# UNIT-1

## MEANING OF ACCOUNTING & ACCOUNTING STANDARDS

**Que 1.** Define Book-keeping.

**Ans:** Book-keeping is mainly concerned with recording of financial data relating to the business operations in a significant manner.
It ensures that records of the individual financial transactions are correct, up-to-date and comprehensive.

**Que 2.** What is Accounting? What are its main objectives & limitations?

**Ans:** A process of RECORDING, CLASSIFYING, SUMMARISING, ANALYSING and INTERPRETING the financial transactions and communicating the results thereof to the persons interesting in such information.

OBJECTIVES

1. Accounting is an art as well as science.
2. Accounting records events and transactions of financial nature only.

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3. Accounting records transactions by expressing them in terms of money.
4. Accounting is historical in nature.
5. Calculation of profit or loss of the business.
6. To know the solvency position.

LIMITATIONS

1. Historical in Nature: Accounting is historical in nature and reflects the past position of business organization.
2. Records only Monetary Transactions: It provides only incomplete information as accounting records only those transactions which can be expressed and measured in terms of money.
3. Price level changes: The accounting statements do not show the effect of price level changes on the value of assets since it is based on historical cost.
4. Window Dressing: Accounting principles are not static.
Information contained in accounting may be manipulated by the accountants.
5. Real Value not known: Sometimes, the records prepared in accounting fail to show a

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true and fair position of profitability and financial soundness of the business enterprise.

Que 3. What are the advantages of Accounting?

Ans: Advantages:

1. Helpful in taking managerial decisions.
2. Provides complete record.
3. Provides information about the profit and loss.
4. Provides information about financial position.
5. Enables comparative study.
6. Useful in future planning.
7. Helpful in detection of errors or frauds.
8. Proof in court of law.
9. Helpful in assessment of tax liability.

Que 4. Who are the internal and external users of accounting information?

Ans: Internal users are people within a business organization who use financial information
Ex- owners, managers, and employees
External users are people outside the business entity who uses accounting informat
Ex- suppliers, banks, customers, investors, etc.

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Que 5. What are the difference between book-keeping and Accounting?

Ans:

| Basis | Book Keeping | Accounting |
| --- | --- | --- |
| Meaning | It is concerned with identifying financial transactions; measuring them in money terms; recording them in the books of accounts and classifying them. | It is concerned with summarizing the recorded transactions, interpreting them and communicating the results to the users. |
| Stage | It is primary stage | It is secondary stage. It begins where book keeping ends. |
| Objective | maintain systematic records of financial transactions. | ascertain net results of operations & financial position & to communicate info. to the interested parties |
| Nature | This job is routine in nature. | This job is analytical and dynamic in nature |
| Performance | Junior staff performs the function. | Senior staff performs the function. |
| Relation | It is the basis for accounting. | Accounting begins where book keeping ends. |

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Que 6. What is Co
Ans: • It is the
mainly co
which is
the purpo
cost contr
• It ascertai
services re
managemen
exercising

Que 7. What is
Ans: • management
preparing
operations
short-term
• It helps
by identify
interpreting
to manag

Ques6. What is Cost Accounting?

Ans: • It is the branch of accounting which is mainly concerned with costing information, which is useful to the management for the purpose of ascertaining cost and cost control.

• It ascertains the cost of production or services rendered and helps the management in decision making and exercising controls.

Ques7. What is Management Accounting?

Ans: • Management accounting is the process of preparing reports about business operations that help managers make short-term and long-term decisions.

• It helps a business persue its goals by identifying, measuring, analyzing, interpreting and communicating information to managers.

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Que 8. What are the branches of Accounting ?

Ans: Branches of Accounting –

1. Financial Accounting.
2. Management Accounting.
3. Cost Accounting.
4. Tax Accounting.
5. Auditing.
6. Forensic Accounting.
7. Fiduciary Accounting.
8. Fund Accounting.
9. Social Accounting.

Que 9. Explain Accounting Cycle in detail.

Ans:
- The accounting cycle is a collective process of identifying, analyzing, and recording the accounting events of a company.
- It is a standard 8-step process that begins when a transaction occurs and ends with its inclusion in the financial statements.

Steps of Accounting Cycle

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1. Identify Transactions: An organization begin its accounting cycle with the identification of those transactions that comprise a bookkeeping event.
2. Record Transactions in Journal: Next comes recording of transactions using journal entries.
The entries are based on the receipt of an invoice, recognition of sale.
3. Posting: Once a transaction is recorded as a journal entry, it should post to an account in the general ledger.
The general ledger provides a breakdown of all accounting activities by account.
4. Unadjusted Trial Balance: After the company posts journal entries to individual general ledger accounts, an unadjusted trial balance is prepared.
The trial balance ensures that total debits equal to the total credits in the financial records.
5. Worksheet: Analyzing a worksheet and identifying adjusting entries make up the fifth step in the cycle.
It ensures that debits and credits are equal.

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6. Adjusting Journal Entries: At the end of the period, adjusting entries are made. These are the result of corrections made on the worksheet and the results from the passage of time.

7. Financial Statements: upon the posting of adjusting entries, a company prepares an adjusted trial balance followed by the actual formalized financial statements.

8. Closing the Books: An entity finalizes temporary accounts, revenues, and expenses, at the end of the period using closing entries.

- These closing entries include transferring net income into retained earnings.

Ques10. What do you mean by Assets? Describe its types.

Ans: Asset: The economic resources that can be usefully expressed in monetary terms are known as assets of an enterprise.

For ex- machinery used for the manufacturing of units.

Types of Assets -

1. Tangible Assets! Assets having physical existence are called tangible assets. These assets can be touched and seen
Ex- land, plant and machinery, debtors etc.

2. Intangible Assets! The assets which cannot be seen or touched are called intangible assets.
Ex- goodwill, trademarks, copyrights, patents, etc.

3. Fixed Assets! Fixed assets are the assets held by the business enterprise for long term purposes such as buildings, machinery, furniture, computers, etc.

4. Current Assets! Current Assets are those assets that can be converted into cash during short-term period (1 Year).
Ex- Debtors, Stocks, Bills, Cash in Hand etc.

Que 11. What do you mean by liabilities? Describe its various types

Ans: Liabilities: Debts or obligations that the business enterprise has to pay are known as liabilities.
For ex- goods purchased on credit, loan taken from bank etc.

Types of liabilities:

1. Internal liability: A liability owned by business to the owner is an internal liability. It includes capital and all accumulated profit and reserves.

2. External liability: Liability that is payable to outsiders is known as external liability. Ex- bank over draft, creditors, bills payable etc.

3. Long-term liabilities: Liabilities that are payable usually after a period of one year are known as long-term liabilities. For ex- long term loan taken from Bank.

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4. Short-term liabilities: liabilities or obligations payable within a period of one year are known as short term liabilities. For ex- goods purchased on credit from creditors, bills payable issued, etc.

~~Ques 12. Define the term Assets & liability.~~

Ques 12. Difference between capital and Revenue expenditure.

Ans: Capital Expenditure: The amount incurred for acquiring or improving some assets, which would give benefit for more than one accounting year and not kept for resale in the ordinary course of business enterprise, is termed as capital expenditure. They are non-recurring in nature.

Revenue Expenditure: The amount incurred on maintaining the earning capacity of the business, benefit of which is direct and would be available in the same accounting year itself in which such expenditure has been incurred is termed as revenue expenditure.

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Que 13. What do you mean by Deferred Revenue Expenditure?

Ans: Deferred Revenue Expenditure is an expenditure which is incurred in the present accounting period but its benefits are incurred in the following or in the future accounting period.

Ex- Marketing, Advertising

Que 14. What is the difference between Cash discount and Trade discount?

Ans: Cash discount!

- Cash discount is an allowance or concession given by the supplier to the buyer on the amount due from him.
- recorded in the books of account.
- given on timely payment or early payment

Trade discount!

- Trade discount is an allowance or concession given by the supplier to the buyer on the invoice price of the goods.
- Given due to bulk purchase, not recorded in the books of account

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# Types of Account

① Personal Account – i) Natural Person – Ram, Mohan
ii) Artificial Person – company, firm, Bank
iii) Representative Person – Capital, Drawing

② Real Account – i) Tangible – Machine, building,
(Assets) furniture, Typewriter, computer
ii) InTangible – Patents, Copyright, Trademark.

③ Nominal Account – Rent, Salary, Commission, Interest {Received or paid}

Tangible Asset – Goods – Sales
Purchase
Sales rate
Purchase rate

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1. Personal Account

- These accounts type are related to persons.
- These persons may be natural persons like Raj's account, Rajesh's account, Ramesh's account.
- These persons can also be artificial persons like firms, companies, bodies carparate.

Rule: Debit the receiver.
Credit the giver.

2. Real Account

- These account types are related to assets or properties.
- Further classified as Tangible real account and Intangible real account.

Rule: Debit what comes into the business.
Credit what goes out of the business.

3. Nominal Account

- These account types are related to income or gains and expenses or losses.

Rule: Debit all the expenses and losses
Credit the incomes and gains

Ques Classify the following accounts

1. Furniture - Real
2. Capital - Personal
3. Intrest - Nominal
4. Cash - Real
5. Carriage - Nominal
6. Wages - Nominal
7. Purchase - Real
8. Printing & Stationary - Nominal
9. Drawing - Personal
10. ICICI Bank - Personal
11. Travelling Expenses - Nominal
12. Sales - Nominal
13. Advertisement expenses - Nominal
14. IIMT UNIVERSITY - Personal

15. Sales return - Nominal
16. STOCK - Real
17. Interest - Nominal
18. Amit - Personal
19. HDFC BANK - Personal

Que machine purchased for cash → Real

Real debit credit

Que salary paid in cash → Real

Nominal debit credit

Que cash received from Om → Personal

Real debit credit

SESSIONAL FIRST

Que Explain the Entity Concept

Ans. • Business entity concept is one of the accounting concepts that states that business and the owner are two separate entities and therefore, should be considered separate from each other.

• As per this concept, the financial transactions pertaining to the business entity should be recorded separately from the business owners transactions.

• This concept is also known as the Economic Entity Concept.

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Que Journal

- A journal is a detailed record of all the transactions done by a business.

- Reconciling accounts and transferring information to other accounting records is done using the information recorded in a journal.

- When a transaction is recorded in a company's journal, it's usually recorded using a double-entry method, but can also be recorded using a single-entry method of bookkeeping.

Que Discuss the concepts and principles of accounting in detail.

* Principles of Accounting

1. Monetary unit Principle

- The monetary unit principle states that all business transactions must be in terms of money.
- Money is the common unit used for recording business transactions such as capital, assets and liabilities.

2. Going concern Principle

- The going concern principle assumes that a business is likely to continue its activities for an indefinite period.
- It means that the organization will not liquidate and will not be dissolved.

3. Dual aspect of the duality principle

- The duality principle suggests that every business should record its transactions in two separate accounts.

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- The equation of the dual aspect principle is :

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

4. <u>Cost Principle</u>

- The cost principle states that a business should record its assets at the purchase price and not the market price.
- The purchase price includes the installation and transportation charges.

5. <u>Accrual Principle</u>

- Accrual Principle states that a business must record the transactions during the accounting period in which they occur, irrespective of when the business receives the cash flow for the transaction.

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## 6. Full disclosure Principle

- Full disclosure Principle means that accountants include all the relevant and necessary information in the financial statements.
- This principle ensures that users, investors, creditors and readers of the financial information receive no misleading information.

## * Concepts of Accounting.

## 7. Business Entity Concept.

- Acc. to business Entity Concept business is considered to be separate from its owners.

## 8. Accounting Period Concept

- Acc. to this concept the life of an enterprises be broken into smaller periods so that its performance

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is measured at regular intervals.

9. Objective evidence concept

- In objective evidence concept all the transactions recorded should have an evidence of recording vouchers, invoices, and cash receipts etc.
- This makes accounting more reliable.

Journal vs ledger

| Journal | ledger |
| --- | --- |
| 1. All transactions are first recorded in the journal. | 1. All transactions entered in a journal are posted into ledger. |
| 2. The process of recording entries in the journal is called journalizing. | 2. The process of recording the entries in the ledger is called ledger posting. |
| 3. Journal is not to be balanced. | 3. Every ledger account is to be balanced. |
| 4. Book of primary entry. | 4. Book of second entry/ final entry. |
| 5. Full details are recorded. | 5. Full details are not recorded. |

* Journalize the following transaction

| Date. 2015 | Particulars | Amount |
| --- | --- | --- |
| Jan 1 | Started business with cash | 60,000 |
| Jan 4 | open an account in a bank | 20,000 |
| Jan 9 | Purchased goods | 9800 |
| Jan 13 | Sold goods | 12,100 |
| Jan 19 | Purchased goods from Shalini | 25,000 |
| Jan 25 | Sold goods to Sonika | 10,900 |
| Jan 26 | Returned goods to Shalini | 1200 |
| Jan 28 | Goods returned from Sonika | 3000 |

Answer

| Date | Particulars | LK | Amount (Dr) | Amount (Cr) |
|---|---|---|---|---|
| 2015 | | | | |
| Jan 1 | Cash acc. Dr. | | 60,000 | |
| | (being business started | | | 60,000 |
| | with cash) | | | |
| Jan 4 | Bank acc. Dr. | | 20,000 | |
| | To cash acc. | | | 20,000 |
| | (being acc. open in | | | |
| | Bank) | | | |
| Jan 9 | Purchase acc Dr. | | 9800 | |
| | To cash acc. | | | 9800 |
| | (being goods purchased) | | | |
| Jan 13 | Cash acc. Dr. | | 12,100 | |
| | To sales acc. | | | 12,100 |
| | (being goods sale) | | | |
| Jan 19 | Purchase acc. Dr. | | 25,000 | |
| | To Shalini | | | 25,000 |
| | (being goods purchased | | | |
| | from Shalini) | | | |

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| | | | |
|---|---|---|---|
| Jan 25 | Sonika Dr. | 10,900 | |
| | To sales acc. | | 10,900 |
| | (being goods sold to Sonika) | | |
| Jan 26 | Shalini Dr. | 12,00 | |
| | To Purchase return | | 1200 |
| | (being goods return to shalini) | | |
| Jan 28 | Sales return acc. Dr. | 3000 | |
| | To Sonika | | 3000 |
| | (being goods ret. by Sonika) | | |

~~Marks~~

Started business with cash ₹ 1,00,000

goods purchased for cash ₹ 10,000

goods sold for cash 2000

General

| Particulars | L.F | Debit ₹ | Credit ₹ |
| --- | --- | --- | --- |
| Cash acc Dr | | 1,00,000 | |
| To Capital acc | | | 1,00,000 |
| (being business started) | | | |
| Purchase acc Dr | | 10,000 | |
| To Cash acc | | | 10,000 |
| (being goods purchased) | | | |
| cash acc Dr | | 2000 | |
| To sales acc | | | 2000 |
| (being goods sold) | | | |

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+ Ledger Posting.

Cash Account

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| April 1 | To capital acc. | | 1,00,000 | | by purchase | | 10,000 |
| | To sales acc | | 8,000 | | by balance c/d | | 98,000 |
| | | | 1,08,000 | | | | 1,08,000 |

Capital Account

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| | by balance c/d | | 1,00,000 | April 1 | by cash acc | | 1,00,000 |
| | | | 1,00,000 | | | | 1,00,000 |

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## Purchase a/c

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| | To cash a/c | | 10,000 | | by balance c/d | | 10,000 |
| | | | 10,000 | | | | 10,000 |

## Sales a/c

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| | by balance c/d | | | | by cash a/c | | 8000 |
| | | | 8,000 | | | | 8,000 |

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Que Journalise the following transactions -

2009

| | | |
|---|---|---|
| 1 January | Ram started business with cash | 10,000 |
| 4 Jan | Purchase goods from Mohan on credit | 2000 |
| 5 Jan | Paid cash to Mohan | 1000 |
| 6 Jan | Sold goods to Suresh | 2000 |
| 8 Jan | Received cash from Suresh | 3000 |
| 15 Jan | Purchased goods from Mohan | 2000 |
| 20 Jan | Paid cash to Mohan | 1000 |
| 25 Jan | Sold goods to Suresh | 2000 |
| 30 Jan | Received cash from Suresh | 1000 |

Answer

| Date | Particulars | | C.F | Debit ₹ | Credit ₹ |
|---|---|---|---|---|---|
| 2009 | | | | | |
| Jan 1 | Cash acc. | Dr | | 10,000 | |
| | To Capital acc. | | | | 10,000 |
| | (being business started with cash) | | | | |
| Jan 4 | Purchase acc | Dr | | 2000 | |
| | To Mohan's acc | | | | 2000 |
| | (being goods purchased) | | | | |

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| | | | |
|---|---|---|---|
| Mohan's acc Dr | | 1000 | |
| To cash acc | | | 1000 |
| (being cash paid to Mohan) | | | |
| Suresh's acc Dr | | 2000 | |
| To Sales acc | | | 2000 |
| (being goods paid to Suresh) | | | |
| Cash acc Dr | | 3000 | |
| To Suresh's acc | | | 3000 |
| (being cash received from Suresh) | | | |
| Purchase acc Dr | | 2000 | |
| To Mohan's acc | | | 2000 |
| (being goods purchased from Mohan) | | | |
| Mohan's acc Dr | | 1000 | |
| To Cash acc | | | 1000 |
| (being cash paid to Mohan) | | | |
| Suresh's acc Dr | | 2000 | |
| To Sales acc | | | 2000 |
| (being goods sold to Suresh) | | | |

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| | | | | |
|---|---|---|---|---|
| Jan 30 | Cash acc Dr | | 1000 | |
| | To Suresh's acc | | | 1000 |
| | (being cash received from Suresh) | | | |

LEDGER

Dr Cash Account Cr

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| 2009 | | | | | | | |
| Jan 1 | to capital acc | | 10,000 | Jan 5 | By Mohan's acc | | 1000 |
| Jan 9 | To Suresh's acc | | 3000 | Jan 20 | By Mohan's acc | | 1000 |
| Jan 30 | To Suresh's acc | | 1000 | Mar 31 | By balance c/d | | 12,000 |
| | | | 14,000 | | | | 14,000 |

Dr Capital Account Cr

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| Mar 31 | To balance c/d | | 10,000 | Jan 1 | By cash acc | | 10,000 |
| | | | 10,000 | | | | 10,000 |

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Dr **Purchase Account** Cr

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| 2009 | | | | | | | |
| Jan 4 | To Mohan's acc | | 2000 | Mar 31 | By balance c/d | | 4000 |
| Jan 15 | To Mohan's acc | | 2000 | | | | |
| | | | 4000 | | | | 4000 |

Dr **Suresh's ~~Mohan's~~ acc** Cr

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| 2009 | | | | | | | |
| Jan 6 | To sales acc | | 2000 | Jan 8 | By cash acc | | 3000 |
| Jan 25 | To Sales acc | | 2000 | Jan 30 | By cash acc | | 1000 |
| | | | 4000 | | | | 4000 |

Dr **Mohan's acc** Cr

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| Jan 25 | To cash acc | | 1000 | Jan 4 | by Purchase acc | | 2000 |
| Jan 20 | To cash acc | | 1000 | Jan 15 | by Purchase acc | | 2000 |
| Mar 31 | To balance c/d | | 2000 | | | | |
| | | | 4000 | | | | 4000 |

~~Sales Acc~~

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Dr. Sales Account Cr

| Date | Particulars | J.F | Amount | Date | Particulars | J.F | Amount |
|---|---|---|---|---|---|---|---|
| Mar 31 | To balance c/d | | 4000 | Jan 6 | By Surish's | | 2000 |
| | | | | Jan 25 | By Surish's | | 2000 |
| | | | 4000 | | | | 4000 |

TRIAL BALANCE

① Total Method

| Particulars | L.F | Amount (Dr) | Amount (Cr) |
|---|---|---|---|
| 1. cash acc | | 14,000 | 2000 |
| 2. Capital acc | | — | 10,000 |
| 3. Purchase acc | | 4000 | — |
| 4. Mohan's acc | | 2000 | 4000 |
| 5. Surish's acc | | 4000 | 4000 |
| 6. Sales acc | | — | 4000 |
| | | 24,000 | 24,000 |

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(a) Balance Method

| | Particulars | L.F | Amount (Dr) | Amount (Cr) |
|---|---|---|---|---|
| 1. | Cash acc | | 12000 | — |
| 2. | Capital acc | | — | 10,000 |
| 3. | Purchase acc | | 4000 | — |
| 4. | Mohan's acc | | — | 2000 |
| 5. | Suresh's acc | | — | — |
| 6. | Sales acc | | — | 4000 |
| | | | 16,000 | 16,000 |

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## * TRIAL BALANCE

A Trial Balance is a statement of debit and credit balance extracted from the ledger with a view of testing the arithmetical accuracy of the book.

### Characteristics of Trial Balance

The main characteristics of trial balance are –

1) Trial balance is only a list or statement and not an account.

2) It is prepared with the help of ledger accounts and cash book.

3) It is prepared on a particular date.

4) It is prepared for checking arithmetical accuracy of the accounts.

5) It provides the basis for the preparation of final accounts or financial statements.

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## Methods of Preparing Trial Balance

1. **Total Method:**

- under this method, the total of debit and credit of all ledger accounts and cash book will be written in the trial balance.

- In the first column name of accounts, in second column ledger folio of accounts, in third column total of debit and in fourth column total of credit will be written.

| | | Total | |
|---|---|---|---|
| No. of Accounts | LF | Amount (Dr) | Amount (Cr) |
| | | | |

2. **Balance Method:**

- Under this method, trial balance is prepared by taking the balance of all ledger accounts and the cash book.

3. Total and Balance Method:
It is a combination of both the methods. The name of accounts and ledger folio are written like total method but the amount of debit and credit are written twice.

| S.No. | Name of acc. | L.F. | Total Amount (Dr) | Total Amount (Cr) | Balance Amount (Dr) | Balance Amount (Cr) |
|---|---|---|---|---|---|---|
| | | | | | | |

* Objectives of Trial Balance

1. To ascertain the balances of all accounts opened in the ledger on a particular date.

2. To clarify the fact that each transaction has been recorded in the two accounts as per double entry system.

3. To ensure that posting and other acc. process have been completed without any arithmetical error

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4. To facilitate in the preparation of Trading of acc, Profit & Loss acc & Balance sheet

5. To help in ascertaining important conclusions by comparing balances of accounts of previous year.

Trial Balance vs Ledger

| S.no. | Basis | Trial Balance | Ledger |
|---|---|---|---|
| 1. | Period | trial balance is prepared on a particular date. | ledger is prepared for a particular period. |
| 2. | Serial | trial balance is prepared after ledger posting. | ledger is prepared before trial balance. |
| 3. | Basis | prepared on the basis of balances or totals of accounts. | prepared on the basis of journal & subsidiary books. |
| 4. | Compulsory | It is not compulsory to prepare. | It is a must to prepare ledger |

* Importance of Trial Balance

1) checking of Arithmetic Accuracy: arithmetical errors made during the posting in ledger may be known through trial balance. Equality of both sides of trial Balance discloses arithmetical accuracy in ledger.

2) Helpful in finding errors: Trial balance helps in finding errors made in accounting.

3) Knowledge of Balance of Accounts: There are numerous accounts in ledger, so, frequently ledger has to be opened to find the balance of accounts, which can easily be known by preparing trial balance.

4) Facilitates in preparing Final Accounts: Trial balance facilitates in preparing final accounts which are prepared to determine trading results and economic status of business.

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# Limitations of Trial Balance

1) If any transaction has been omitted to be recorded in journal or ledger, then it cannot be ~~disco~~ disclosed by the trial Balance.

2) If posting of journal entry is not made in the ledger, then such error cannot be known through trial balance.

3) If any journal entry is passed with wrong amount, then such error is not known through trial balance.

4) Trial balance does not disclose errors of principles of accounts.

5) If posting of one journal entry is made more than once then trial balance cannot disclose such error

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# UNIT-3
# BUSINESS INCOME

## * Depreciation

Depreciation is the gradual and permanent decrease in the value of an asset from any cause.

## * Features or Characteristics of Depreciation

1. Depreciation is a decline in the value of a fixed assets (except land).

2. Such fall is of a permanent nature.

3. Depreciation is a gradual and continuous process because the value of the assets will decline either by their constant use or obsolescence due to expiry of time.

4. It decreases only the book value of the asset, not the market value.

5. The term depreciation is used only in respect of tangible fixed assets.

6. It is a non-cash expense.

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1) By Constant Use: due to constant use of fixed assets in business operations wear and tear arise in them which results in the reduction of their values.

2) By Expiry of Time: The value of majority of assets decreases with the passage of time even if they are not being put to use in the business

3) By Expiry of legal Rights: There are certain assets which have a definite span of life such as lease.
For ex: if a lease has been obtained for 20 years for 5 lac, it will lose 1/20th i.e. 25K of its value each year whether utilised or not.

4) By Obsolesence: quite often, due to new inventions and improved technology the old assets become obsolete.

5) **By Accident:** sometimes a machine may be destroyed due to fire, earthquake, flood etc. or a vehicle may be damaged due to accident.

6) **By Permanent fall in Market Price:** sometimes the fall in the value of a certain fixed assets is treated as depreciation such as permanent fall in the value of investments.

*** Need, Important or Objects of Providing Deprecl...**

1) To ascertain the correct profit or loss

2) To show true and fair view of financial statements.

3) For ascertaining the accurate cost of production.

4) To provide funds for replacement of assets.

5) to meet the legal requirement

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## * Methods of Providing or Allocating Depreciation

1. Straight Line Method
2. Written Down Value Method.
3. Annuity Method
4. Depreciation Fund Method
5. Insurance Policy Method
6. Revaluation Method.

## * Straight Line Method

- This method is also termed as 'Original Cost Method' because under this method depreciation is charged at a fixed percentage on the original cost of the asset

- The amount of depreciation remains equal from year to year and as such the method is also known as 'Equal Instalment Method' or 'Fixed Instalment Method'.

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- Under this method, the amount of depreciation is calculated by deducting the scrap value from the original cost of the asset and then by dividing the remaining balance by the no. of years of its estimated life.

$$\text{Yearly Depreciation} = \frac{\text{original cost} - \text{estimated scrap val.}}{\text{shelf life}}$$

* Merits of Straight Line Method

1. Simplicity: ~~cta~~ calculation of depreciation under this method is very simple and as such the method is widely popular.

2. Equality of Depreciation Burdens: under this method, equal amount of depreciation is debited to the Profit and Loss Account of each year. Hence, the burden of depreciation on each year's net profit is equal.

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3. Assets can be completely written off:
under this method, the book value of an asset can be reduced to net scrap value or zero value, which is not possible under some other methods.

4. Knowledge of original cost and up-to-date depreciation:
under this method, the original cost of the asset is shown in the Balance sheet and the up-to-date depreciation is shown as a direct deduction from it

* Demerits of Straightline Method

1. Ignores the actual use of the asset.
actual use of the asset is not considered in computation of depreciation.

2. Ignores the Interest factor
does not take into account the loss of interest on the amount invested in the asset.

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3. Difficulty in the determination of scrap value.
It may be quite difficult to access the true scrap value of the asset after a long period say 10 or 15 years after the date of its installation.

4. Difficult to Estimate Life
It is very difficult to estimate the useful life of the assets.

5. Not suitable for Valuable Assets
Straight line method may not be suitable for valuable assets such as land and buildings.

Example
On 1st April 2015, a limited company purchased a machine for ₹ 1,90,000 and spent ₹ 10,000 on its installation. Scrap value = ₹ 50,000 at the end of sixth year.
Give Machine Acc and Depreciation acc in the books of the Company for 4 years.

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2015
April 1
2016
April 1
2017
April 1
2018
April 1
2019
April 1

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$$\text{Depreciation} = \frac{2,00,000 - 50,000}{6} = \frac{1,50,000}{6}$$

$$= 25,000$$

Dr Cr

| Date | Particulars | Amount | Date | Particulars | Amount |
|---|---|---|---|---|---|
| 2015 | | | 2016 | | |
| April 1 | To Bank acc | 1,90,000 | mar 31 | by dep | 25,000 |
| | To Bank acc (exp) | 10,000 | " | by balance c/d | 1,75,000 |
| | | 2,00,000 | | | 2,00,000 |
| 2016 | | | 2017 | | |
| April 1 | To balance b/d | 1,75,000 | Mar 31 | by dep | 25,000 |
| | | | " | by balance c/d | 1,50,000 |
| | | 1,75,000 | | | 1,75,000 |
| 2017 | | | 2018 | | |
| April 1 | To balance b/d | 1,50,000 | mar 31 | by dep | 25,000 |
| | | | " | by balance c/d | 1,25,000 |
| | | 1,50,000 | | | 1,50,000 |
| 2018 | | | 2019 | | |
| April 1 | To balance b/d | 1,25,000 | Mar 31 | by dep | 25,000 |
| | | | " | by bal c/d | 1,00,000 |
| | | 1,25,000 | | | 1,25,000 |
| 2019 | To balance b/d | 1,00,000 | | | |

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# Depreciation Account

Dr | | | | | Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|---|---|---|---|---|---|
| 2016 | | | 2016 | | |
| mar ~~Apr~~ 31 | To Machine acc | 25,000 | 31 Mar | by profit & loss | 25,000 |
| | | 25,000 | | | 25,000 |
| 2017 | | | 2017 | | |
| Mar 31 | To Machine acc | 25,000 | Mar 31 | by profit & loss | 25,000 |
| | | 25,000 | | | 25,000 |
| 2018 | | | 2018 | | |
| Mar 31 | To Machine acc | 25,000 | Mar 31 | by profit & loss | 25,000 |
| | | 25,000 | | | 25,000 |
| 2019 | | | 2019 | | |
| Mar 31 | To Machine acc | 25,000 | Mar 31 | by profit & loss | 25,000 |
| | | 25,000 | | | 25,000 |

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* Written Down Value Method

- Under this method, as the value of asset goes on diminishing year after year, the amount of depreciation charged every year also goes on declining.

- As the value of asset and also the depreciation charged on it goes on reducing year after year, the method is also known as 'Reducing Instalment Method' or 'Diminishing Balance Method'.

* Merits of Written Down Value Method

1. Easy Calculation: It is easy to calculate the depreciation under this method, even if some new assets are purchased year after year.

2. No undue pressure in later years: The efficiency and usefulness of a machine is more in the earlier years than in later years.

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Hence, the depreciation in first few years should be more in comparison to the later years. This is ensured by adopting the Diminishing Balance Method.

3. Balance of asset is never written off to zero:
This method ensures that the asset is never reduced to zero so that some depreciation, however small, is debited to Profit & Loss Account so long as the asset remains in use.

4. Approved method by Income Tax Authorities:
This method of providing depreciation is permissible under Income Tax regulations.

* Demerits

1. Asset cannot be completely written off –
under this method, the value of an asset, even it becomes obsolete and useless, cannot be reduced to zero.

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2. Omission of Interest Factor: as with the original cost method, this method also does not take into consideration the loss of interest on the amount invested in the asset

3. Difficulty in determining the rate of depreciation
under this method, the rate of providing depreciation cannot be easily decided.

4. Knowledge of Original cost and upto-date depreciation not possible:
under this method, the original cost of various assets is not shown in the Balance sheet

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Ex Dr Cr.

| Date | Particulars | Amount | Date | Particulars | Amount |
|---|---|---|---|---|---|
| 2016 | | | 2017 | | |
| April 1 | To Bank acc | 60,000 | Mar 31 | by dep (10%) | 6000 |
| | | | " | by bal c/d | 54,000 |
| | | 60,000 | | | 60,000 |
| 2017 | | | 2018 | | |
| April 1 | To balance b/d | 54,000 | Mar 31 | by dep (10%) | 5400 |
| | | | | by balance c/d | 48600 |
| | | 54,000 | | | 54,000 |
| 2018 | | | 2019 | | |
| April 1 | To balance b/d | 48600 | Mar 31 | by dep (10%) | 4860 |
| | | | | by bal c/d | 43740 |
| | | 48,600 | | | 48,600 |
| 2019 | | | 2020 | | |
| April 1 | To balance b/d | 43,740 | Mar 31 | by dep (10%) | 4374 |
| | | | | by bal c/d | 39366 |
| | | 43,740 | | | 43,740 |
| 2020 | | | | | |
| April 1 | To balance b/d | 39366 | | | |

# Depreciation Account

Dr. | | | | | Cr

| Date | Particulars | Amount | Date | Particulars | Amount |
|---|---|---|---|---|---|
| 2017 | | | 2017 | | |
| Mar 31 | To Machine acc | 6000 | mar 31 | by profit & loss | 6000 |
| | | 6000 | | | 6000 |
| 2018 | | | 2018 | | |
| mar 31 | To Machine acc | 5400 | mar 31 | by profit & loss | 5400 |
| 2019 | | | 2019 | | |
| Mar 31 | To Machine acc | 4860 | Mar 31 | by profit & loss | 4860 |
| 2020 | To Machine acc | 4374 | 2020 | | |
| Mar 31 | | | mar 31 | by profit & loss | 4374 |

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| Basis | Straight Line | Written Down Value |
|---|---|---|
| Amount | equal depreciation is charged every year. | depreciation goes on decreasing every year. |
| basis of cal of dep. | depreciation is charged on the original cost of the asset. | depreciation is charged on the reducing balance of the asset. |
| Zero level | The book value of the asset reduced to zero. | The book value of the asset can never be reduced to zero. |
| Rate of depreciation | rate of dep is kept low in comparison to diminishing balance method. | rate of dep. is kept high in comparison to original cost method. |
| Approval of Income Tax | not approved by Income Tax authorities. | approved by Income Tax authorities. |
| Suitability | suitable for assets in which repair charges are less & the possibility of obsolescence is less such as land & buildings. | suitable for assets which require more repair expenses with the passage of time. |

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# UNIT-II

## * Subsidiary Book

- Subsidiary Books are the books that record the transactions which are similar in nature in an orderly manner.

- They are also known as special journals or Day books.

- In big organizations, it is not easy to record all the transactions in one journal and post them into various accounts.

- So, for the easy and accurate recording of all the transactions, the journal is subdivided into many subsidiary books. For every type of transaction, there is a separate book.

## * Types of Subsidiary Book

- cash book
- Purchase book
- Sales Book
- Purchase ~~Boo~~ return book.
- Sales return book
- Journal Proper, etc

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- The first and most important subsidiary book is the cash book.

- It records all the transactions related to cash and bank receipts and payments.

- 3 types -
1) single column cash book
2) double column cash book
3) triple column cash book

## Ledger

- An accounting ledger is an account or record used to store bookkeeping entries for balance sheet and income-statement transactions.

- A ledger is also known as the principal book of accounts and ~~of~~ it forms a permanent record of all business transactions.

- The purpose of ledger is to take the entries made in the journal and logs and tallies up all transactions that affect a specified account.

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# UNIT-3

## * Final Account

- Final Accounts are the accounts, which are prepared at the end of a fiscal year.

- It gives a precise idea of the financial position of the business/organization to the owners, management, or other interested parties.

- The final accounts ~~of~~ for all companies must be produced on or by the $31^{st}$ of March every year.

## * Three types of Final Account

### ① Trading Account

- This is often the first final account to be tabulated.

- This account is used to determine the gross profit or the gross loss that is incurred by a corporation at the end of a financial year.

② Profit and Loss Account

- Once a trading account is finished, the profit and loss account is readied.

- This final account is also known as an income statement in some companies.

③ Balance Sheet

- The Balance Sheet is the most important financial tool for any enterprise to assess its financial position and where it stands for future planning and implementation.

- Balance Sheet also helps identify areas where the company is facing hurdles and difficulties.

# UNIT-II
## RATIO ANALYSIS

- Ratio analysis refers to the analysis of various piece of financial information in the financial statements of a business.
- They are mainly used by external analysts to determine various aspects of a business, such as its profitability, liquidity, and solvency.

**Accounting Ratio**

Accounting ratio is the comparison of two or more financial data which are used for analyzing the financial statements of companies.

Types

- Financial/Liquidity ratio
- Profitability ratio
- Turnover ratio
- Solvency ratio

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1. Current Ratio: The current ratio, also known as the working capital ratio, measures the capability of a business to meet its short-term obligations that are due within a year.

$$\text{current ratio} = \frac{\text{current assets}}{\text{current liability}}$$

- Ideal current ratio is 2:1

current assets = cash, cash equivalents, marketable securities, ~~a~~ accounts receivable, notes receivable, Inventory, prepaid expenses

Current liabilities – notes payable, accounts payable, accrued expenses, deferred revenue.

2. Liquidity Ratio: A liquidity ratio is used to determine a company's ability to pay its short-term debt obligations.

$$\text{Liquid ratio} = \frac{\text{liquid asset}}{\text{current liability}}$$

Liquid asset = current asset – stock

3. Gross profit ratio: Gross profit ratio is a profitability measure that is calculated as the ratio of Gross Profit to Net Sales.

$$\text{Gross profit ratio} = \frac{\text{gross profit}}{\text{net sales}} \times 100$$

$$\text{gross profit ratio} = \frac{(\text{sales} - \text{cost of goods sold})}{\text{net sales}} \times 100$$

4. Net Profit Ratio:

$$\frac{\text{Net Profit}}{\text{net sales}} \times 100$$

- It measures overall profitability.

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Que Explain the uses (importance / advantages) and limitations of ratio analysis.

⇒ Advantages

1. Forecasting and planning
Helps in forecasting and planning by performing trend analysis.

2. Budgeting
Helps in estimating budget for the firm by analysing previous trends.

3. Efficiency
Helps in determining how efficiently a firm or an organisation is operating.

4. Performance
provides significant info. to users of accounting information regarding the performance of the business.

5. Comparison
Helps in comparison of two or more firms.

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Disadvantages

1. Financial statements seem to be complicated.

2. If the data received from financial accounting is incorrect, then the info. derived from the ratio analysis could not be reliable.

3. Unauthenticated data may lead to misinterpretation of ratio analysis.

4. To get a conclusive idea about the business a series of ratios is to be calculated. A single ratio cannot serve the purpose.

5. It is not necessary that a ratio can give the real present situation of a business as the result is based on historical data.

6. Ratio analysis is effective only where same acc. principles and policies are adopted by other concern too. otherwise inter-company comparison will not disclose a real picture at all.

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