

1 Mark Questions

Q. 1. Accounting records business transactions and events which are of financial nature. Is this a limitation of accounting?

Ans. Yes, it is a limitation of accounting because there are some events which impact business but are not recorded because they are not of financial nature.

Q. 2. Goods withdrawn by the proprietor for his own use have not been recorded in the books of account. Which accounting principle has not been followed?

Ans. Business Entity Principle.

Q. 3. An accountant always charges depreciation on fixed assets @ 20% p.a. Which principle is followed by the accountant?

Ans. Consistency Assumption.

Q. 4. Management creates provision for doubtful debts @ 5% on debtors every year based on its past experience. Name the two accounting principles followed in this process.

Ans. Consistency and Prudence.

Q. 5. The Accounts Manager of Pioneer Sports does not want to give previous year amounts, a practice followed by the firm for the past many years. Is it a good decision?

Ans. It is not a good decision because Consistency Concept is being ignored.

Q. 6. Realisation concept has been formulated to resolve the issues relating to revenue recognition. Do you agree?

Ans. Yes. The essence of Realisation Concept is timing of revenue recognition.

Q. 7. Do you think that invoice is a source document?

Ans. Yes.

Q. 8. Why contra entry in two column Cash Book is not posted into ledger?

Ans. When two column Cash Book is maintained, Cash and Bank Accounts are not maintained in the ledger. Therefore, such entries are not posted into ledger.

Q. 9. Imprest System of Petty Cash is used for easing the work of the Head Cashier. Do you agree?

Ans. Yes, it distributes the work of handling cash.

Q. 10. Cash Book is a principal book and not a subsidiary book. Do you agree?

Ans. No. Cash Book is a principal book and also subsidiary book.

Q. 11. Balance of Petty Cash is an asset for the firm. Do you agree?

Ans. Yes, it is an asset.

Q. 12. Profit is earned on sale of fixed asset, what should be the accounting treatment of it?

Ans. Profit on sale of fixed asset is a capital profit and, therefore, should be transferred to Capital Reserve.

Q. 13. Which account should be debited for creating provision for doubtful debts?

Ans. Profit & Loss Account should be debited for provision for doubtful debts.

Q. 14. Drawings by the proprietor in cash is debited to Drawings Account and credited to Cash Account. Is the accounting entry correct?

Ans. Yes, it is correct.

Q. 15. At the time of preparing the financial statements, Drawings Account is transferred to Capital Account. Is it correct?

Ans. Yes, it is correct.

Q. 16. The accountant feels that since Sales Book is maintained, there is no need to open Sales Account. Is he correct in his views?

Ans. No, he is not correct because Sales Book records only credit sales whereas Sales Account records both cash and credit sales.

Q. 17. An accountant has debited the Purchases Account by the amount of furniture purchased for office use. Which error has been committed by the accountant?

Ans. Error of Principle.

Q. 18. Do you agree that Liabilities side of the Balance Sheet represents credit balances?

Ans. Yes. Liability Accounts always have credit balances.

Q. 19. Accrued incomes and income due but not received are two different terms. Do you agree?

Ans. No.

Q. 20. Closing stock appearing in the Trial Balance is shown in the Trading Account only. Is it correct?

Ans. No, it is shown in the Balance Sheet.

Q. 21. Prepaid expenses are assets of the business. Is it correct?

Ans. Yes.

3 Marks Questions

Q. 1. Rakesh started his business of retail trade at a moderate level on October 1, 2022. He desires that he should prepare first Profit & Loss Account and Balance Sheet on March 31, 2023 and thereafter every year on March 31. You have to appraise his decision and ascertain whether his decision is justified.

Ans. Rakesh has made a correct decision. By doing so he has followed the fundamental accounting concept of Going Concern and also Periodicity Principle.

Q. 2. Sunil is an architect and has got a contract in which he has received an advance fee of ₹ 1,00,000. He has shown it as his income for the year. Is he correct in doing so?

Ans. Sunil is not correct in treating it as his income because he has not rendered the service yet. It means he has not earned the income. It should be accounted as income received in advance, *i.e.*, liability.

Q. 3. Madan, a businessman has employed Sujit and has estimated his value at ₹ 10,00,000. He has accounted it as an asset in the books of account. Is he correct in doing so?

Ans. No, he is not correct because in accounting only those transactions and events are recorded which can be measured in terms of money. Value of manpower cannot be measured in money terms and, therefore, should not be accounted.

- Q. 4.** Inderpal has shown interest earned and interest paid at net amount in the Profit & Loss Account. Is he correct in doing so?
- Ans.** No, he is not correct because Full Disclosure Principle is not followed. Interest earned is an income whereas interest paid is an expense. By netting it, correct expense and correct income is not shown in the Profit & Loss Account.
- Q. 5.** Shivreet has stationery stock amounting to ₹ 500 as at the end of the financial year. His accountant has written it off to Profit & Loss Account. But, Shivreet has asked him to show it as stock of stationery. Is he right in doing so?
- Ans.** Accounting is guided by the Materiality Concept. Since the amount of stationery stock is not material, it should be written off to Profit & Loss Account. Materiality Concept requires that a transaction having insignificant effect should be ignored. Stock of stationery being not material, it is better to write it off.
- Q. 6.** Anuj has prepared the accounts showing closing stock at higher value by valuing them at Market Price so that higher profits are shown, which in turn will help getting better loan facility from the bank. Is it in line with the good business practices?
- Ans.** The action of Anuj is not in line with good business practices. Besides, it amounts to misleading the bank. The stock should be valued at lower of cost or net realisable value (market value) following the Prudence Concept.
- Q. 7.** Due to a major loss in the current year, the accountant of the firm has not charged depreciation on fixed tangible assets.
Whether his decision not to charge depreciation is correct?
What will be the impact of the decision on financial statements?
- Ans.** Depreciation is the process of allocating cost of fixed assets over its estimated useful life. Therefore, depreciation being an expense should be debited to the Profit & Loss Account.
Impact of not charging depreciation on fixed assets will result in higher profit or lower loss. It will also result in showing fixed assets in the Balance Sheet at higher value.
- Q. 8.** Proprietor of the firm has taken goods for his personal use. The accountant has accounted it as sale in the books of account. Is he correct in his accounting?
- Ans.** No, he is not correct in his accounting. The goods taken by the proprietor should be debited to Drawings Account for the reason that the goods taken for personal use do not have an element of profit.
- Q. 9.** The accountant of a small firm feels that incomplete records system should not be followed. In spite of that it is easy to maintain accounts on Single Entry basis. The accountant suggests that Double Entry Accounting System should be followed. Is the suggestion correct? Give reasons.
- Ans.** The suggestion given by the accountant is correct.
Double Entry System gives better and reliable results. Under the incomplete records system, all the accounts are not maintained and, therefore, Trial Balance cannot be prepared. As a result, locating errors becomes difficult.

4 Marks Questions

Q. 1. Hariharan had started a new mid-sized business. He being new to accounting sought advice from a chartered accountant on maintenance of accounts. He was advised that he should follow Double Entry System of Accounting maintaining accounts on accrual basis. Some of his friends advised him to maintain accounts on Cash Basis of Accounting. He decided to follow the advice of the chartered accountant. You have to appraise, judge and justify whether the decision of Shri Hariharan is correct.

Ans. The decision of Hariharan to maintain accounts on Double Entry System of Accounting following Accrual Concept is correct because when accounts are maintained on accrual-based double entry system of accounting, correct income, expenditure, liabilities and assets are shown in the financial statements. It is important to know the correct income, expenditure, liabilities and assets as it enables the businessman to plan his finances. Had he followed Cash Basis of Accounting, the business would not have shown correct financial performance and financial position as credit transactions would not have been recorded.

Q. 2. Avtar established a small business and has not maintained regular books and records his transactions through accounting equation. Whether his decision is correct? What is the effect thereof?

Ans. Recording the transactions by means of accounting equation is that the accounts are being maintained on Double Entry System of Accounting. In effect, Avtar will know what his liabilities are and what are the assets owned by him. Since his business is small and presuming that the accounts are maintained by the proprietor himself, the decision seems to be correct. Had he maintained the accounts maintaining complete set of books, it would have required specialised knowledge, besides it being expensive and time-consuming.

Q. 3. A firm has voluminous transactions and, therefore, it records its transactions in Cash Book, Journal and other Subsidiary Books. The firm follows financial year for its accounts. It prepares its financial statements by April 15 every year. What does this indicate?

Ans. It shows that the accounting staff is working as a team. As a result, in spite of many individuals working on separate books of account, the financial statements are prepared within a short period after year-end.

It shows the value of team spirit, which means improved and synchronised performance by the accounting staff.

Q. 4. An accountant of a large-sized firm records all the transactions in a Journal instead of maintaining Subsidiary Books. His views on this are that it will result in better control and also large team of accountants will not be required. Whether his decision is correct?

Ans. No, his decision is not correct because of the following reasons:

- (i) It ignores the concept of division of work and specialisation;

- (ii) Maintaining a Journal book alone will make the book unwieldy and difficult to handle;
- (iii) Posting will become a complicated and time-consuming process;
- (iv) Difficult to prepare the Trial Balance and locate the errors, if any;
- (v) It leads to possibilities of manipulations and frauds as tracking of Cash and Bank will become difficult.

Q. 5. The Chief Accountant of Rana Motors has taken a decision that adjustments for outstanding expenses and prepaid expenses of the current year should not be made while preparing the financial statements.

- (i) Whether his decision is correct?
- (ii) Which accounting concepts are not being followed?

Ans. (i) The decision of the Chief Accountant is not correct.

- (ii) The decision is not correct because the fundamental accounting concept, *i.e.*, Accrual Concept and Matching Concept is being ignored. As a result, Profit & Loss Account will not show correct profit earned or loss incurred. Also, Balance Sheet will not show correct financial position.

Q. 6. The Chief Accountant of Grand Marketing has taken a decision that adjustments for accrued incomes and incomes received in advance of the current year should not be adjusted while preparing the financial statements.

- (i) Whether his decision is correct?
- (ii) Which accounting concepts are not being followed?

Ans. (i) The decision of the Chief Accountant is not correct.

- (ii) The decision is not correct because the fundamental accounting concept, *i.e.*, Accrual Concept and Matching Concept, is not being followed. In the case of accrued income being not accounted in the current year, cost will be accounted whereas income will not be accounted. Similarly, in the case of incomes received in advance, income will be accounted whereas cost will be accounted in the next year. Thus, Profit & Loss Account will not show correct profit earned or loss incurred. Also, Balance Sheet will not show correct financial position.

Q. 7. In spite of all efforts by the accounting team for the agreement of Trial Balance, the difference is placed temporarily in Miscellaneous Expense Account.

Whether the decision is correct? If not, name the account in which the difference should have been placed explaining the nature of the account?

Ans. The difference in Trial Balance has been wrongly placed in Miscellaneous Expenses Account. Thus, the decision is not correct. The difference should have been placed in an account titled Suspense Account. Suspense Account is neither an asset account, nor a liability account. It depends on whether the balance in Suspense Account is debit or credit, it is placed accordingly in the Balance Sheet.