1 THEORETICAL FRAMEWORK

THIS CHAPTER INCLUDES

- Meaning and Scope of Accounting
- Accounting Concepts, Principles and Conventions
- Accounting Terminology
- Capital and Revenue Expenditures and Receipts
- Contingent Assets and Contingent Liabilities
- Accounting Policies
- Valuation Principles, Accounting Estimates

OBJECTIVE QUESTIONS

1995 - Nov [5] State with reasons whether the following statement is true or false:

(3) Wages paid for erection of machinery are debited to Profit and loss account. **(1.5 marks)**

(4) Amount paid for acquiring goodwill is deferred revenue expenditure. **(1.5 marks)**

(10) Patent Rights is in the nature of Nominal A/c's. **(1.5 marks)**

Answer:

(3) False: It is a capital expenditure and hence should be debited to machinery A/c.

(4) False: It is a capital expenditure since it involves acquisition of an intangible asset, which is a fixed asset.

(10) False: It is a Real A/c because it is an intangible asset.

1996 - May [5] State with reasons whether the following statement is true or false:

(3) Overhead expenses of a second hand machinery purchased are revenue expenditure. **(2 marks)**

(5) Goodwill is not a fictitious asset. **(2 marks)**

Answer:

(3) False: Such expenses are incurred to derive long-term benefits of enduring nature. So it is a capital expenditure.

(5) True: Goodwill is an intangible asset.

1996 - Nov [5] State with reasons whether the following are true or false:

(7) Motor repairs charges including replacement of certain worn out parts incurred before using a second hand car purchased recently is a capital expenditure. **(2 marks)**

Answer:

True: As these charges were incurred to derive a long-term benefit.

1997 - May [5] State with reasons whether the following are true or false:

(1) The gain from sale of capital assets need not be added to revenue to ascertain the net profit of a business. **(2 marks)**

Answer:

False: It should be considered to ascertain the net profit, as it is not due to normal business operation.

1997 - Nov [5] State with reasons whether the following statement is true or false:

(1) An expenditure intended to benefit beyond the current period is a revenue expenditure. **(2 marks)**

(7) Sale of office furniture should be credited to Sales A/c. **(2 marks)**

(10) Expenditure which results in acquisition of a permanent asset of enduring benefit to the business is a capital expenditure. **(2 marks)**

Answer:

(1) False: Revenue expenditure is that expenditure which benefits the period in which it is incurred i.e. current period.

(7) False: It should be credited to Furniture A/c because it is a capital receipt.

(10) True: Because it will generate enduring benefits and help to generate revenue for more than one accounting period.

1998 - May [5] State with reasons whether the following statement is true or false:

(3) Goodwill is a current asset. **(2 marks)**

(6) Wages paid to workers to produce a tool to be captively consumed is capital expenditure. **(2 marks)**

(7) Accrual concept implies accounting on cash basis. **(2 marks)**

Answer:

(3) False: Goodwill is a fixed asset and is in the nature of Real A/c. It is not a fictitious asset but an intangible asset.

(6) **True:** Wages paid to workers for creating an asset to be used in business is capital expenditure.

(7) **False:** Accrual concept implies accounting done on due or accrual basis. It involves the recognition of revenues and costs as they accrue irrespective of the actual receipts or payments.

1999 - May [5] State with reasons whether the following statement is true or false:

(iv) Nominal Accounts are balanced in the end of the accounting year. **(2 marks)**

(vii) Expenses incurred on white-washing of a factory building done after every six months is Revenue Expenditure. **(2 marks)**

(x) Amount spent for replacement of worn out parts of a machine is capital expenditure. **(2 marks)**

Answer:

(iv) **False:** The balances of nominal a/cs are transferred to Profit & Loss A/c. They are not balanced.

(vii) **True:** As they are incurred in the normal maintenance course of the asset.

(x) **False:** It is a part of maintenance cost, and hence revenue expenditure.

1999 - Nov [5] State with reasons whether the following statement is true or false:

(i) Temporary shed put up at project site to house materials is a capital expenditure. **(2 marks)**

(v) Heavy advertising to introduce a new product is capital expenditure. **(2 marks)**

(vii) Current cost gives an alternative measurement base. **(2 marks)**

(x) Legal fees paid to acquire a property is capital expenditure. **(2 marks)**

Answer:

(i) **True:** Because it is incidental to the main construction and the expenditure on it is a part of construction cost.

(v) **False:** Since it does not create any property of tangle or intangible nature and so the expenditure is spread over the period for which its effect would remain.

(vii) **True:** Generally the value of an asset is determined on the basis of cost of acquisition. Current cost is also an alternative measurement base where assets are carried at cash or cash equipment.

(x) **True:** It is a part of the cost of that property and it is incurred to possess the ownership right of that property.

2000 - May [5] State with reasons whether the following statement is true or false:

(i) Expenditure on renovation of a theatre which has increased the seating capacity by 10% is deferred revenue expenditure. **(2 marks)**

(iii) Outstanding expenditure is a nominal account. **(2 marks)**

(ix) Travelling expenses of ₹ 80,000 paid to a technician for the installation of a new machine is debited to Profit and Loss Account. **(2 marks)**

Answer:

(i) **False:** It is a capital expenditure a it has contributed to the revenue earning capacity of the business over more than one accounting period.

(iii) **False:** It is a personal account as it represents a liability due to some person.

(ix) **False:** The expenditure is a capital expenditure since it has been incurred to put the asset in working condition.

2000 - Nov [5] State with reasons whether the following statement is true or false:

(4) Wages paid for erection of new machinery are debited to Machinery A/c. **(2 marks)**

(7) Expenditure which results in acquisition of a permanent asset is a revenue expenditure. **(2 marks)**

Answer:

(4) **True:** Because it is a capital expenditure.

(7) **False:** It is a capital expenditure since it will generate benefit for over more than one years.

2001 - Nov [5] State with reasons whether the following statement is true or false:

(iii) Patent Right is in the nature of Real Accounts. **(2 marks)**

Answer:

True: It is an intangible asset and is in the nature of Real account.

2002 - May [5] State with reasons whether the following statement is true or false:

Wages paid for erection of machinery are debited to the Machinery Account. **(2 marks)**

(8) In double account, all business transaction are recorded as having dual aspect. **(2 marks)**

Answer:

True: It should be debited to Machinery Accounts, as it is a capital expenditure.

(8) **True:** In double entry book-keeping system, every transaction has a dual aspect or a two fold effect in accounting where one account is debited by an amount and the other is credited by the same.

2002 - Nov [5] State with reasons whether the following statement is true or false:

(ii) Legal fees paid to acquire a building is a capital expenditure. **(2 marks)**

Answer:

True: Legal fees is to be capitalised.

2002 - Nov [5] State with reasons whether the following statement is true or false:

(vi) Transactions and events are guides by generally accepted accounting principles and the transactions and events are guided by those principles. **(2 marks)**

Answer:

True: Every country adopts some generally accepted accounting principles and the transactions and events are guided by those principles.

2003 - May [5] State with reasons whether the following statement is true or false:

(i) Accounting can be viewed as an information system which has its input processing methods and output. **(2 marks)**

(ii) The value of human resources is generally shown as assets in the Balance Sheet. **(2 marks)**

(iii) Revenue are matched with expenses in accordance with the matching principle. **(2 marks)**

(iv) The financial statement must also disclose the relevant and reliable information in accordance with the Full Disclosure Principle.

(2 marks)

(ix) Equity + LTL - CL = FA + CA. **(2 marks)**

Answer:

(i) **True:** Accounting is a processing system whose input is financial transaction and out put is financial statement communicating various information to various interested groups.

(ii) **False:** The human recourse still cannot be defined in terms of money.

(iii) **True:** The matching concept involves that the revenue earned in an accounting year is matched with the expenses incurred during the same period to generate that revenue.

(iv) **True:** The financial statement must also disclose the relevant and reliable information as per AS-1 i.e. Disclosure of Accounting policies.

(ix) **False:** The correct equation is as follows :–

Equity +LTL+ CL= CA+FA.

2003 - Nov [5] State with reasons whether the following statement is true or false:

(i) Accounting involves communication. **(2 marks)**

(ii) The economic life of an enterprise is artificially split into periodic intervals in accordance with the going concerns assumption. **(2 marks)**

(iv) The return of goods by a customer should be debited to Return Outward Account. **(2 marks)**

Answer:

(i) **True:** Accounting starts only when there is a communication of business transactions to the accounting department. It also communicates the results obtained from arranging of data to interested parties like investors, creditors, employees etc..

(ii) **True:** As it facilitates the determination of revenue and expenses of a specific period.

(iv) **False:** It is debited to Return Inwards A/c.

2004 - May [5] State with reasons whether the following statement is true or false:

(viii) Patent-Right is in the nature of Real Account. **(2 marks)**

Answer:

True: Patent is an intangible asset and the accounts relating to it are intangible real accounts.

2004 - Nov [5] State with reasons whether the following statement is true or false:

(i) Accounting principle is general rule followed in preparation of Financial Statements. **(2 marks)**

(ix) Capital is equal to assets less external liabilities. **(2 marks)**

Answer:

(i) **True:** Accounting principles suggests the rules of action, which are universally accepted by the accountants for the recording of accounting transactions.

(ix) **True:** Capital + Reserves & Surplus (internal liabilities) = All Assets - External Liabilities

2005 - May [5] State with reasons whether the following statement is true or false:

(i) Goods worth ₹ 600 taken by the proprietor for personal use should be credited to purchase account. **(2 marks)**

(ii) Rent paid account is a Nominal Account whereas, Rent received account is a Real account. **(2 marks)**

(iii) Amount paid to Management company for consultancy to reduce the working expenses is revenue expenditure. **(2 marks)**

Answer:

(i) **True:** Goods taken by the proprietor for personal use should be debited to Drawings Account and Credited to Purchase Account.

(ii) **False:** Rent is an either income or expense so it is a nominal account whether it is received or receivable or paid or payables.

(iii) **False:** Amount paid or payable to management company for consultation to reduce the working expenses is deferred revenue expenditure. Such expenditure gives long term benefit to the business entity, and it can not be realised in the market directly.

2005 - Nov [5] State with reasons whether the following statement is true or false:

(ii) As per the concept of conservatism, the accountant should provide for all possible losses, but should not anticipate income. **(2 marks)**

Answer:

True: Concept of conservation states that the accountants should not anticipate income and should provide for all possible losses.

2006 - May [5] State with brief reasons whether the following statements are True or False :

(iii) "Marshalling" and 'Grouping' has the same meaning. **(2 marks)**

Answer:

True: Marshalling and grouping are the same things because under marshalling also transactions are assembled or grouped at one location/place.

SHORT NOTES

1998 - Nov [6] Write short notes on the following:

(i) Going concern concept. **(5 marks)**

(iv) Contingent liability. **(5 marks)**

Answer:

(i) **Going concern concept:** It means that the business will go on indefinitely i.e. the business is not going to be liquidated in foreseeable future. This concept is a fundamental to the accounting theory. The Balance sheet is prepared on the basis of this concept and the prepaid expenses are shown as assets in the B/S because of this concept only. The creditors supply the goods and services expecting the continuation of business for a long period.

(iv) The term 'Contingent liability' can be defined as

"(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past event but is not recognised because:
   (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   (ii) a reliable estimate of the amount of the obligation cannot be made."

1999 - May [6] Write short note on the following:
(ii) Double Entry System. **(5 marks)**

Answer:

Double Entry System:

It is a system of book keeping. It was developed in England. It is a system which recognises that every transaction has a two fold effect. Under "Double Entry System" there are two approaches of recording business transactions:
(i) Traditional Approach i.e. Book Keeping Approach.
(ii) Modern Approach i.e. Accounting-equation Approach.

Under the traditional approach, transactions are recorded into different books of accounts i.e. Journal, Ledger, Subsidiary Book, etc.

Under the modern approach, business transactions are recorded through accounting equation i.e. Assets = Capital + Liabilities.

Advantages:

1. There is a complete record of every transaction because under this system all the accounts i.e. personal, real and nominal are maintained and all the aspects of debit and credit are recorded.
2. It provides all day-to-day and reliable information.
3. It easily makes available the full details of every transaction.
4. It helps in checking of unnecessary expenditures.
5. It helps in testing of ledger posting by trial balance and also the arithmetical accuracy.
6. It helps in ascertaining the financial position of the business by preparing Balance Sheet.

2004 - Nov [6] Write short notes on the following:
(iii) Accounting Convention. **(5 marks)**
(iv) Capital expenditure and Revenue expenditure. **(5 marks)**
(v) Role of Accountants in society. **(5 marks)**

Answer:

(iii) Accounting Convention: In order to make universally accepted system of book keeping system some principles or conventions are used by the all accountants.

Some of the most fundamental principles/conventions are as follows:

(1) Separate entity principle: It means that the business is treated as a separate and distinct from the proprietor. All the transactions of the business are recorded in the books of the business from the point of view of the business as an entity. The proprietor is treated as a creditor to the extent of his capital.

(2) Going concern principle: Means that business will go on indefinitely. i.e. business is not going to be liquidated in foreseeable future. This concept is fundamental to accounting theory. Following points signify the importance of this concept :–

(i) On the basis of this concept we prepare Balance Sheet.

(ii) Prepaid expenses are shown as assets in the balance sheet only because of this concept.

(3) Money measurement principle: Means that only those transaction, which can be expressed in terms of money, are recorded in the books of account. It implies that transactions or fact, which cannot be expressed in terms of money, are not recorded in the books of accounts, though they may be very useful for the business.

This concept makes the accounting data homogenous and helps in understanding the affairs of the business.

(4) Cost concept: Closely related to going concern concept. According to the concept, assets are recorded in the accounting records at the price paid to acquire them and the cost will be the basis for all subsequent accounting for the asset.

The cost concept does not mean that the asset will always be shown at cost. It has also been stated above that cost becomes the basis for all future accounting for the asset. It means that asset is recorded at cost at the time of it's purchase about it may systematically be reduced in it's value by charging depreciation.

The become largely irrelevant for judging the financial position of the business. This is the reason for the growing importance of inflation accounting.

(5) **Dual Aspect Principle:** It is the core of accounting according to this principle, all business transactions involve two fold aspects and both the aspects have to be recorded in the books of account.

In order to understand this principle, it is necessary for us to understand simultaneously the meaning of three terms (i) Assets (ii) Capital (iii) Creditors (External liabilities).

Since total assets of the business are acquired out of the money contributed by the proprietors and creators of the business, it is easy to express the effects of the transaction as under.

Capital + Liabilities = Assets

The above relationship is known as the "Accounting Equation."

Note: Since all this is looked at from the business point of view, there is a dual aspect of all transactions.

The system of recording transaction based on this concept is called "double entry system".

(6) **Accounting Period Principle:** Suggests that life of the business is divided into appropriate segments for studying the results shown by the business after segmentation. This is because though the life of the business is considered to be indefinite, the measurement of income and studying the financial position of the business after a very long period would not be helpful in taking proper corrective steps at the appropriate time interval, the business-man must 'stop' and 'see back' how things are going on. In accounting such a segment or time interval is called accounting period. It is usually of one year.

This concept facilitates the preparation of financial statements. The principle of segregating capital expenditure from revenue expenditure is based on this concept. At the end of each accounting period, an income statement disclosing the income of business is prepared. Alongwith income statement, a statement of financial position i.e. Balance Sheet is also prepared.

(7) **Periodic matching of Cost and Revenue Principle:** This is based on the accounting period concept. The paramount objective of running a business is to earn profit. In order to ascertain the profit made by the business during a period, it is necessary that revenues of the period should be matched with the cost of the period.

(8) **Realization Principle:** It is related to recognition of revenues. According to this concept, revenue should be recorded only when it is realized. When the property in goods or services are passed to the buyer and he becomes legally liable to pay.

(9) **Consistency Principle:** Accounting rules, practices and conventions should be continuously observed and applied i.e. these should not change from 1 year to another. Continuation of one practice for a number of years indicate consistency e.g. if an asset is depreciated on diminishing balance method in 1 year the same method of depreciation be adopted in other year also.

(10) **Disclosure Principle:** According to this convention, financial statements should be honestly prepared and to the end full disclosure of all significant information should be made. All information which is of material interest to proprietor, creditors and investors should be disclosed in the financial statements.

(11) **Conservatism Principle:** Conservatism means taking the gloomy side of the situation. Future is uncertain. Though an estimate is made about future events and circumstances, but no one can guess the future with perfect certainty in business. Hence, some arrangements or provision is made to meet the future uncertainties. Every sincere business makes an estimate of future loss and then some provision for it is made such as provision for bad debts. Businessmen mostly ignore the items of future profit. This tendency is termed as conservatism and it is very natural tendency and is in existence since long.

(12) **Materiality Principle:** According records should be made of all material facts and immaterial items may be mixed out with material items and then recorded or they may be ignored. This is a convention. Materiality is a very important convention which

occupies not only a key position in accounting but forms a base for accounting.

(iv) Capital Expenditure: An expenditure intended to benefit future periods is known as capital expenditure. In other words, if the benefit of an expenditure is not exhausted in one accounting period, but is spread over future periods, the expenditure is known as capital expenditure. For instance, a table or a chair bought during the current accounting period is intended to be used over and over again, so that the benefit of its usage is spread over a number of future accounting periods. The same is true of land, buildings, plant and machinery, etc.

Accordingly, any expenditure incurred in the acquisition of an asset to be used over a number of years is capital expenditure. Similarly, an expenditure on an existing asset, in the form the additions or improvements, with a view to increasing its revenue earning capacity, is also a capital expenditure.

Revenue Expenditure: As contrasted with capital expenditure, revenue expenditure benefits a current period. Accordingly, an expenditure the benefit of which is exhausted in the period in which it is incurred, is known as revenue expenditure. A revenue expenditure neither results in the acquisition of an asset, nor is it incurred to increase the revenue earning capacity of an existing asset. It is, in fact, incurred to retain the original revenue earning capacity of an asset. As such, the expenditure is of a revenue nature.

(v) Role of Accountants in society: In the present competitive scenario accountants play a dual role. They not only look into conventional matters relating to tax, costing, management accounting, company legislation etc. but also act in matters of modern concepts like financial policies, economic principles etc.

In brief we can put forward the role of accountants in the following points:

(i) They maintain the books and accounts of the business in a way that they show a true & fair view of the position of the business.

(ii) They act as an auditor both internal and external.

(iii) They provide service as an tax consultant.

(iv) They act as financial advisors.

(v) They also assist in the share registration, registration of company etc.

2005 - Nov [6] Write short notes on the following:

(i) Accrual basis of Accounting. **(3 marks)**

(ii) Qualitative characteristics of Financial Statements. **(3 marks)**

Answer:

(i) Accrual basis of Accounting: Accrual or mercantile basis of accounting refers to a system of recording revenues and expenses whether or not they have been received or paid in cash at the time of recording.

Accounting on accrual basis signifies that owner's equity is effected by the profit earned or loss suffered by an enterprise during the accounting period and not as money is received or paid.

Therefore, while ascertaining the profit or loss, not only those expenses which have been paid in cash should be considered, but also expenses which have become due though not paid should be taken into account.

Similarly all the incomes earned during the accounting period should be considered whether they have been received in cash or not.

(ii) Qualitative Characteristics of Financial Statements: Financial statements have some qualitative characteristics so that they may provide more information to the users. These are the qualitative characteristics of financial statements:

(1) Understandability;
(2) Relevance;
(3) Reliability; and
(4) Comparability;
(5) Faithful Representation;
(6) Completeness.

(1) Understandability: Required quality of information should be provided so that financial statements become more understandable for users. For this reason, it is assumed that users have a reasonable knowledge of business and economic activities and they study information with reasonable diligence. Information regarding complicated matters should be included in the statement because of it's relevance to the economic decision-making needs of the users and it should not be excluded merely on the ground that it may be too difficult for some users to understand.

(2) **Relevance:** Incorporate that information in the financial statement which is relevant for decision making. Quality of relevance of the information is determined when it influences the economic decisions of users.

(3) **Reliability:** Information must be reliable. Level of reliability of the information is high when it is free from material errors and biased decisions. Information may be relevant but so unreliable in nature or representation that its recognition may be badly misleading.

(4) **Comparability:** Financial Statements should be prepared in such a way that users of the financial statements must be able to compare their information with other information or financial statements in order to identify trends in performance, Cash flows, and financial position.

(5) **Faithful Representation:** Information must be represented faithfully so that its degree of reliability is high.

(6) **Completeness:** In order to present more reliable information in the financial statements it must be complete within the boundary of materiality and cost. An omission of information may cause information to be false or misleading and therefore unreliable and deficient in terms of relevance.

DISTINGUISH BETWEEN

1996 - Nov [6] Distinguish between the following:

(a) Capital expenditure and Revenue expenditure. **(3 marks)**

Answer:

Difference between Capital Expenditure and Revenue Expenditure

Basis	Capital Expenditure	Revenue Expenditure
Object	It result in acquisition of fixed asset which are meant for use and not resale.	It does not result in acquisition of any fixed asset.
Benefit of such expense	It results in improving the earning capacity of fixed asset.	It results in the repairs and maintenance of the business assets.
Period of use	The benefit of such expenditure will be for more than one year.	The benefit of such expenditure expires during the year.
Written off	All items of capital expenditure, which are not written off, are shown in the B/S as assets.	All revenue items the benefit of which has exhausted during the year are transferred to trading, P & L A/c.
Carry forwarded	These items are carried forward to the next year.	These items are not carried forward to the next year but whose benefit has not expired are carried forward to the next year.

1997 - May [6] Explain the difference between the following:

(1) Commission and Discount. **(5 marks)**

Answer:

Commission: Commission may be defined as the remuneration relating to services performed in connection with the purchases, sales, or other types of business transactions. Generally, commission is provided on profits. It is allowed as a percentage of net profit before charging any such commission. It is shown on the debit side of P & L A/c as an expense.

Discount: Discount is an allowance or a deduction allowed from an amount due. There are three types of discounts permissible:

(i) **Cash Discount:** Which is allowed to a debtor on prompt payment of cash.

(ii) **Trade Discount:** Which is allowed to a buyer on the printed price lists.

(iii) **Quantity Discount:** Which is allowed to a buyer on the catalogue price on a bulk purchase of items or goods.

Discount allowed is shown on the debit side of the P & L A/c and Discount received is shown on the credit side of the P & L A/c

1997 - Nov [6] Distinguish between the following:

(a) Real account and Nominal account. **(5 marks)**

Answer:

Real Accounts: These are the accounts of tangible or intangible assets owned by an enterprise. These accounts relate to the assets of the firm and not the debts. A separate account for each class of property is maintained so that the businessman can easily find out the value of each asset on any particular date, Eg.- Building A/c, Furniture A/c, Stock A/c, Goodwill, Patent, copyright etc.

The Rule of Real Account is:

Debit what comes in

Credit what goes out

Nominal Accounts: These accounts are related to the incomes, expenses, gains and losses of the business. These accounts are debited when any expense is incurred and credited when there is any income. For e.g. Rent, Rates, Lighting, Insurance, Dividend, Commission, Loss by Fire etc.

The Rule of Nominal Account is:

Debit all expenses and losses

Credit all incomes and gains

1998 - May [6] Distinguish Between:

(b) Capital Receipts and Revenue Receipts. **(5 marks)**

Answer:

Capital Receipt: These are the money received from the activities other than normal business activities e.g. Issue of shares and debentures, sale of fixed assets. Such receipts are of non-recurring nature. They do not affect profit and are shown as a liability or as a reduction from the assets.

Revenue Receipt: These are the money received in the course of normal business activities. e.g. Sales, interest, dividend, etc. Such receipts are of recurring nature and for general purpose. They are shown on the credit side of profit & loss A/c.

1999 - Nov [6] Briefly explain the differences between the following:
(c) Personal and Impersonal Accounts. **(5 marks)**
Answer:
Personal Accounts: These accounts are opened for persons: natural persons, artificial persons or representative persons. e.g. Amit A/c, ABC Ltd. A/c, Salary payable A/c etc.
Impersonal Accounts: These are not the personal accounts. These include Real and Nominal accounts.

Real Accounts are the accounts of tangible and intangible assets of the firm which carry the probable future benefits.

Nominal Accounts are the accounts of incomes, gains, expenses and losses.

2002 - Nov [6] Distinguish between the following:
(b) Cash Discount and Trade Discount **(5 marks)**
Answer:

Sl. No.	Cash Discount	Trade Discount
1.	Cash discount is a discount allowed to a debtor on prompt payment of cash.	Trade discount is a deduction allowed to the buyers from the gross or catalogue price.
2.	It is allowed to facilitate prompt payment.	It is allowed by the seller to the purchaser for the purpose of selling more goods.
3.	It is allowed only when the customers make the payment within a fixed period.	It is allowed immediately when the seller sells the goods to the customers.
4.	It is recorded in the books of accounts.	It is not recorded in the Books of accounts.

5.	It is not shown in the invoice.	It is shown in the invoice as a deduction.

DESCRIPTIVE QUESTIONS

1998 - Nov [5] Discuss briefly the relationship of Accounting with:

(i) Economics. **(3 marks)**
(ii) Statistics. **(3 marks)**
(iii) Mathematics. **(3 marks)**
(iv) Law. **(3 marks)**
(v) Management. **(3 marks)**

Answer:

(i) Accounting & Economics:
Accounting has some economic specialty of its own. It deals with prices and not the values. It deals with the prices of property and services and not with the property and services themselves. Accounting uses price because it can serve as a quantitative representation of the physical and actual property and services. From the viewpoint of economists, there is a very close relationship between accounting and economics. Emphasis has been laid down to test the economic theories and to apply the economic principles in the concern where accounting is a rich source. Accounting is a major supplier of information to economic agents about the various aspects.

(ii) Accounting and statistics:
Statistical methods are very helpful and useful in the interpretation and development of the accounting data. While the accounting records generally take a view of events in short term and are mainly confined to a year, a statistical analysis is more useful if a long-term view is taken for the purpose. Statistical tools are very helpful in taking decisions when they are applied to accounting data.

(iii) Accounting and Mathematics:
The dual aspect concept of fundamental accounting assumption is expressed in terms of mathematical equation, which is popularly

known as Accounting Equation i.e.

Assets=Capital + Liabilities.

Mathematics has a useful impact on the users of the accounts. If the mathematics of the user is strong its accounting may also be strong because the knowledge of mathematics helps in computations and calculations. The econometric models are also being developed for the users.

(iv) Accounting and Law:

An enterprises works under various statutory laws. The transactions and accounts are also effected by various laws such as companies Act, Sales of goods Act, Negotiable Instrument Act, Customs Act, etc. The financial statements must be prepared in accordance with relevant provisions of the applicable laws.

(v) Accounting and Management:

Accounting provides necessary information to the management for discharging its functions. Since an accountant plays an active role in management, he knows the needs of the system and data. A large portion of accounting information is made for management's decision making. Thus management and accounting are related to each other.

2000 - May [6] Briefly explain the following:

(a) Periodicity Concept. **(5 marks)**

Answer:

The life of business is based on going concern assumption and the measurement on the basis of this assumption is not possible for a long period. The owner cannot wait for such a long time, so a small workable fraction of time is selected from an unending life cycle of the business enterprise for measuring the performance and looking at the financial position. Generally, a period of one year is taken for measuring and appraising the performance of the financial position. Thus, the periodicity concept makes the accounting system and the term 'accrual' workable.

2001 - Nov [4] (b) Define "Accounting". **(6 marks)**

Answer:

Accounting: Although accounting is used by almost all the persons and institutions but accounting, as an organized activity is associated with everyday business. Due to importance of accounting for a business, accounting is called the "Language" of business. According to American Accounting Association, "accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information". According to this definition, accounting is a processing system whose input is financial transactions and output is financial statements communicating various information to various interested groups. Thus we can conclude.

1. Accounting is a process comprising
   (a) Recording of transactions.
   (b) Classifying and summarizing of transactions.
   (c) Interpreting the results.
   (d) Communicating the results to interested parties.
2. Accounting requires transactions to be expressed in monetary terms.
3. It is not confined only to recording but also related to interpreting the results.
4. It helps in communicating information to various groups interested in them.

2002 - Nov [2] (b) (ii) What services can a Chartered Accountant provide to the Society. (Give Names only)? **(4 marks)**

Answer:

A chartered Accountant can provide following services to the society:

(a) Taxation.
(b) Auditing.
(c) Legal services.
(d) Financial Management.
(e) Financial Analysis.
(f) Investment decisions.

2003 - May [6] Briefly explain the following:

(a) Cash and Mercantile system. **(5 marks)**

Answer:

Cash Basis of Accounting: Accounting under which the transactions are recorded in the books of accounts when they are received or paid in cash. It is based on collection and payments of cash. It implies that the financial effect of transactions is recorded only in the period in which the cash is actually received or paid by the business concern. No recording is made when a receipt or payment is merely due.

Mercantile Basis of Accounting: It is the method of recording transactions by which revenues, and expenses are reflected in the accounts in the period in which they accrue. It is based on accrual of income and expenditure. It implies that monetary effect of transactions is recorded only in the period in which expenses are incurred and incomes are earned.

2003 - Nov [6] (b) What is meant by Accounting Policies? Give four examples of Accounting Policies? **(5 marks)**

Answer:

Accounting Policies:

Accounting policies means specific methods or principles of accounting adopted by an enterprise for a particular transaction or event in the preparation and presentation of financial statements. While adopting a particular accounting policy, main consideration should be to prepare financial statement so as to represent true and fair view of the state of affairs of the enterprise.

For e.g.

1. Valuation of fixed assets, stock, goodwill, investment, etc.
2. Method of depreciation, amortization.
3. Treatment of goodwill, contingent liabilities.
4. Conversion of foreign currency items.

2004 - May [3] (b) What are the Fundamental Accounting Assumptions? Discuss briefly? **(6 marks)**

Answer:

Fundamental Accounting Assumptions: It includes those basic assumptions or conditions upon which the subject of accounting is based. It states the preparation and presentation of financial statement. If these assumptions are not followed, their disclosure is necessarily required. AS-1 prescribes the following assumptions generally accepted as fundamental accounting assumptions:

1. Going concern.
2. Consistency.
3. Accrual.

Going concern: The enterprise is generally viewed as a going concern i.e. continuing in operation in foreseeable future. It means that there is no natural death of business and this is a basic assumption for the preparation of balance sheet.

Consistency: It is assumed that accounting policies adopted and used are consistent i.e. they remain same from one period to another.

Accrual Basis: The revenue and costs are recognized for the financial statement purpose, when they are earned or incurred, not as money is received and paid.

2007 - Nov [5] Answer the following :

(x) What is meant by Accounting estimate? **(2 marks)**

Answer :

The result of many business activities are uncertain, because of uncertain future. Many of the financial statement items are not measured with precision but measured on the basis of estimates. This is called accounting estimate.

On account of such uncertainties, management makes various estimates and assumption of assets, liabilities, incomes and expenses as on the date of preparation of the financial statements.

Such process of estimation involves judgement, which is based on the latest information available. e.g. estimation of Bad debts

2008 - May [5] Answer the following :

(vi) "One of the characteristics of financial statements in neutrality" – Do you agree with this statement? **(2 marks)**

Answer :

Yes, Qualitative characteristics are the attributes that make the information provided in the financial statement useful to users. One of the characteristics of financial statement is neutrality. According to it, to be reliable, the information contained in the financial statement must be neutral. It should be free from any sort of bias. Financial statements are not neutral, if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

2008 - Nov [5] Answer the following:

(x) Give the four qualitative characteristics which the financial statements should observe. **(2 marks)**

Answer :

The financial statements should have the following qualitative characteristics:

(i) Understandability
(ii) Relevance
(iii) Reliability
(iv) Comparability.

2011 - Nov [7] Answer the following:

(e) What are the qualitative characteristics that improve the usefulness of information provided in the financial statements? **(4 marks)**

Answer :

Qualitative characteristics are those attributes which make the information provided in the financial statement useful to the users.

The principal qualitative characteristics are as follows:

1.	**Understandable**	The basic quality of financial statement is that it is understandable by the user. However to understand, the user is expected to have basic knowledge of business and accounting.
2.	**Relevance**	The information provided in the financial statement will loose its importance if it is not relevant. An information is relevant when it influences the decision of users while evaluating the past, present and future.
3.	**Materiality**	The information provided in a financial statement is relevant only if it is material. Materiality provides a threshold rather than being a primary qualitative characteristic.
4.	**Reliability**	The financial statement loses its purpose if it is not reliable. Thus it should be error free and unbiased showing the true and fair picture.
5.	**Neutrality**	The financial statement should be neutral. It should not be a manipulated statement.

6.	**Completeness**	The financial statement should be complete in all respect within the boundary of materiality and cost. An omission can make information misleading.
7.	**Substance over form**	The purpose of financial statement is to provide information. It should be thus presented in accordance with their substance and economic reality and not merely their legal form.
8.	**Comparability**	The measurement and display of information should be consistent in order to make it comparable over times to come.

2016 - Nov [7] (c) Explain in brief, the alternative measurement bases, for determining the value at which an element can be recognized in the Balance Sheet or Statement of Profit and Loss. **(4 marks)**

Answer:

Measurement is the process of determining money value at which an element can be recognised in the balance sheet or statement of profit and loss. There are four alternative measurement bases for the purpose. These bases relate explicitly to the valuation of assets and liabilities.

Measurement bases are as follows:

1. Historical cost
2. Current cost
3. Realisable value
4. Present value

In preparation of financial statements, all or any of the measurement basis can be used in varying combinations to assign the cost.

PRACTICAL QUESTIONS

2000 - Nov [4] (b) State with reasons, how you would classify the following items of expenditure:

(i) Overhauling expenses of ₹ 25,000 for the engine of a motor car to get better fuel efficiency.

(ii) Inauguration expenses of ₹ 25 lakhs incurred on the opening of a new manufacturing unit in an existing business.

(iii) Compensation of ₹ 2.5 crores paid to workers, who opted for voluntary retirement. **(2 marks each)**

Answer:

(i) Overhauling expenses are incurred to derive better fuel efficiency and to decrease the running cost in future. Thus it is beneficial for long term and must be capitalised. Hence, it is a capital expenditure.

(ii) This expenditure is revenue in nature as it may not generate long term benefit for over more than one accounting year.

(iii) Expenditure on voluntary retirement is revenue in nature. Since the amount of expenditure is very high, so it is better to treat it as deferred expenditure and write-off it over the future years.