FINANACIAL ACCOUNTING

Calicut University examination questions and answers

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MODULE 1
INTRODUCTION TO ACCOUNTING

Meaning of Accounting

Accounting is the art of recording, classifying, summarizing, analyzing and interpreting the financial transactions and communicating the results thereof to the interested person

Definition of Accounting

According to American Institute of Certified Public Accounts "Accounting is the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are , in part at least, of a financial character and interpreting the results there of".

Features or characteristics or nature of Accounting

(1) Accounting is an art.
(2) Accounting is a science.
(3) Recording of business transactions.
(4) Classifying business transactions.
(5) Summarizing the classified data
(6) Analysis and interpret the summarized data
(7) Communicating information to the interested parties.
(8) Records transaction and events which are financial character.

Objectives of Accounting or functions of accounting

1. To keep systematic records.
2. To ascertain the operational profit or loss.
3. To ascertain the financial position of the business.
4. To make information available to various users.
5. To protect business properties.
6. To facilitate rational decision making.
7. To ascertain the cost of production and selling price.
8. To control expenditure of business.
9. To satisfy the requirements of law.
10.To calculate the amount due to and due from others.

Importance of accounting (Uses or advantages)

1. It serves as a historical record.
2. It facilitates the preparation of financial statements.
3. It supplies information to interested persons
4. It helps the management in taking important business decisions.
5. It facilitates comparative study of the performance of business over different periods.
6. It provides evidence in case of disputes.
7. It helps to forecast the future.
8. It provides information for judging the efficiency of business
9. It is useful in getting loans.
10. It helps in valuation of good will.
11. It helps in controlling expenses.
12. It helps in controlling employees.
13. It helps in prevention and detection of errors and frauds.

Scope of Financial accounting

(1) Book-keeping
(2) Financial Statements
(3) Analysis and interpretation of financial statements.
(4) Financial reporting
(5) Accounting principles
(6) Accounting standards.

Limitations of Accounting

1. It is historical in nature.
2. Transactions of non-monetary nature will not be recorded in accounting.
3. Information recorded in accounts is influenced by the personal judgment of the accountant.
4. In accounting valueless assets are also shown.
5. In accounting price changes are not considered.
6. It is not an exact science.
7. Use of different accounting methods reduces the reliability of accounts.
8. Account records show only actual cost figures.

Accounting Concepts or principles

Accounting concepts are those assumptions, principles or conditions on which the accounting system is based. Principles are set of rules to be followed in accounting. The following are important accounting concepts or principles:

1. **Business Entity Concepts**: According to these concepts, a business is treated as separate Entity distinct from its owner. This means that in accounting the business and owner must be treated separately. Thus, when one person invests amount in to the business, it will be deemed to the liability of the business. The concept of separate entity is applicable to all form of business.

2. **Going concern concepts: A**ccording to this, it is assumed that business will exist for a long time. There is no intention t o liquidate the business in the immediate future.

3. Money measurement concepts: Accounting records only those transactions which are expressed in monetary terms. Transactions which cannot be expressed in money do not find place in the books of accounts.

4. Cost Concepts: According to this concept, all transactions are recorded in the books of accounts at actual price involved.

5. Dual aspect Concepts: according to this concept, every transaction has two aspects. These two aspects are receiving aspect and giving aspect. These two aspects have to be recorded. The basis of this principle is that for every debit, there is an equal and corresponding credit.

6. Realization Concept: According to this principle revenue is said to be realized when goods or services are sold to be a customer. It emphasizes the fact that the mere receipt of an order for goods or services cannot be taken for the realization of revenue. So advanced payment received from a customer cannot be considered as revenue earned.

7. Matching Concept: According to this concept, cost of a business of a particular period is compared with

the revenue of that period in order to ascertain net profit or net loss.

8. Accounting period Concept: According to this assumption, the life of a business is divided in to different periods for preparing financial statements. Generally business concern adopt twelve months period for measuring the income of the concern. This time interval is known as accounting period.

Accounting conventions

Accounting conventions are the customs and traditions which guide the accountant while preparing accounting statements. Some of the accounting conventions are:-

(1) **Convention of consistency**: - This convention follows that the basis followed in several accounting periods should be consistent. This means the methods adopted in one accounting year should not be changed in another year. Then only comparison of results is possible.

(2) **Convention of conservatism**: - This is a convention of playing safe, which is followed while preparing the financial statements. The idea of this convention is to consider all possible losses and to ignore all probable profits.

(3) **Convention of Materiality**: - Materiality means relevance or importance or significance. It is generally accepted in the accounting circle that the accounting statements and records must reveal all material facts.

(4) **Convention of full disclosure**: - The accounting convention of full disclosure implies that accounts must be honestly prepared and all material information must be disclosed therein.

Meaning of accounting standards

Accounting standards are considered as a guide for maintaining and preparing accounts. They are the rules that ensure uniformity of preparation, presentation and reporting of accounting information.

Definition of accounting standards

Accounting standards may be defined as the accounting principles and rules which are to be followed for various accounting treatments while preparing financial statements on uniform basis and which will reveal the same meaning to all the interested groups.

Need for accounting standards (Objects of accounting standards):

1. To communicate uniform results to external users as well as internal users for decision making.
2. To serve as a tools for information systems catering the needs of management, owners , creditors , Government etc.
3. To facilitate inter firm, intra firm comparison.
4. To make the financial statement more reliable comparable and understandable.

Accounting standard Board of India (ASB)

The institute of Chartered Accountant of India, set up, Accounting Standard Board. The primary duty of ASB is to formulate the accounting standard for India. During the formulation of accounting standards, the ASB considered the applicable laws, usage, customs and the business environment existing in our country. The ASB will give due consideration to International Accounting Standards (IASs) issued by the International Accounting Standard Committee and tries to integrate them to the extent possible. The body consists of the following members: Company Law Board, CBDT, Central Board of Excise and Customs, SEBI, Comptroller and Auditor General of accounts, UGC, Educational and Professional institutions, and councils of the institutes and representatives of Industry.

Objectives and functions of the ASB:

(1) To suggest areas in which accounting standards need to be developed.
(2) To formulate accounting standards.
(3) To review the accounting standards at periodical intervals.
(4) To provide guidance on accounting standards.
(5) To carry out other functions relating to accounting standards.

Accounting Standards in India

ASB of India has issued 32 accounting standards so far. They are as follows

As1: Disclosure of accounting policies
As2: Valuation of inventories
As3: Cash flow statements
As4: Contingencies and events occurring after the B/S date
As5: Prior period and extra ordinary items and change in accounting policies
As6: Depreciation accounting
As7: Accounting for construction contracts
As8: Accounting for research and development
As9: Revenue recognition
As10: Accounting for fixed assets
As11: Accounting for effects of changes in foreign exchange rates
As12: Accounting for govt. grants
As13: Accounting for investments
As14: Accounting for amalgamation
As15; Accounting for retirement benefits in the financial statements of employers
As16: Borrowing cost
As17: Segment reporting
As18: Related party disclosures
As19: Leases
As20: Earning per share
As21: Consolidated financial statement
As22: Taxes on income
As23: Accounting for investment in associates in consolidated financial statement
As24: Discontinuing operations

As25: Interim financial reporting
As26: Intangible assets
As27: Financial reporting of interest in joint ventures
As28: Impairment of assets.
As29: Provisions, contingent liabilities and contingent assets
As30: Financial instruments-recognition and measurements
As31: Financial instruments-presentation
As32: Financial instruments disclosure

Journal

A book of original entry in which transactions are recorded in the order of their occurrence is called journal. Journal is a primary record of business transactions.

Ledger

It is a collection of all accounts debited or credited in journal. Ledger is defined as," a book in which all the personal, real, and nominal accounts of business are kept for permanent records so that up to date statement of an account can be easily known".

Posting

Posting means transferring the debit and credit items from the journal to their respective accounts in the ledger. It is the process of recording the transaction from journal to ledger.

Cash book: For recording all cash transactions

Purchase book: For recording credit purchases of goods

Sales book: For recording credit sales

Purchase Return Book. For recording the goods returned by the trader to the suppliers

Sales return book: For recording the goods returned to the trader by his customer

Bills receivable book: For recording all bills received by the trader from his customer

Bills payable book: For recording all the bills given (accepted) to suppliers

Trial Balance

Trial balance is a statement containing the various ledger balances on a particular date. This statement is prepared to check the correctness of ledger posting and balancing of accounts. If the total of the debit balances is equal to the credit balances. It is implied that posting and balancing of accounts are correct

Features of trial balance

1. It is prepared on a specific date
2. It is not a part of double entry and not an account
3. It is a statement of balance of all accounts or totals of ledger accounts
4. Total of the debit and credit columns of the trial balance must tally
5. If the debit and credit columns are equal it is presumed that accounts are arithmetically accurate
6. Difference in the debit and credit columns indicate that some mistakes have been committed
7. Tallying of trial balance is not a conclusive proof of accuracy of books of accounts; it serves to prove only the arithmetical accuracy of books

Objectives of trial balance

1. To ascertain the arithmetical accuracy of the ledger accounts
2. To help in locating errors
3. To help in the preparation of final accounts

MODULE 2
CAPITAL & REVENUE

Capital income:

The term capital income means an income which does not grow out of or pertain to the running of the business proper. It is synonymous to the term capital gain

Revenue income:

Revenue income means an income, which arises out of and in the course of the regular business transactions of a concern.

Capital expenditure: It means an expenditure, which has been incurred for the purpose of obtaining a long term advantage. It consists of expenditure the benefit of which is not fully consumed in one accounting period, but spreads over several accounting periods. It is nonrecurring in nature. In short expenditure incurred for increasing earning capacity of a business is known as capital expenditure

2. Revenue expenditure: An expenditure that arises out of and in the course of regular business transactions of a concern is termed as revenue expenditure. It includes the money spend on day to day operations of business for current and immediate use. It is repetitive in nature. Its benefit will be realized in the current year itself. Wages, legal expenses, transport charges, freight and carriage etc are some of the revenue expenses. it is charged to the trading and profit and loss account.

3. Deferred revenue expenditure: It is that class of revenue expenditure which is incurred during a particular year but benefit of which may extend to a number of years. The whole amount of such expenditure cannot be treated as the expenditure of the year in which it is incurred. Therefore a portion of such expenditure is charged every year to profit and loss account and remaining portion is shown on the asset side of the balance sheet.

1. **Capital receipts:** it consists of payments made by the shareholders or proprietor of the business or receipts from the sale of fixed assets. Sale of machinery or furniture is capital receipt.
2. **Revenue receipt**: all incomes or receipts that are received by a business in the ordinary conduct of activities are called revenue receipts. Sale of goods, interest and rent received etc are examples.

MODULE 3
FINAL ACCOUNTS OF A SOLE TRADER

Trading account

Trading account gives the overall result of trading, that is purchasing and selling of goods. The result of trading accounting may be gross profit or gross loss. If the sale proceeds exceed the cost of goods sold the difference is gross profit. Opening stock, purchases, direct expenses, are debited and sales and closing stock are credited to this account.

Profit and loss account

Profit and loss account is prepared to ascertain the net profit or net loss of the business for an accounting period. The amount of gross profit is shown on the credit side. Indirect expenses, operating expenses and losses are shown on the debit side of this account and all incomes and gains are shown on the credit side .If credit side is more than debit side, the difference is net profit.

Manufacturing account

Manufacturing account is an account prepared by manufacturing concerns to ascertain cost of goods manufactured during a period. All the expenses relating to manufacturing activity are debited.

The total represents cost of manufactures, which is transferred to trading account

Balance sheet

Balance sheet is a statement showing the assets and liabilities of a business on a particular date. It reveals the financial position of a business. Hence it is also known as position statement. In the words of Francis R Stead, 'balance sheet is a screen picture of financial position of a going business at a certain moment.

Outstanding expenses

These are those expenses which remains unpaid at the end of the accounting period. If it is given in the adjustment, it should be added to the concerned expenses on the debit side of the trading account or profit or loss account and it should also be shown in the balance sheet as liability. If it is given in the trial balance, it should be shown in the balance sheet as liabilities.

Prepaid expenses

Prepaid expenses are payments made in the current year but related to the next accounting year. Prepaid expenses are also known as expenses paid in advance or unexpired expenses. If it is given in the adjustment, it should deducted from the concerned expenses on the debit side of trading accounting or profit and loss account and it should also be shown on the asset side of balance sheet. If it is given in the trial balance, it should be taken only in the balance sheet as asset

Accrued income

This is the income earned but not received by the end of the accounting year. This is also known as outstanding incomes. If it is given in the adjustment, it should be added to the concerned income on the credit side of the profit and loss account and it should also be shown on the asset side of balance sheet .If it is given in the trial balance, it should be shown only in the balance sheet on the asset side

Income received in advance

It means income which has been received by business before it been earned by the business. It relate to the next accounting period. It is also known as unearned income or income received in advance.

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Bad debts

When an amount due from debtors is found irrecoverable it is called bad debt .it is a loss the business.

MODULE 4

ACCOUNTS FOR NON PROFIT CONCERN

Receipts and payment account

Receipts and payment account is a summary of all cash transactions for a particular period. It is prepared from the cashbook at the end of the year. It contains of all cash receipts and payments.

Income and expenditure account

It is a revenue account prepared by a nonprofit organization to ascertain surplus or deficit for a particular period. It is a nominal account. In this account only revenue receipts and revenue expenses are recorded. All revenue expenses of the current year are recorded on the debit side and revenue incomes of the current year are recorded on the credit side, the difference between incomes and expenditure represents surplus or deficit.

Subscription

It is a recurring income for nonprofit organizations. This is one of the main sources of revenue.

This is shown on the credit side of income and expenditure account.

Donations

The amount received from a person, firm or company by way of gift is called a donation. Donations may be specific donation or general donations.

Specific donations: if the donations are for a specific purpose, example donation for building, donation for library, donation for furniture etc it must be treated as capital receipts and should be shown on the liability side of the balance sheet.

General donations': when the donations are given for a general purpose, it is the amount which will determine whether it is a capital or revenue receipts. Donation of a comparatively small amount must be treated as income. But if the amount of such donation is big , it must be treated as capital receipts and it should be shown on the liability side of the balance sheet.

Grants

Grant received from central, state or local bodies for routine expenses are treated as income. Grant for specific purpose such as constructions of buildings, purchase of x-ray equipments etc is capitalized

Legacy

It is the amount received by the nonprofit organizations as per the will of a deceased person. It is a capital receipt and is shown on the liability side of the balance sheet, but if the amount is small it may be treated as income and may be shown on the credit side income and expenditure account In the absence of any specific information legacy must be preferably be capitalized.

Endowment fund

The fund meant for permanent means of support is known as endowment fund. It is a capital receipt

Entrance fees

This is the amount of fee collected on the admission of members. Accountants differ on the treatment of entrance fees. Many feel that since the amount is collected only once and as it is of non recurring in nature it should be capitalized and taken to the liability side of the balance sheet but others argue that though it is paid is each members only once, the clerk or institution receives fairly regularly every year because of regular entrance of members. So it should be shown as an income in the credit side of income and expenditure account.

Life membership fee

Life membership may, sometime, be granted to members on their making a lump sum payment in lieu of annual subscription. As the service has to be rendered for a long time without further payment, it must be treated as capital receipts and should be capitalized.

Honorarium

Amount paid to a person for the specific service rendered by him is called honorarium. For example payment made to singers ,dancers etc is shown on the expenditure side

Special purpose fund

If there is any special purpose fund example tournament fund, charity fund, prize fund, endowment fund etc. and there are certain items of expenses and incomes relating to that fund.

MODULE 5
ACCOUNTING FROM INCOMPLETE RECORDS-SINGLE ENTRY SYSTEM

Single entry system

Kohler defines single entry system as “a system of book keeping which as a rule only records of cash and personal accounts are maintained, it is always incomplete double entry varying with circumstances”

MODULE 6
HIRE PURCHASE AND INSTALLAMENT SYSTEM

Hire Purchase system

It is a system of purchase under which the buyers enters into agreement with the seller to pay the price in installments. The buyer gets the possession of goods immediately on paying the down payment but does not get ownership. He becomes the owner only after the last installment is paid. Under this system the buyer fails to pay any installment, the seller has the right to tack back the goods.

Installment system

It is a system of a sale in which the price of the article is paid in installments along with interest on unpaid balances. Under this system the buyer gets the possession and ownership of the goods at the time of signing agreements.

Difference between hire purchase and installment system

Hire purchase	Installment system
1.agreements of hiring	1.agreement of sale
2.system the ownership in the goods sold passes to the buyer only on payment of the last installment	2.ownership passes to the buyer immediately at the time of sale
3.If the buyer fails to pay any installment, the hire vendor can possess the goods	3.the seller cannot possess the goods
4.The buyer can return goods sold to the seller	4.goods once sold cannot be returned
5.The risk of bad debt is relatively less	5.risk of bad debt is relatively more

MODULE 7
DEPARTMENTAL ACCOUNTS

Department accounts

Departmental accounts are accounts relating to different department of a business and are used to ascertain the trading results of each department separately. Such accounts disclose not only the profits of each of the department but also the profits of the whole business.

Inter departmental transfers

Transfer of goods or services by one department to another department are called inter departmental transfers

General profit and loss account

It is a statement prepared to record those items which cannot be apportioned to separate departments. Those items are profit on sale of investment/assets, loss on sale if investment/assets, audit fees, transfer fees etc

MODULE 7
BRANCH ACCOUNTS

Branch accounts

A branch is a segment of a business. It is a chain of shops functioning in different localities under the control of the head office. The system of operating business at several places through one’s own establishment s is called branch organization. Branch accounts are accounts relating to different branches

and are used to ascertain the trading result of each branch separately.

Types of branches

(1) Dependent branches
(2) Independent branches
(3) Foreign branches.

Dependent branches

Dependent branches are branches, which don't maintain its own set of books. All records have to be maintained by the head office.

Debtor system

Under this method, head office opens only one account for each branch called branch account. Its purpose is to ascertain the profit or loss made by each branch. Such branch account is nominal in nature

Whole sale branch system

This system is adopted when the head office supplies goods to the branch at a price which it supplies to wholesalers. Thus under this system, branch is treated at par with wholesale branch.

Interdependent branch

Independent branch means a branch which maintains its own set of books. In this system, branches are treated as separate independent units.

MODULE 5
ACCOUNTING FOR HOTELS

Working Papers

Working papers consists of collections of data, computations, memoranda, preliminary drafts of financial statements and other useful papers used by accountants. With the help of the data collected from the various departments of a hotel, computations, memoranda, preliminary drafts of financial statements etc., the final financial statements can be easily prepared. In short, working papers are sheets of paper containing accounting data, calculations etc. which assist the accountants in the preparation of financial statements.

Room Rate

Room rate simply refers to room rent. It is the charge fixed by the hotel for accommodation provided to the guests. It is the rate at which the guests are charged for the rooms let out to them.

Check-out System: Under this system, a check-out time is fixed by the hotel authorities by taking into consideration the timings of buses, trains or flights. Generally, 12 noon is taken as check-out time. One full days charge is levied from one check-in time to the following check-out time. Naturally, if any guest occupies more than the check-out time, he has to pay another day's room rent. Generally, the check-in time and check-out time are the same. This system is widely adopted by hotels in India.

Room occupancy rate: It is the ratio of the number of rooms occupied by the guests to the total number of lettable rooms available. It is usually expressed as a percentage. It is calculated as below:

$$= \frac{No.of\ rooms\ occupied}{No.of\ lettable\ rooms\ available} x100$$

Bed occupancy rate : In most of the hotels, there are single-bedded rooms, double bedded rooms and family rooms. Hence, total number of beds is more than the total number of lettable rooms. In this case, bed occupancy rate is more important than room occupancy rate. The bed occupancy rate refers to the ratio of beds occupied by the guests in a hotel to the total number of beds available in the hotel. It is expressed as a percentage. It is calculated as below:

$$= \frac{No.of\ beds\ occupied}{No.of\ total\ beds\ available} x100$$