

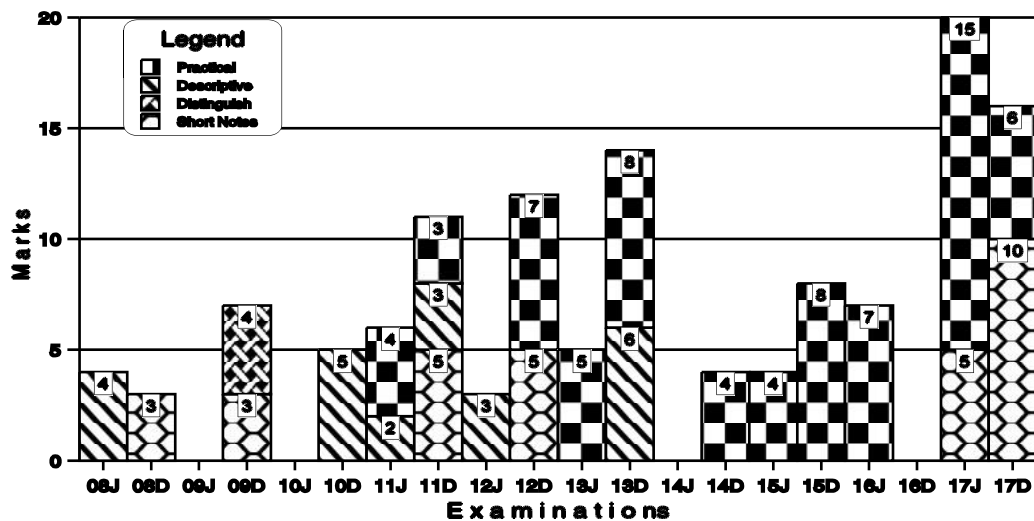
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FUNDAMENTALS OF ACCOUNTING

THIS CHAPTER INCLUDES

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| <ul style="list-style-type: none"> ● Basics ● Concepts ● Conventions ● GAAP ● Capital & Revenue Transactions | <ul style="list-style-type: none"> ● Subsidiary Books ● Trial Balance ● Types of Errors ● Rectification of Errors |
|---|---|

Marks of Short Notes, Distinguish Between, Descriptive & Practical Questions



CHAPTER AT A GLANCE

Book-keeping	“Book-keeping is an art of recording business transactions in a set of books.”
Financial Accounting	“An art of recoding, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of a financial character, and interpreting the results thereof.”
Cost Accounting	“Application of costing and cost accounting principles, methods and techniques to the science, art and practice of cost control and the ascertainment of profitability as well as the presentation of information for the purpose of managerial decision-making.”
Management Accounting	Management Accounting is concerned with the use of Financial and Cost Accounting information to managers within organizations, to provide them with the basis in making informed business decisions that would allow them to be better equipped in their management and control functions.
Accounting Cycle	When complete sequence of accounting procedure is done which happens frequently and repeated in same directions during an accounting period, the same is called an accounting cycle.
Generally Accepted Accounting Principles	A widely accepted set of rules, conventions, standards, and procedures for reporting financial information, as established by the Financial Accounting Standards Board are called Generally Accepted Accounting Principles (GAAP).

Types of Accounts	<p>(1) Personal Account : As the name suggests these are accounts related to persons.</p> <p>(2) Real Accounts : These are accounts related to assets or properties or possessions.</p> <p>(3) Nominal Account : These accounts are related to expenses or losses and incomes or gains.</p>
Capital and Revenue Expenditures	<p>Capital expenditure is the outflow of funds to acquire an asset that will benefit the business for more than one accounting period. A capital expenditure takes place when an asset or service is acquired or improvement of a fixed asset is effected.</p> <p>Revenue expenditure is the outflow of funds to meet the running expenses of a business and it will be of benefit for the current period only. A revenue expenditure is incurred to carry on the normal course of business or maintain the capital assets in a good condition.</p>
Deferred Revenue Expenditures	<p>Deferred revenue expenditures represent certain types of assets whose usefulness does not expire in the year of their occurrence but generally expires in the near future. These type of expenditures are carried forward and are written off in future accounting periods.</p>
Capital and Revenue Receipts	<p>A receipt of money is considered as capital receipt when a contribution is made by the proprietor towards the capital of the business or a contribution of capital to the business by someone outside the business. Capital receipts do not have any effect on the profits earned or losses incurred during the course of a year.</p> <p>A receipt of money is considered as revenue receipt when it is received from customers for goods supplied or fees received for services rendered in</p>

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	the ordinary course of business, which is a result of the firm's activity in the current period. Receipts of money in the revenue nature increase the profits or decrease the losses of a business and must be set against the revenue expenses in order to ascertain the profit for the period.
Books of Prime Entry	A journal is often referred to as Book of Prime Entry or the book of original entry. In this book transactions are recorded in their chronological order. The process of recording transaction in a journal is called as 'Journalisation'. The entry made in this book is called a 'journal entry'.
Ledger	Ledger is the main book or principal book of account. The entries into ledger accounts travel through the route of journal and subsidiary books.
Trial Balance	Trial Balance is defined as "a list or abstract of the balances or of total debits and total credits of the accounts in a ledger, the purpose being to determine the equality of posted debits and credits and to establish a basic summary for financial statements."
Rectification Entries (Rectification of errors)	These entries are passed when errors or mistakes are discovered in accounting records. These entries are also known as Correction Entries.

SHORT NOTES**2008 - Dec [8]** Write note on:

(e) Materiality concept.

(3 marks)

Answer:

Materiality Concept : Materiality principle is an exception of full disclosure principle. According to this principle, all the items having significant economic effect on the business of the enterprise should be disclosed in the financial statements and any insignificant item which will only increase the work of the accountant but will not be relevant to the users need should not be disclosed in the financial statements. The term materiality is the subjective term. It is on the judgment, common sense and discretion of the accountant that which item is material and which is not. For example stationary purchased by the organization though not used fully in the accounting year purchased still shown as an expense of that year because of the materiality concept. Similarly depreciation on small items like books, calculators etc., is taken as 100% in the year of purchase though used by the company for more than a year, this is because the amount of books or calculator is very small to be shown in the balance sheet though it is the asset of the company.

The materiality depends not only upon the amount of the item but also upon the size of the business, nature and level of information, level of the person making the decision etc. Moreover an item material to one person may be immaterial to another person. What is important is that omission of any information should not impair the decision-making of various users.

2009 - Dec [8] Write note on:

(d) Accounting Bases;

(3 marks)

Answer :

Accounting Bases : There are three bases of Accounting :

- 1. Accrual Base :** Here, income as well expenses are considered on the bases of their occurrence in an Accounting period and not on the bases of their actual receipts and payments.
- 2. Pure Cash Base :** Here the Revenues are not recognized and recorded unless they are received in cash. Similarly expenses are recognized only when they are paid in cash.
- 3. Modified Cash Base or Hybrid system :** The system is the mixture of both the bases of accounting as stated above. In this system Accrual base is followed for expenses and cash system is followed for revenues. Such system is followed by professionals who term their Income Statements as 'Receipts and Expenditure Account'.

2011 - Dec [8] Write short note on:

(e) Money measurement concept.

(5 marks)

Answer :

Money Measurement Concept in accounting also known as Measurability Concept means that only transactions and events that are capable of being measured in monetary terms are recognized in the financial statements.

All transactions and events record in the financial statements must be reduced to a unit of monetary currency. Where it is not possible to assign a reliable monetary value to a transaction or event, it shall not be recorded in the financial statements. However, any material transactions and events that are not recorded for failing to meet the measurability criteria might need be disclosed in the supplementary notes of financial statements to assist the users in gaining a better understanding of the financial performance and position of the entity.

2012 - Dec [8] Write short note:

(c) Accounting convention of consistency;

(5 marks)

Answer :

In order to enable the management to draw important conclusions regarding the working of a company over a number of years it is essential that accounting practices and methods remain unchanged from one accounting period to another. According to AS-1 consistency is a fundamental assumption and it is assumed that accounting policies are consistent from one period to another. Where this assumption is not followed, the fact should be disclosed with proper reasons.

Kohler has talked about three types of consistencies :

- (i) **Vertical consistency:** Consistency maintained within the interrelated financial statements of the same date.
- (ii) **Horizontal consistency:** This enables the comparison of performance of the organization in one year with its performance of previous/next year.
- (iii) **Third dimensional consistency:** Performance of one organization can be compared with that of another organization in the same industry.

2017 - June [8] Write short note on the following:

- (a) The Accrual Concept

(5 marks)

Answer:

The Accrual Concept :

The accrual concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the business is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.

When goods are sold on credit as per normally accepted trade practices, the business gets the legal right to claim the money from the customer. Acquiring such right to claim the consideration for sale of goods or services is called accrual of revenue. The actual collection of money from customer could be at a later date.

Similarly, when the business procures goods or services with the agreement that the payment will be made at a future date, it does not mean that the expense effect should not be recognized. Because an obligation to pay for goods or services is created upon the procurement thereof, the expense effect also must be recognized.

Today's accounting systems based on accrual concept are called as Accrual System or Mercantile System of Accounting.

2017 - Dec [8] Write short notes on the following:

- (a) Objectives of Accounting
(b) Methods/ Criteria to the selection and application of Accounting policies

(5 marks each)

DISTINGUISH BETWEEN

2009 - Dec [1] (h) Distinguish between capital receipts and revenue receipts.

(4 marks)

Answer :

Capital receipts and revenue receipts:-

Receipts which are obtained in the course of normal trading operations are revenue receipts (e.g. sale of goods, interest income). On the other hand, Receipts which are not revenue in nature are capital receipts (e.g. sale of fixed assets, secured and unsecured loans, owners contribution etc.) Revenue receipts are credited to profit and loss account. On the other hand capital receipts are not directly credited to profit and loss account. Profits and Loss on sale of fixed assets is calculated and recorded in profit and loss account.

DESCRIPTIVE QUESTIONS

2008 - June [1] {C} (f) State with reasons whether the following is *True or False* :

Hema Pvt. Ltd. adopts the practice of disclosing the significant policies pertaining to each relevant item in the appropriate schedule (wherein the said item forms a part) to the Income Statement or Balance Sheet. This is a perfectly valid disclosure. **(2 marks)**

(i) What is meant by Notes to Accounts ? **(2 marks)**

Answer :

(f) **True** : As per AS-1 Disclosure of Accounting Policies, every company should comply with the Accounting Standard and Relevant Accounting Policies, any deviation from the relevant Accounting Standard, reasons, for such deviation and the accounting policies should be disclosed separately.

Answer:

(i) Notes to account are the explanations of the management about the items in the financial statement (Profit & Loss A/c and Balance Sheet). The management gives more explanations and information about the items of Profit and Loss A/c and Balance Sheet and any other items, by way of Notes to Accounts.

For example:

1. Disclosure of details of contingent liability by notes to accounts.
2. Disclosure of litigation about the claim recoverable, each receivable

etc.

2010 - Dec [5] (b) State the various accounting concepts. **(5 marks)**

Answer :

Various Accounting concepts are as follows :

1. Money measurement concept
2. Dual aspect concept
3. Going concern concept
4. Periodicity concept
5. Accrual concept
6. Matching concept
7. Realisation concept
8. Materiality concept
9. Consistency concept
10. Business entity concept
11. Historical cost concept

2011 - June [1] {C} (f) Name four errors which are not detected by Trial Balance. **(2 marks)**

Answer :

- (i) Errors not disclosed by Trial Balance even on its agreement.
- (ii) Wrong entries in books of original records.
- (iii) Complete omission of a transaction.
- (iv) Compensating errors.
- (v) Errors of principles.

2011 - Dec [7] (c) Classify the following expenditures into Capital Expenditure and Revenue Expenditure :

- (i) Expenses on a foreign tour to purchase a machinery
- (ii) Annual maintenance fee of a machine
- (iii) Money spent to reduce working cost
- (iv) Compensation paid to workers under voluntary retirement scheme
- (v) Legal expenses to recover dues from customers
- (vi) Salaries paid to Engineering staff in erecting a machine **(3 marks)**

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Answer :

- (i) **Capital Expenditure** : Expenses incurred till the date of ready to put to use of an assets will be capitalized.
- (ii) **Revenue Expenditure** : Expenses incurred after the use of the assets is a revenue expenditure.
- (iii) **Capital Expenditure** : Any Expenditure incurred to increase the revenue generating capacity is a Capital Expenditure.
- (iv) **Revenue Expenditure** : Because it will not help to increase our revenue generating capacity.
- (v) **Revenue Expenditure** : Expenses arises during ordinary course of business is revenue expenses.
- (vi) **Capital Expenditure** : Expenses incurred till the assets is ready to put to use is a capital expenditure.

2012 - June [3] (b) Classify the following accounts into Personal, Real and Nominal accounts.

(i) Patent Rights a/c (ii) Drawing a/c (iii) Purchases a/c (iv) Prepaid Insurance a/c (v) Donation a/c (vi) Bank Overdraft a/c. **(3 marks)**

Answer:

Personal A/c – Drawings, Prepaid insurance, Bank Overdraft
Real A/c – Patent rights
Nominal A/c – Purchases, Donations

2013 - Dec [1] {C} Answer the following question (give workings wherever required):

- (ii) State briefly the three fundamental accounting assumptions.

(2 marks)

Answer:

The three fundamental assumptions are (a) going concern; (b) consistency; and (c) accrual.

Going Concern: It is assumed that the concern would be continuing in operation for the foreseeable future. It is also assumed the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of operations.

Consistency: The accounting policies followed are consistent from one accounting period to another.

Accrual: The revenues and expenses are accrued, that is recognised as

they are earned or incurred and recorded in the financial statements of the periods to which they relate.

2013 - Dec [2] (b) What are the steps or phases of 'Accounting Cycle'?
(4 marks)

Answer:

Steps/ Phases of Accounting Cycle:

- (i) **Recording of Transaction:** As soon as a transaction happens it is at first recorded in subsidiary book.
- (ii) **Journal:** The transactions are recorded in Journal chronologically.
- (iii) **Ledger:** All journals are posted into ledger chronologically and in a classified manner.
- (iv) **Trial Balance:** After taking all the ledger account's closing balances, a Trial Balance is prepared at the end of the period for the preparations of financial statements.
- (v) **Adjustment Entries:** All the adjustments entries are to be recorded properly and adjusted accordingly before preparing financial statements.
- (vi) **Adjusted Trial Balance:** An adjusted Trial Balance may also be prepared.
- (vii) **Closing Entries:** All the nominal accounts are to be closed by the transferring to Trading Account and Profit and Loss Account.
- (viii) **Financial Statements:** Financial statement can now be easily prepared which will exhibit the true financial position and operating results.

PRACTICAL QUESTIONS

2011 - June [3] (c) State with reasons whether the following items are Capital expenditure or Revenue expenditure:

- (i) A factory building was constructed at a cost ₹ 15,00,000. A sum of ₹ 64,000 were incurred for the construction of the temporary huts for storing building materials.
- (ii) ₹ 5,000 paid for removal of stock to a new site.
- (iii) Expenses incurred in connection with obtaining a licence to start the

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business were ₹ 15,000.

(4 marks)**Answer :**

- (i) Construction cost of factory building and temporary huts both are capital expenditure. Because factory building gives benefit more than one year and it can be used for production. Construction of temporary huts for storing building material is also capital expenditure because it helps to construct factory building.
- (ii) Amount paid for removal of stock to a new site is a revenue expenditure because stock is revenue in nature and any amount spent on it is also revenue in nature.
- (iii) Expenses incurred in connection with obtaining a license to start the business of ₹ 15,000 is a Capital Expenditure because without spending on it, we cannot start the business and it is a non recurring expenditure.

2011 - Dec [2] (a) For the year ending 31st December, 2011, the Sales, Purchases, Opening Stock and Closing Stock of a Trader was ₹ 5,00,000, ₹ 3,80,000, ₹ 65,000 and ₹ 52,000 respectively. Some goods were destroyed by fire (without realization of any value) during the year. If the Trader earned Gross Profit @ 25% on Sales for the year, calculate the value of goods destroyed by fire. **(3 marks)**

Answer :

Calculation of goods destroyed by fire

Opening Stock	65,000
(+) Purchases	<u>3,80,000</u>
	4,45,000
(-) Sales less Gross profit [5,00,000 –(25% of 5,00,000)]	3,75,000
(-) Closing Stock	<u>52,000</u>
Goods destroyed by fire	<u>18,000</u>

2012 - Dec [4] (c) Mr. X is owner of a Cinema Hall. He spent a heavy amount for complete renovation of the hall, for installation of air-condition machines and for sitting arrangement with cushion seats. As a result the revenue has been doubled. He also spent for few more doors for emergency exit.

State your opinion about the treatment of the entire expenditure. **(2 marks)**

Answer :

If due to any expenditure, the future benefits from the assets increases beyond its previously assessed standard of performance, then it should be capitalized. The size of the expenditure is not important for capitalizing the expenditure. In the present case, renovation expenses should be capitalized because it has enhanced the revenue generating capacity of the hall but expenditure for making more emergency exit does not enhance the revenue generating capacity of the hall, so it should be charged to revenue.

2012 - Dec [6] (b) The total of debit side of the Trial Balance of Lotus Stores as at 31.03.2012 is ₹ 3,65,000 and that of the credit side is ₹ 2,26,000.

After checking, the following mistakes were discovered:

Items of account	Correct figures (as it should be) (₹)	Figures as it appears in the Trial Balance (₹)
Opening stock	15,000	10,000
Rent and rates	36,000	63,000
Sundry creditors	81,000	18,000
Sundry debtors	1,04,000	1,58,000

Ascertain the correct total of the Trial Balance. **(5 marks)**

Answer :

**In the books of Lotus Stores calculation of correct
Total of Trial Balance**

Particulars	Dr.	Cr.
Total of Trial Balance as per on 31.03.12	3,65,000	2,26,000
<i>Add:</i> under statement of op. stock	5,000	—
<i>Less:</i> over statement of Rent & Rates	27,000	—
<i>Add:</i> under statement of sundry creditors	—	63,000
<i>Less:</i> over statement of sundry debtors	54,000	—
Correct Total	<u>2,89,000</u>	<u>2,89,000</u>

2013 - June [4] (a) State whether the following items are in the nature of Capital, Revenue and/or Deferred Revenue Expenditure:

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- (i) Expenditure on special advertising campaign ₹ 66,000; suppose the advantage will be received for six years.
- (ii) An amount of ₹ 8,000 spent as legal charges for abuse of Trade Mark.
- (iii) Legal charges of ₹ 15,000 incurred for raising loan.
- (iv) Share issue expenses ₹ 5,000.
- (v) Freight charges on a new machine ₹ 1,500 and erection charges ₹ 1,800 for that machine. **(1 × 5 = 5 marks)**

Answer:

- (i) As per Para 56 of AS 26, the expenditure incurred on intangible items would have to expense off when they are incurred. So, the Advertisement Expenses is not carried forward to the next year and the full amount is shown in the Profit & Loss A/c. So, ₹ 66,000 consider for revenue expenditure.
- (ii) Revenue expenditure ₹ 8,000
- (iii) Capital expenditure ₹ 15,000
- (iv) Capital expenditure ₹ 5,000
- (v) Capital expenditure = 1,500 + 1,800 = ₹ 3,300.

2013 - Dec [1] {C} Answer the following questions (give workings wherever required):

- (i) A trader acquired furniture & fittings for ₹ 10,000 but included the same in purchase account. He paid ₹ 5,000 to a supplier which was omitted to be recorded in the books. State the types of errors and pass journal entries to rectify the errors.
- (iii) The company maintains 10% of debtors as provision towards bad debts. It has routed all bad debts through the provision account. The opening balance of provision as on 01.04.2012 was ₹ 68,000. The closing provision i.e. on 31st March, 2013 was ₹ 92,000. Bad debts written off debited to provision account was ₹ 28,000. How much should be debited to Profit & Loss Account towards provision for doubtful debts for the year ended 31st March, 2013?

(2 marks each)

Answer:

- (i) The first error is **error of principle**. The capital expenditure has been claimed as revenue expenditure. The second one is, **error of omission**.

The Journal Entries are:

Particulars		₹	₹
Furniture & Fittings A/c	Dr.	10,000	10,000
To Purchase A/c			
[Being error in purchase A/c being rectified]			
Sundry Creditors A/c	Dr.	5,000	5,000
To Cash A/c			
[Being the omission to record the transaction now being recorded]			

(iii) Provision for bad and doubtful debts account

Date	Particulars	₹	Date	Particulars	₹
31.03.2013	To Sundry Debtors	28,000	01.04.2012	By Balance b/d	68,000
31.03.2013	To Balance c/d	92,000	31.03.2013	By P & L A/c	52,000
		1,20,000			1,20,000

2013 - Dec [6] (b) State with reason whether the followings are capital or revenue expenditure:

- (i) Freight charges of ₹ 12,000 incurred for machinery purchased for ₹ 2,00,000.
- (ii) ₹ 90,000 being expenditure incurred for well equipped labour welfare centre.
- (iii) Compensation of ₹ 1,50,000 each paid to three employees who were retrenched.
- (iv) Purchase of TV set for ₹ 30,000 to be installed in the reception hall.

(1 x 4 = 4 marks)

Answer:

- (i) Expenditure incurred towards freight charges for bringing the machinery to the location and till regular production is capital expenditure. Hence, the freight charge is to be capitalized.
- (ii) Labour welfare centre is a permanent addition and therefore a capital expenditure.
- (iii) Compensation to retrenched employees will not bring any permanent benefit and hence is revenue expenditure.
- (iv) Television set purchased is a capital expenditure unless the person acquiring the same is a dealer of television sets.

2014 - Dec [2] Answer the question:

- (b) Pass necessary journal entries to rectify the following errors assuming that the errors were detected after the preparation of final accounts:
- Return inward book was undercast by ₹ 18,000.
 - Goods purchased for proprietor's use for ₹ 10,000 debited to purchase account.
 - ₹ 5,200 paid for freight on machinery was debited to freight account.
 - No adjustment entry was passed for an amount of ₹ 15,000 relating to outstanding rent.
 - Furniture of ₹ 13,000 purchased from Chandra Furniture House was entered in purchase book.
 - ₹ 10,000 received from Mohan has been credited to Sohan.

(4 marks)

Answer:

		₹	₹
(i) Profit & Loss Adjustment A/c	Dr.	18,000	
To Suspense A/c			18,000
(Under cash of return inward book rectified.)			
(ii) Capital A/c	Dr.	10,000	
To Profit & Loss Adjustment A/c			10,000
(Drawing rectified.)			
(iii) Machinery A/c	Dr.	5,200	
To Profit & Loss Adjustment A/c			5,200
(Wrong debit to freight A/c now rectified.)			
(iv) Profit & Loss Adjustment A/c	Dr.	15,000	
To Outstanding Rent A/c			15,000
(Adjustment entry for outstanding rent passed.)			
(v) Furniture A/c	Dr.	13,000	
To Profit & Loss Adjustment A/c			13,000
(Furniture wrongly entered in purchase book now rectified)			
(vi) Sohan's A/c	Dr.	10,000	
To Mohan's A/c			10,000
(Wrong credit to Sohan's A/c rectified.)			

2015 - June [2] Answer the question:

(a) Journalise the following transactions in the books of SHIVA.

- 01.05.2015 — Started business with ₹ 5,00,000 of which 50% amount was borrowed from SBI and 20% amount was borrowed from his sister Patta.
- 05.05.2015 — Purchased goods from Chinu Mart worth ₹ 1,60,000 at 25% trade discount and 40% amount paid in cash.
- 08.05.2015 — Sold goods to Satish ₹ 60,000 at 20% trade discount and received $\frac{1}{4}$ amount in cash.
- 15.05.2015 — Paid to Chinu Mart ₹ 69,500 in full settlement of A/c.

(4 marks)

Answer:

Journal of SHIVA

Date	Particulars	L. F.	Amount ₹	Amount ₹
1.5.15	Cash A/c Dr. To Capital A/c To Loan from Patta A/c To Loan from SBI A/c (Being business started)		5,00,000	1,50,000 1,00,000 2,50,000
5.5.15	Purchases A/c Dr. To Cash A/c To Chinu Mart A/c (Being goods purchased and trade discount received)		1,20,000	48,000 72,000
8.5.15	Satish A/c Dr. Cash A/c Dr. To Sales (Being goods sold and trade discount allowed)		36,000 12,000	48,000

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15.5.15	Chinu Mart A/c To Cash A/c To Discount A/c (Being payment made to Chinu Mart in full settlement of his account)	Dr.	72,000	69,500 2,500
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2015 - Dec [2] Answer the question.

(a) Trial Balance of ANKIT LTD. failed to agree and the difference was put into Suspense Account pending investigation which discovered the following:

- (i) Discount received ₹ 1,320 had been debited to Discount allowed as ₹ 132.
- (ii) Goods of the value of ₹ 200 returned by Kishan were entered in the Sales Day Book and posted therefrom to the credit of Krishan as ₹ 20.
- (iii) A credit purchase of ₹ 500 from N. Kumar was recorded as sale to M. Kumar for ₹ 50.
- (iv) A credit sale of machine of P. Dass for ₹ 600 recorded through Sales Day Book as sale to C. Dass for ₹ 60.

Required:

Pass the Rectifying Entries in the Book of Ankit Ltd.

(4 marks)**Answer:**

**In the books of ANKIT LTD.
Journal Entries**

(i)	Suspense A/c To Discount received To Discount allowed (Being wrong debit to discount allowed commission of recording discount received, now rectified)	Dr.	1,452	1,320 132
(ii)	Krishan A/c Sales A/c Sales Return A/c	Dr. Dr. Dr.	20 200 200	

	To Kishan A/c To Sales A/c (Being sales returns recorded as sale with wrong amount and wrong posting therefrom, now rectified)		200 220
(iii)	Sales A/c Dr. Purchase A/c Dr. To N. Kumar To M. Kumar (Being the credit purchase recorded as sale, now rectified)	50 500	500 50
(iv)	Sales A/c Dr. P. Dass A/c Dr. To Machinery To C. Dass (Being the credit sale of machine recorded as sale, now rectified)	60 600	600 60

2015 - Dec [5] Answer the question.

- (a) MILTON LTD. sold goods worth ₹ 1,00,000 to NARMADA LTD. Narmada Ltd. asked for discount of ₹ 16,000 which was agreed by Milton Ltd. The sale was effected and Goods despatched. After receiving, Goods Worth ₹ 14,000 was found defective, which they returned immediately. They made the payment of ₹ 70,000 to Milton Ltd. The accountant of Milton Ltd. booked the Sales for ₹ 70,000.

Discuss whether the accounting entry passed by the accountant of the company is correct? **(4 marks)**

Answer:

The accounting entry passed by the accountant of the company is incorrect as it does not depict the original transaction. Sales should be shown at the gross amount and thereafter, entry of sales return should be passed.

The goods returned cost 14,000 on which discount was availed which needs to be reversed.

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$$\text{Discount} = \frac{14,000 \times 16,000}{1,00,000}$$

$$= 2,240$$

2016 - June [3] (a) The trial balance of M/s SEWADA & CO., on 31st March, 2016 did not agree. In order to close the books, the accountant placed the difference for ₹ 12,385 (Dr.) to Suspense Account for necessary adjustments in the next period. On 30th April, 2016 the following errors, arising in 2015-16 were detected:

- (i) ₹ 1,000 allowed as cash discount to a trade debtor was not debited to the discount account.
- (ii) Credit sale of ₹ 4,850 was posted to the credit of the customer's account as ₹ 4,535.
- (iii) Machinery purchased for ₹ 50,000 in cash was posted to the Purchases Account in the ledger.
- (iv) Sales Book was overcast by ₹ 2,000 in February, 2016.

Required:

- (a) Pass the necessary Journal Entries to rectify these errors.
- (b) Prepare suspense account in the book of SEWADA & CO.

(5+2 = 7 marks)**Answer :**

(a)

Date	Particulars	Dr. (₹)	Cr. (₹)
2016 April 30	P & L Adjustment A/c To Suspense A/c (Being discount allowed not posted to discount A/c, now rectified)	1,000	1,000
April 30	Customer's A/c To Suspense A/c (Being credit sale of ₹ 4,850 wrongly posted to the credit of customer's a/c, as ₹ 4,535, now rectified)	9,385	9,385
April 30	Machinery A/c To P & L Adjustment A/c (Being machinery purchased a/c, now rectified)	50,000	50,000

April 30	P & L Adjustment A/c To Suspense A/c (Being sales day book overcast, now rectified)	2,000	2,000
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Suspense A/c

Date	Particulars	₹	Date	Particulars	₹
2016 April 1	To Balance b/d	12,385	2016 April 30	By P & L Adj. A/c	1,000
			April 30	By Customer A/c	9,385
			April 30	By P & L Adjustment	2,000
		12,385			12,385

2017 - June [2] (b) The Trial Balance of a concern has agreed but the following mistakes were discovered after the preparation of Final Accounts.

- (i) No adjustment entry was passed for an amount of ₹ 2,000 relating to outstanding rent.
- (ii) Purchase book was overcast by ₹ 1,000.
- (iii) ₹ 4,000 depreciation of Machinery has been omitted to be recorded in the book.
- (iv) ₹ 600 paid for purchase of stationary has been debited to Purchase A/c.
- (v) Sales books was overcast by ₹ 1,000.
- (vi) ₹ 5,000 received in respect of Book Debt had been credited to Sales A/c.

Show the effect of the above errors in Profit and Loss Account & Balance Sheet. **(6 marks)**

5.22**Solved Scanner CMA Inter Gr. I Paper 5 (New)****Answer:****Effects of the errors in Profit and Loss A/c and Balance Sheet**

Profit and Loss A/c	Balance Sheet
(a) Profit was overstated by ₹ 2,000	(a) Capital was also overstated by ₹ 2,000 and outstanding Liability was understated by 2,000.
(b) Gross profit was under stated by ₹ 1,000 and also the Net Profit.	(b) Capital was understated by ₹ 1,000.
(c) Net Profit was overstated by ₹ 4,000.	(c) Machinery was overstated by ₹ 4,000 and so the Capital A/c was also overstated by ₹ 4,000.
(d) No effect on Net Profit.	(d) No effect in Balance Sheet.
(e) Gross Profit & Net Profit were overstated by ₹ 1,000.	(e) Capital was overstated by ₹ 1,000.
(f) Gross Profit & Net Profit were overstated by ₹ 5,000.	(f) Capital & Sundry Debtors were overstated by ₹ 5,000.

2017 - June [3] (a) Khetan Ltd. has received two lakh subscriptions during the current year under its new scheme whereby customers are required to pay a sum of ₹ 4,500 for which they will be entitled to receive a magazine for a period of 3 years. Khetan wants to treat the entire amount as revenue for current year. Comment. **(3 marks)**

(b) Alex. Ltd. intends to set up a solar plant. Alex Ltd. has acquired a dilapidated factory, having an area of 7500 acres at a cost of ₹ 70,000 per acre. Alex Ltd. has incurred ₹ 50,00,000 on demolishing the old factory building thereon. A sum of ₹ 43,57,500 (including 5% Sales Tax) was realized from sale of material salvaged from the site. Alex Ltd. also incurred Stamp Duty and Registration Charges of 5% of Land Value, paid Legal and Consultancy Charges ₹ 5,00,000 for land acquisition and incurred ₹ 2,00,000 on Title Guarantee Insurance. Compute the value of land acquired. **(6 marks)**

Answer:

(a) As illustrated in AS 9 'Revenue Recognition', revenue received or billed should be deferred and recognised either on a straight line basis over time or, where the items delivered vary in value from period to period,

revenue should be based on the sales value of the item delivered in relation to the total sales value of all items covered by the subscription. Accordingly, in the given case the accounting treatment adopted by Khetan Ltd. to treat the entire amount as revenue for the current year is not in accordance with AS 9. The revenue should be recognized on a straight line basis over the period of 3 years.

Answer:

(b) Cost of Land acquired (7500 × 70,000)	=	5,250 lacs
<i>Add:</i> Demolishing Cost	=	50 lacs
<i>Less:</i> Salvage Value of Material (43,57,500×100/105)	=	41.50 lacs
<i>Add:</i> Stamp Duty & Valuation (5,250 × 5%)	=	262.50 lacs
<i>Add:</i> Legal & Consultancy Charge	=	5 lacs
<i>Add:</i> Title Guarantee Insurance	=	<u>2 lacs</u>
Value of Land	=	<u>5,528 lacs</u>

2017 - Dec [4] (b) The Trial Balance of a concern has agreed but the following mistakes were discovered after the preparation of final Accounts.

- (i) No adjustment entry was passed for an amount of ₹ 2,000 relating to outstanding rent.
- (ii) Purchase book was overcast by ₹ 1,000.
- (iii) ₹ 4,000 depreciation of Machinery has been omitted to be recorded in the book.
- (iv) ₹ 600 paid for purchase of stationary has been debited to Purchase A/c.
- (v) Sales books was overcast by ₹ 1,000.
- (vi) ₹ 5,000 received in respect of Book Debt had been credited to Sales A/c.

Show the effect of the above errors in Profit and Loss Account & Balance Sheet. **(6 marks)**

