Short Answers

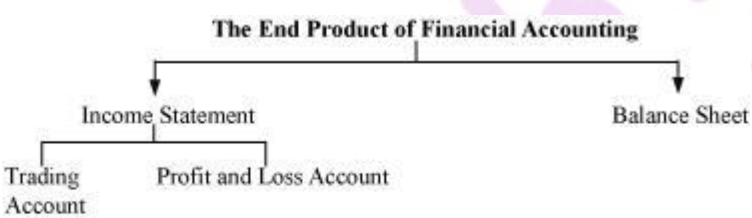
1. Define Accounting

Accounting is defined as the systematic process of identifying, recording, classifying, summarising, interpreting and communicating information about financial transactions to the users of the accounting information such as the owners, government, investors, creditors etc.

It provides the following information:

1. Resources available in the firm.
2. The means employed to finance those resources
3. Results achieved by using those resources.

2. State the end product of financial accounting.



The end product of Financial Accounting are:

1. Income statements also called as Trading and/or Profit and Loss Account: An Income statement including the Trading and Profit and Loss Account, determines the financial results of a business in terms of gross/net profit or loss.

2. Balance Sheet: A balance sheet depicts the true financial position of a business providing information like assets and liabilities of a business firm, to the users of accounting information namely, owners, investors, creditors, government.

3. Enumerate main objectives of accounting.

The main objectives of accounting are given below:

1. To keep a systematic record of all the financial transactions.

2. Determining the profit earned or loss accrued during an accounting period. A profit and loss account will show the same.

3. To determine the financial position of the business at the end of each accounting period by preparing a balance sheet.

4. Assisting management in decision making, effective control, forecasting, etc.

5. Assessing the progress, growth and trend of business from year to year.

6. To detect and prevent frauds and errors.

7. Communicating information to various users.

8. Following legal bindings and prohibition.

4. Who are the users of accounting information?

Two types of users are there for accounting information. They are:

1. Internal Users
2. External Users

Internal Users include management, employee and owners. While external users consist of investors, creditors, government, public and customers.

5. State the nature of accounting information required by long-term lenders?

The following are the few of the accounting information that is required by long term lenders:

1, Repaying capacity of business
2. Profitability
3. Operational deficiencies
4. Potential growth of business
5. Liquidity

6. Who are the external users of information?

External users of information are the individual or the organisations having a direct or indirect interest in the business firm. Some of the examples of external users of information are government, suppliers, banks, labour unions, tax authorities, etc.

7. Enumerate information needs of management.

The information needs of management are as follows:

1. Gather data that assist in decision making and planning.
2. To determine the soundness of business by preparing reports on funds, profits and costs.
3. To compare current financial statement with past statements of own and of other similar business to determine the operating efficiency of the business.

8. Give any three examples of revenues

Three examples of revenues are:

1. Dividends
2. Sales Revenue
3. Interest Received

9. Distinguish between debtors and creditors; profit and gain

Following are some of the differences between Debtors and Creditors

Basis of Comparison	Debtors	Creditors
Meaning	Persons or organisations that are liable to pay money to the firm are called debtors	Persons or organisations who receive money from the firm are called creditors
Shown in	The balance sheet as assets	The balance sheet as liabilities

Following are points of difference between profit and gain

Basis of Comparison	Profit	Gain
Meaning	Profit is the sum of total income minus the total expenses	An economic benefit that is derived by disposing of an asset
Generation	Within the usual business operation	It is generated outside of the business operation

10. ‘Accounting information should be comparable’. Do you agree with this statement? Give two reasons.

Accounting information should always be comparable because::

1. It helps in inter-firm comparison and to assess the viability and advantage of policies adopted by other firms.
2. Helps in intra-firm comparisons that determine the changes and results of various policies and plans adopted in different time periods. This also helps to figure out the errors, determine the growth and assist in the planning.

11. If the accounting information is not clearly presented, which of the qualitative characteristic of accounting information is violated?

Qualitative characteristics like comparability, reliability and understandability, are violated if the accounting information is not clearly presented. This is because if the accounting information is not clearly presented, then the meaningful comparison may not be possible, as the data is not trustworthy, which may lead to faulty conclusions.

12. “The role of accounting has changed over the period of time”- Do you agree? Explain.

The role of accounting is ever-changing in nature. In earlier times, accounting was concerned with the recording of the financial events, i.e. record-keeping activity; nowadays, accounting is done with the rationale of not only maintaining records but also providing an information system that provides important and relevant information to various accounting users. The need for this change is brought over due to the ever-changing and dynamic business environment, which is more competitive in nature now than it was in earlier times. Further, there are various relevant activities like decision making, forecasting, comparison, and evaluation that brought about these changes in the role of accounting.

13. Giving examples, explain each of the following accounting terms: • Fixed assets • Revenue • Expenses • Short-term liability • Capital

Fixed assets: These are held for the long term and increase the profit earning capacity of the business, over various accounting periods. Fixed assets are not for sale; for example, land, machinery, buildings, etc.

Gains: Gains arise from irregular activities or non-recurring transactions outside the regular activities of a business; for example, profit on the sale of fixed assets, appreciation in the value of an asset, profit on the sale of an investment, etc.

Profit: This refers to the excess of revenue over the expense. It can be categorised into gross profit or net profit. Net profit gets added to the capital of the owner, which increases the owner’s capital. For example, goods sold above their cost.

Short term liabilities: These are liabilities that are incurred with an intention to be paid or are payable within a year; for example, bank overdraft creditors, outstanding wages, bills payable, short-term loans, etc.

Revenue: It refers to the amount received from day to day activities of a business, viz. amount received from sales of goods and services to customers; rent received, the commission received, dividends, royalties, interest received, etc.

Expenses: These are costs that are incurred to maintain the profitability of the business, like depreciation, rent, wages, interest, salaries, etc. These help in maintaining production, business operations and generate revenue for the business.

Capital: It refers to the amount invested by the owner of a firm. It can be in the form of cash or asset. It is treated as an obligation of the business towards the owner of the firm. As business is treated separate or distinct from the owner. Capital = Assets − Liabilities.

14. Define revenues and expenses

Revenues− It refers to the amount received from day to day activities of the business, like sale proceeds of goods and rendering services to the customers. Rent received and interest received are also considered as revenue, as they are regular in nature and concerned with day to day activities. Revenues appear on the credit side of the profit and loss account or trading account.

Expenses− It refers to those costs that are incurred to earn revenue for the business. Expenses help in maintaining the profitability of the business. It is the amount spent to meet the short-term needs of the business. Expenses appear on the debit side of the profit and loss account or trading account. For example, wages, salaries paid, rent paid, outstanding wages, etc.

15. What is the primary reason for the business students and others to familiarise themselves with the accounting discipline?

Any monetary transaction must be recorded in such a manner that various accounting users are able to understand and interpret these results in the same manner without any ambiguity.

It is necessary for Business students and others to familiarise themselves with the accounting discipline for the following reasons given below:

1. Helps to learn the various aspects of accounting.

2. Gain knowledge on how to maintain books of accounts.

3. Helps in learning how to summarise accounting information.

4. With the knowledge, one can interpret the accounting information with relative accuracy.

Long Questions

1. What is accounting? Define its objectives.

Accounting is defined as the systematic process of identifying, recording, classifying, summarising, interpreting and communicating information about financial transactions to the users of the accounting information such as the owners, government, investors, creditors etc.

Objectives of Accounting:

1. Systematic recording of business transaction− It is necessary to maintain systematic records of every business transaction, as it is beyond human capacities to remember such large number of transactions. Skipping the record of any one of the transactions can lead to erroneous and faulty results.

2. Determining profit earned or loss incurred− Profit or Loss needs to be calculated in order to determine the net result at the end of an accounting period, trading and profit and loss account is prepared for that purpose. It provides information regarding the quantity of goods that have been purchased and sold, expenses incurred and amount earned during a financial year.

3. Determining the financial position of the firm− Only determining profit earned or loss incurred is not enough; a proprietor is also interested in knowing the financial position of his/her firm, i.e. the value of the assets, amount of liabilities owed, net increase or decrease in his/her capital. A balance sheet facilitates in determining the true financial position of the business.

4. Assisting management− Systematic accounting helps the management in effective decision making, better control on cash management policies, preparing budget and forecasting in a more efficient way.

5. Assessing the progress of the business− Accounting helps in assessing the progress of business from year to year, as accounting facilitates inter-firm as well as intra-firm comparison.

6. Detecting and preventing frauds and errors− It is essential to detect and prevent fraud and errors, mismanagement and wastage of the finance. Systematic recording helps in the easy detection and correction of frauds, errors and inefficiencies, if any.

7. Communicating accounting information to various users− An important step in the accounting process is to communicate financial and accounting information to various users including both internal and external users like owners, management, government, labour, tax authorities, etc. This assists the users to understand and interpret the accounting data in an appropriate and meaningful manner without any ambiguity.

2. Explain the factors which necessitated systematic accounting.

The following factors necessitated systematic accounting.

1. Only financial transactions are recorded− Events that are financial in nature should only be recorded in the books of accounts. For example, the salary of an employee is recorded in the books but his/her educational qualification is not recorded.
2. Transactions are recorded in monetary terms− Transactions which can be expressed in monetary terms are the ones which can be recorded in the books. For example, if a business has four machines and two buildings, then their monetary value is recorded in the books, i.e. two buildings costing Rs. 4, 00,000, four machines costing Rs. 1, 00,000. Thus the total value of assets is Rs. 5, 00,000.
3. Art of recording− Transactions should be recorded in the order of their occurrence.
4. Classification of transaction− Business transactions of similar nature are classified and posted under respective accounts. For example, transactions related to machinery will be posted in the Machinery Account.
5. Summarising Data− All business transactions are summarised in the form of Trial Balance, Trading Account, Profit and Loss Account and Balance Sheet that provides necessary information to end users.
6. Analysing and interpreting data− Systematic accounting records enable users to analyse and interpret the accounting data in the most appropriate manner. These accounting data and information are presented in the form of graphs, statements, charts that enhance to easy communication and understandability by various users. Moreover, these also facilitates in decision making and future predictions.

3. Describe the informational needs of external users.

There can be various external users of accounting who need accounting information for decision making, investment planning and for assessing the financial position of the business. Here are some of the external users of a business.

1. Banks and other financial institutions− Banks provide finance in the form of loans and advances to various businesses. Therefore, they need information regarding liquidity, creditworthiness, solvency and profitability to process loans.
2. Creditors− They are individuals and organisations to whom a business owes money on account of credit purchases of goods and receiving services; hence, the creditors require information about creditworthiness of the business.
3. Investors and potential investors: They are people or organisation that invest or are planning to invest in the business. Hence, in order to assess the viability and prospects of their investment, investors need information about profitability and solvency of the business.
4. Tax authorities: They need information about sales, revenues, profit and taxable income in order to determine various types of tax levied on the business.
5. Government: The government needs the information to determine national income, GDP, industrial growth, etc. The accounting information assists the government in the formulation of various policies and measures to address various economic problems like poverty, employment etc.
6. Researcher− Many research institutes like NGOs and other independent research institutions like CRISIL, stock exchanges, etc. undertake various research projects and these accounting information facilitates their research work.
7. Consumer− A business tries building up reputation among customers, which can be created by the supply of better quality products and post-sale services at reasonable and affordable prices. Business that has a transparent financial record, is assisting the customers to know the correct cost of production and accordingly assess the price charged by the business for its products. This helps in building rapport for the business.

8. Public− Public is always having a keen interest in knowing the proportion of the profit that the business spends on various public welfare schemes; for example, charitable hospitals, funding schools, etc. The same information is also revealed by the profit and loss account and balance sheet of the business which is published annually.

4. What do you mean by an asset and what are the different types of assets?

Any valuable thing that has a monetary value, which is owned by a business, is an asset. In other words, assets are the monetary values of the properties or the legal rights that are owned by business organisations.

Fixed Assets: Assets that are held for the long term and which increase the profit earning capacity and productive capacity of the business are called fixed assets. These assets are not for sale, for example, land, building, machinery, etc.

Current Assets− Assets that can be easily converted into cash or cash equivalents are called current assets. These are essential to run the day to day business activities; for example, cash, debtors, stock, etc.

Tangible Assets− Assets that have a physical existence, i.e., which can be seen and touched, are known as tangible assets; for example, car, furniture, building, etc.

Intangible Assets− These are assets that cannot be seen or touched, i.e. those assets that do not have any physical existence, are intangible assets; for example, goodwill, patents, trademark, etc.

Liquid Assets− Assets that are kept either as cash or cash equivalents are regarded as liquid assets. These can be converted into cash in a very short period of time; for example, cash, bills receivable etc.

Fictitious Assets− These are assets that have no tangible existence or realizable value but represents actual cash expenditure. The purpose of creating a fictitious asset is to account for expenses e.g. such as those incurred in starting a business. It cannot be placed under any normal account heading. These assets are written off as soon as possible against the firm's earnings. E.g. Discounts allowed on the issue of shares.

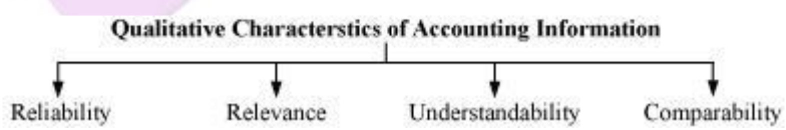
5. Explain the meaning of gain and profit. Distinguish between these two terms.

Profit: An excess of revenue over expenses is known as profit. It is normally categorised as gross profit or net profit. As it increases owner's capital it is added to the capital at the end of each accounting period. For example, goods costing Rs 2, 00,000 is sold at Rs 2,20,000, then the sale proceeds of Rs 2,20,000 is the revenue and 2,00,000 is the expense to generate this revenue. Hence, accounting profit of Rs 20,000 (i.e. Rs 2, 20,000 − Rs 2, 00,000) is the difference between the revenue and expense that is earned by the business.

Gain: Gain arises from irregular activities or non-recurring transactions. In other words, a gain is a result of transactions that are incidental to the business, other than operating transactions. For example, an old machinery of book value Rs 15,000 is sold at Rs 20,000. Hence, the gain is Rs 5,000 (i.e. Rs 20,000 − Rs 15,000). Here, the sale of the old machinery is an irregular activity; hence, this difference is termed as gain.

Thus, in other words the only difference between profit and gain is that profit is the excess of revenue over expense and gain arises from activities other than operating transactions.

6. Explain the qualitative characteristics of accounting information.



The following are the qualitative characteristics of accounting information:

1. Reliability: It means that the user can rely on the accounting information. All accounting information is verifiable and can be verified from the source document, *viz.* cash memos, bills, etc. Hence, all the available information should always be unbiased and free from any errors.

2. Relevance: The users of accounting information need relevant information for decision making, planning and predicting the future conditions. Hence, relevance means that essential and appropriate information should be easily and timely available and any irrelevant information should be avoided.

3. Understandability: Accounting information must be presented in such a way that every user is able to interpret the information in a meaningful and appropriate manner without facing any difficulty.

4. Comparability: This is the most important quality of accounting information. Comparability means accounting information of a current year can be comparable with that of the previous years. Comparability enables intra-firm and inter-firm comparison. It assists in assessing the outcomes of various policies and programmes adopted in different time horizons by the same or different businesses. Further, it helps to determine the growth and progress of the business over time and in comparison to other businesses.

7. Describe the role of accounting in the modern world.

The role of accounting has seen many changes over a period of time. In the modern world context, the role of accounting is not limited to record financial transactions but also to provide a basic framework for various decision making, providing relevant information to various users and assists in both short term and long term planning.

Here are some of the role of accounting in the modern world

1. Assisting the management: Management uses the accounting information for short term and long term planning of business activities. It also helps in predicting future conditions, preparing budgets and various control measures.

2. Comparative study: In the modern world, accounting information helps us to know the performance of the business by comparing the current year’s profit with that of the previous years and also with similar firms in the industry.

3. Substitute of memory: In today's world every business processes large number of transactions. It is beyond human capacity to memorise every transaction. Hence, it becomes essential to record transactions in the books of accounts.

4. Information to end user: Accounting plays an important role in recording, summarising and providing relevant and reliable information to its users, in the form of financial data that aids in decision making.