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1. Define Accounting, Explain in Detail GAAP principles (Accounting concepts & conventions)

Accountancy is the science of recording and classifying business transactions and events, primarily of financial character, and the art of making significant summaries, analysis, and interpretation of those transactions and events and communicating the results to persons who make decision or form judgements.

Generally Accepted Accounting principles (GAAP)
GAAP includes Accounting concepts & Accounting conventions. These principles ensure uniformity, reliability and comparability of financial statement.

Accounting Concepts.

1. Business Entity concept
-> A business is treated as a separate entity from its owner(s)
-> The proprietor's personal transactions are not mixed with business records
-> capital is treated as a liability to the business

2) Dual Aspect concept (Accounting equation)
-> Every transaction has two aspects: debit & credit.
-> Foundation of the double - Entry system
-> Assets = Liabilities + capital.

3) Going concern concept
-> Business is assumed to continue for a long time
-> Assets are recorded at cost, not market value
-> prepaid and outstanding expenses are recorded assuming continuity.

4. Cost concept
- Assets are recorded at the price paid to acquire them
- Market value is not considered for accounting
- Book value = cost - Depreciation

5. Money measurement concept
- Only transactions measurable in monetary terms are recorded
- Non-monetary events like employee satisfaction are ignored
- Assumes currency value is stable.

6) Accounting period concept
- Life of business is divided into equal time periods (usually a year)
- Financial statements are prepared at the end of each period

7. Matching concept
- Expenses should be matched with the revenue of the same period
- Only relevant revenues and expenses should be considered for net profit

8. Realization concept (Revenue Recognition)
- Revenue is recognized when goods / services are provided, not necessarily when cash is received
- Prevents premature revenue recognition

Accounting conventions

1) Convention of consistency

→ Accounting methods should remain consistent over time

→ Allows comparison of financial statement across years

→ ~~4~~ Changes (if any) must be disclosed clearly

2. Convention of Disclosure

→ All material and relevant financial information must be disclosed

→ especially important in companies where management and ownership are seperate.

3 Convention of materiality

→ only significant items that influence decisions should be recorded and reported.

→ Trivial items (e.g staplers, pens) can be treated as expenses

4) Convention of conservation

→ Anticipate no profits but provide for all possible losses

→ Assets and income should not be overstated

→ Liabilities and expenses should not be understand.

2) Write the Format for Journals and Trial Balance

Journal:

→ The book in which the business transactions are recorded in a chronological order, after analyzing them and classifying the benefits according to the principles of debit & credit is called Journal.

→ As all the day to day transactions are recorded in journal this book is also called as "Day book" or "Daily record".

→ All the transactions related to business like purchases, purchases return, sales, sales return, cash receipts, cash payments, loans & advances taken (given), assets acquired, salaries paid are first recorded in the book of Journal

→ Hence Journal is called as "Book of prime entry".

Format

Date	particulars	LF	Debit Amount	Credit Amount
01-01-25	cash A/C Dr		50,000	
	To capital A/c			50,000
	(Being business started with cash)			
02-01-25	Furniture A/C Dr		5,000	
	To cash A/C			5,000
	(Being furniture purchased for cash)			

Trial Balance

→ The trial Balance Contains the debit and credit balance of all LEDER account, It is very much useful in preparation of Final Accounts

→ It is a connecting link between The ledger & Final Account

→ Trial Balance can be prepared at any time & not necessarily at the End of a calendar or accounting year

→ It is the only base for preparation of Final Accounts

A Trial Balance may be simply defined as a statement prepared by putting all Debits on one side and all Credits on the other side to check the arithmetical accuracy of the ledger balance,

Trial Balance ~~format~~

~~Particulars~~

Rule: Debit all asset & Expenses & Losses
Credit all liabilities, income & gains

particulars	Debit Amount	credit Am
Drawings	4,000	
Discount allowed	1500	
Discount received		500
office expenses	2000	
manufacturing expenses	1200	
Bills payable	~~17,000~~	17,000
Bills receivable	10,000	~~[illegible]~~
cash in hand	4,800	
cash at bank	30,800	
office rent	3,600	
Capital		2,00,000
Machinery	60,000	
stock (1st April)	32,000	
Wages	1,00,000	
carriage inwards	1000	
Salaries	10,000	
factory rent	4,800	

Repairs	800	
Fuel & power	11,000	
Buildings	80,000	
SUNTRY debtors	40,000	
Sales		4,07,900
Purchase	2,44,000	
Creditors		25,000
Return inwards	7,200	
Return outwards		4,000
	6,53,700	6,53,700

BEFA Assignment - 2

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Differentiate capital expenditure & Revenue expenditure.

CAPITAL EXPENDITURE	REVENUE EXPENDITURE
1) Items of Revenue expenditure are taken in trading account & profit & loss account	1) Items of capital expenditure are considered in Balance sheet.
2) Expenditure intended to benefit it future periods in contrast the Revenue expenditure, which benefit the current period.	2) It is incurred for generating revenue in the current accounting period & its benefits expenses with such period
3) Capital expenditure is non recurring in nature	3) Revenue expenditure is recurring in nature.

2. Draw the format for final Account

Preparation of final Account involve following three steps.

* Trading Account
* profit & Loss Account &
* Balance sheet

TRADING ACCOUNT

Particulars	Amount	particulars	Amount
To opening stock	xxxx	By sales xxxx less: returns xx	xxx
To Purchase xxx less: returns xx	xxxx	By closing stock	xxxx
To carriage inwards	xxxx	By goods destroyed by fire	xxxx
To wages	xxxx	By gross loss (transferred to P&L account)	
To frieght /cartage	xxxx		
To customs duty	xxxx		
To gas, fuel, coal	xxxx		
To factory superviser	xxxx		
man. Expenses			
Productive expenses			
To gross profit c/d (Transfered to P&L accounts)			

Profit and loss A/c Of --, For The year Ended

Particulars	Amt	Particulars	Amt
To office salaries	xxx	By gross profit b/d	xxx
To rent, rates, taxes	xxx	By Interest received	xxx
To printing & stationery	xxx	By Discount received	xxx
To legal charges	xxx	By commission received	xxx
To Audit fee	xxx	By Income from investments	xxx
To Insurance	xxx	By Dividend on shares	xxx
To General Expenses	xxx	By Rent received	xxx
To Advertisement	xxx		
To Bad debts	xxx		
To Carriage outwards	xxx		
To Repairs	xxx		
To Depreciation	xxx		
To Interest paid	xxx		
To Interest on capital	xxx		
To Interest on loans	xxx		
To Discount allowed	xxx		
To Commission	xxx		
To Net profit.. (transferred to capital a/c)			
	xxx		xxx

Balance sheet

Liabilities	Amt	Assets	Amt
Creditors	xxx	Cash in hand	xxx
Bills payable	xxx	Cash in bank	xxx
Bank overdraft	xxx	Bills receivable	xxx
Loans	xxx	Debtors	xxx
Mortage	xxx	Closing stock	xxx
Reserve fund	xxx	Investments	xxx
Capital xxx		Furniture and fitting	xxx
+ Additional xx		Plant & Machinery	xxx
+ Net profit xxx		Land & Building	xxx
Less	xxxx	Good will	xxx
Drawings	xxx	Prepaid expenses	xxx
Interest on drawings	xx	Outstanding income	xxx
Net loss	xxx		

1) Define Ratio analysis & Explain its limitations

Ratio Analysis is a technique of interpretation of financial statements

Classification of Ratios

1. liquid Ratio (short term solvency)
2. leverage Ratio (long term solvency)
3. Turnover Ratios (performance)
4. profitability Ratios

Limitations

The following are the main limitations of ratio analysis

1. False results if based on incorrect accounting data:
Accounting ratios can be correct only if the data is correct. Sometimes, the information given in the financial statements is affected by window dressing, i.e showing position better than what actually is

2. No idea of probable happening in future.
Ratios are an attempt to make an analysis of the past financial statements; so they are historical document. Now-a-days keeping in view the complexities of the business, it is important to have an idea of the probable happening in future.

3. Variation in accounting methods
The two firms results are comparable with the help of accounting ratios only if they follow the same accounting methods or bases. Comparision will become difficult if the two concerns follow the different methods of providing depreciation or valuing stock

4. Price level change.

change in price levels make comparision for various year

only one method of analysis:
Ratio analysis is only a beginning and give just a fraction of information needed for decision-making so, to have a comprehensive analysis of financial statements, ratios should be used along with other methods of analysis.

6. No common standards.
It is very difficult to lay down a common standard for comparison because circumstances differ from concern and the nature of each industry is different.

7. Different meanings assigned to the same term:
Different firms, in order to calculate ratios may assign different meanings. This may affect the calculation of ratio in different firms and such ratio when used for comparision may lead to wrong conclusions.

2) List out 4 types of Ratios in Detail.
Classification of Ratios.
1. Liquidity Ratios (short term solvency)
2. Leverage Ratios (long term solvency)
3. Turnover Ratios (performance)
4. Profitability Ratios.

Liquidity Ratios: These Ratios are used to measure the short term solvency of the firm
Following are liquidity ratios
1. current ratio
2. Quick ratio

Current Ratio: Ratio of current assets and current liabilities
current ratio = C.A / C.L

A current ratio of 2:1 is usually considered as ideal.
If less than 2, it indicates there is no adequate liquidity and
If greater than 2 it indicates funds are idle and are not invested properly

Quick Ratio: Also called acid test ratio
It is the Ratio of quick assets to current liabilities
Quick Ratio = Q.A / C.L

A quick ratio of 1, is usually considered ideal.
If it is less than 1, it indication of inadequate liquidity
A high quick ratio is not advisable as funds can be more profitably employed.

Leverage Ratio (long term solvency)
1) Debt Equality Ratio = (Debt / Equity) or outsiders fund
→ Debt Equity Ratio = long term liabilities / share holders fund

→ ~~Deb~~ Ideal Debt Equity Ratio is 2:1

→ Debt equity ratio indicates relative claim of debenture holders and share holders against the assets of the business

2) Interest coverage Ratio = $\frac{\text{profit before Interest and taxes}}{\text{Fixed interest charges}}$

→ Ideal Interest coverage Ratio is 6 times
→ The higher the ratio the better it is for the firm
→ The above ratio indicates firms ability to pay interest to debenture holders out of available profits

3) Ratio of properieters funds to total Assets = proprietors funds / total Assets × 100

→ Above ratio indicates financial strength of a firm
→ Proprietor fund also referred as share holders fund

Debt collection Ratio Period = 365 / Debtors Turnover Ratio
→ Ideal debt collection period is 30 – 37 days

Creditors Turnover Ratio = $\frac{\text{Credit purchase}}{\text{Trade Creditors}}$

→ Ideal creditor turnover ratio is 12 times

Debt Payment Period = 365 / Creditor Turnover Ratio

→ Ideal debt payment period is 30 days.

5. Fixed Assets Turnover Ratio = Net sales / fixed assets
→ This ratio indicates how well a firm is utilizing its fixed assets
→ Ideal fixed assets turnover ratio is 5 times

PROFITABILITY RATIO

1) Gross profit Ratio = (Gross profit / net sales) x 100
2) Net profit Ratio = (Net profit after taxes / Net sales) x 100
3) operating Ratio = (Operating expenses / Net sale) x 100
4) Return on Investment (ROI) = $\frac{\text{profit before interest and tax}}{\text{Total Investment}}$

5) Return on Equity (ROE) = (Net profit – Dividends payable to preference shareholders) / Equity share capital

6) Earnings per share (EPS) = Net profit after taxes – preference dividend / Number of equity shares outstanding

7) Price / Earnings Ratio = Market price per share / Earning per share

8) Earnings yield Ratio = Earning per share / Market price per share.

4. Fixed Assets Ratio = Fixed Assets / Capital Employed
→ Above ratio indicates mode of financing fixed assets
→ A Financially well managed company always uses long-term source of finance for financing its fixed assets
→ Ideal fixed assets ratio is 0.67

5. Dividend coverage Ratio: PAT / preference Dividend
⇒ It indicates firms ability to pay dividends out of its profits

Turnover Ratios (Performance)

1. Stock Turnover Ratio: $\frac{\text{Cost of Goods sold}}{\text{Avg stock}}$

Cost of Good sold: Opening stock + Net purchases + All Direct expenses − closing stock

Avg stock: $\frac{\text{opening stock + closing stock}}{2}$

→ Ideal inventory turnover ratio is 8 times.

2) Inventory holding period: 365 / stock Turnover Ratio
: "credit"
↳ Ideal Inventory holding period is 45 days.

3) Debtors Turnover Ratio: = $\frac{\text{credit sales}}{\text{Trade Debtors}}$

Ideal debtor turnover ratio is 10-12 times
Also consider if any opening and closing debtors