be recovered easily through the court.	It may not be easy to maintain a suit for recovery of the amount.
(iv) Proceeds	When these bills are discounted, the proceeds remain with the holder.	When these bills are discounted, the proceeds may be shared by the two parties in pre-determined ratio.

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