

Session 1

**CIMA C02 Fundamental of
Financial Accounting**

CIMA

**OVERVIEW OF FINANCIAL
ACCOUNTING**



Definitions of Accounting

- **Accounting** is the language of the business
- **AAA** defines accounting as the process of **identifying, measuring, and communicating** economic information to permit informed judgment and **decisions by the use of information**
- **AICPA** defines Accounting is a **services activity**. Its function is to provide **quantitative information primarily financial in nature**, about economic entities that is intended to be **useful in making economic decisions** in making reasoned choices among alternative courses of action.

MCQs 1

Accounting can be defined as the process of identifying, measuring and communicating economic information about an entity to a variety of users?

(a) True

(b) False

(a) True

MCQs 2

Which of the following does not describe accounting?

- (a) Language of business
- (b) Useful for decision making
- (c) Is an end rather than a mean to an end
- (d) Used by business, government, non-profit organizations and individuals

(c) Is an end rather than a mean to an end?

MCQs 3

Why should a business keep accounts?

- (a) To discover how well the business is doing
- (b) To record assets and liabilities
- (c) To help run the business efficiently
- (d) All of the above

(d) All of the above

Approaches and Objective of Accounting

□ Approaches of Accounting

American or Modern Approach

British or Conventional or English Approach

□ Objective/Aim/Purpose of Accounting

The major objective of accounting is to **provide useful information** to economic **decision maker**

MCQs 4

What is the main aim of accounting?

- (a) To record every financial transaction individually
- (b) To maintain ledger accounts for every transaction
- (c) To prepare a trial balance
- (d) To provide financial information to users of such information

(d) To provide financial information to users of such information

MCQs 5

Which of the following statements gives the best definition of the objective of accounting?

- (a) To provide useful information to users.
- (b) To record, categorise and summarise financial transactions.
- (c) To calculate the taxation due to the government.
- (d) To calculate the amount of dividend to pay to the shareholders.

(a) To provide useful information to users.

Forms of Accounting

- Just as two types of economic decisions, there are two types of accounting information
- **Financial Accounting and Management Accounting** often are describing two types of accounting information that are widely used business decisions

Financial Accounting

- ❖ Financial accounting can be described as the **recording, classification and summarizing** of monetary transactions of an entity by means of various **financial statements**, during and at the end of an accounting period
- ❖ In accordance with established concepts, principles, accounting standards and legal requirements, and their presentation

Financial Accounting (Cont...)

- ✓ Financial accountants, however, are usually concerned with **summarizing historical data**, often from the same basic records as management accountants but in a different way
- ✓ Financial Accounting information is used for so many purposes that it often is called “**General-Purpose Accounting**”
- ✓ End results of financial accounting are **Financial Statements**

Management Accounting

- Management accounting information is used to **assist the management** in its **operational and strategic planning**
- Management accountants produce information which is **forward-looking**, and used to prepare budgets and make decisions about the future activities of a business
- The most important role of Management accountants is to **set targets** in the form of budget or standards, **measure the actual performance** and then make variance

It is **specific purpose accounting**

MCQs 6

Financial statements differ from management accounts in that they?

- (a) Are prepared monthly for internal control purposes
- (b) Contain details of costs incurred in manufacturing
- (c) Are summarized and prepared mainly for external users of accounting information
- (d) Provide information to enable the trial balance to be prepared

(c) Are summarized and prepared mainly for external users of accounting information

MCQs 7

Which one of the following does not apply to the preparation of financial statements?

(a) They are prepared annually

(b) They provide a summary of the outcome of financial transactions

(c) They are prepared mainly for external users of accounting information

(d) They are prepared to show the detailed costs of manufacturing and trading

(d) They are prepared to show the detailed costs of manufacturing and trading

MCQs 8

The main aim of financial accounting is to?

- (a) Record all transactions in the books of accounts
- (b) Provide management with detailed analyses of costs
- (c) Present the financial results of the organisation by means of recognised statements
- (d) Calculate profit

(c) Present the financial results of the organisation by means of recognised statements

MCQs 9

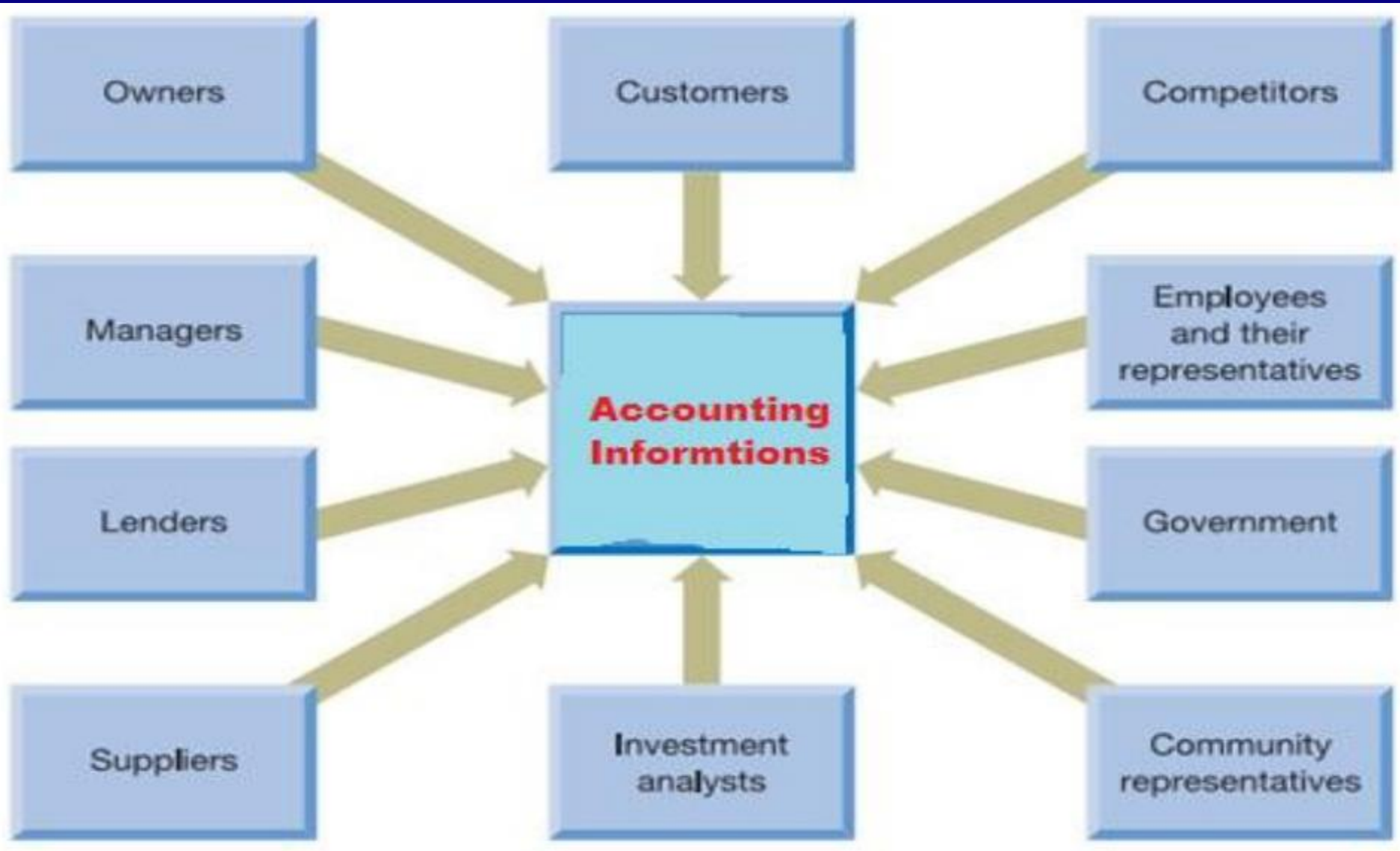
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(c) Are summarised and prepared mainly for external users of accounting information

Users of Accounting Information

- Accounting information is needed by two sets of parties, which are **internal and external**
- Internal users are associated with **management** of the organization
- The external users consist of several **explicit groups** which are outside the organization and has interest (financial and non-financial) in an organization



Internal Users of Accounting Information

- Internal users of accounting are parties who have directly connection with a company
- Management accounting primarily use by internal parties or users
- As well as financial accounting is also use for internal purpose

External Users of Accounting Information

- ❑ External users of accounting are potential investors, customers, banks, government agencies and other parties who are outside the business but need financial information about the business for a **diverse number of reasons**
- ❑ **The Investor Group:** They require information concerning the performance of the company measured in terms of its **profitability (dividend)**. They are also interested in the **corporate social responsibilities (CSR)** of the company

External Users of Accounting Information (Cont...)

- ❑ **The lender group:** This group includes both existing and potential providers of **secured or unsecured, long- or short-term loan finance**. They require information concerning the **ability of the organization to repay the interest** on such loans as they fall due; and the longer-term growth and stability of the organization to ensure that it is capable of repaying the **principal amount** at the agreed time.

External Users of Accounting Information (Cont...)

- ❑ **The employee group:** They require information concerning the ability of the organization to **pay wages and pensions** today. In addition, they are interested in the future of the organization because this will affect their **job security** and future prospects within the organization

External Users of Accounting Information (Cont...)

- ❑ **The Business Contact or Trade Contact Group:** This group includes **customers and suppliers** of the organization. Customers will be concerned to ensure that the organization has the ability to provide the **goods/services** requested and to continue to provide similar services in the future. Suppliers will wish to ensure that the organization will be capable of **paying for the goods/services supplied** when payment becomes due

External Users of Accounting Information (Cont...)

- ❑ **The Government:** This group includes taxation authorities, and other government agencies and departments. The taxation authorities will calculate the organization's **taxation** liability based upon the accounting reports it submits to them
- ❑ **The Public:** This group includes taxpayers, consumers and other community and special interest groups. They require information concerning the **policies of the organization** and how those policies affect the community. The public is increasingly interested in **environmental issues**

MCQs 10

External Users of Financial Accounting Information include all of the following except?

- (a) Investors
- (b) Labor Union
- (c) Line Manager
- (d) General Public

(c) Line Manager

MCQs 11

Internal users of accounting information include which of the following?

- (a) Company officers
- (b) Investors
- (c) Financial institutions
- (d) Competitors

(a) Company officers

MCQs 12

Which one of the following sentences does not explain the distinction between financial accounts and management accounts?

(a) Financial accounts are primarily for external users and management accounts are primarily for internal users

(b) Financial accounts are normally produced annually and management accounts are normally produced monthly

(c) Financial accounts are audited by an external auditor and management accounts do not normally have an external audit

(d) Financial accounts are more accurate than management accounts

(d) Financial accounts are more accurate than management accounts

MCQs 13

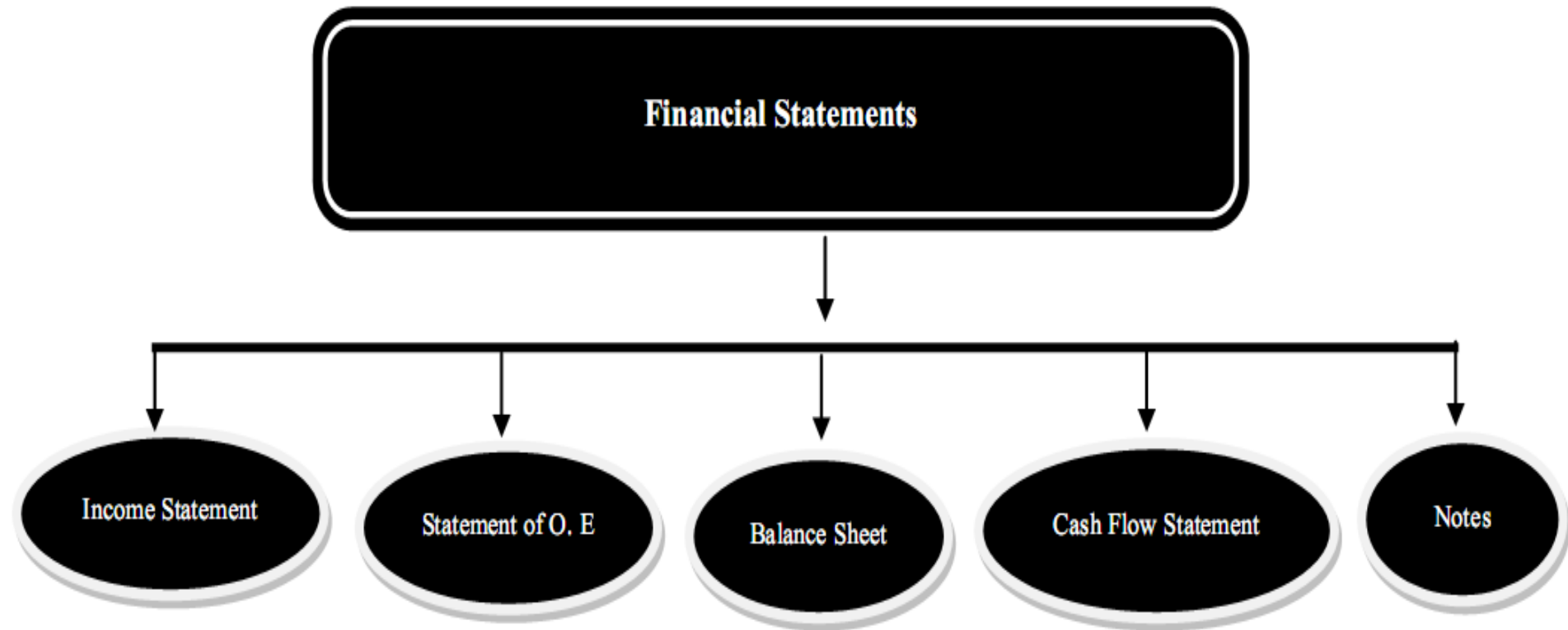
Which of the following are not the information requirement of equity investors?

- (a) Profitability
- (b) Performance
- (c) Dividends
- (d) Ability to repay loans

(d) Ability to repay loans

Financial Statements

End results of financial accounts are financial statements



Financial Statements (Cont...)

- ❖ According to IAS 1 Presentation of financial statements; a complete set of financial statements comprises:
 1. A statement of comprehensive income for the period
 2. A statement of changes in equity for the period
 3. A statement of financial position as at the end of the period
 4. A statement of cash flows for the period
 5. Notes, comprising a summary of significant accounting policies and other explanatory information

MCQs 14

Which of the following financial statements reports financial results as of a single date?

- (a) Balance Sheet
- (b) Income Statement
- (c) Statement of changes in equity
- (d) Statement of cash flows

(a) Balance Sheet

MCQs 15

Which of the following financial statements answers the question ‘How did the business perform’?

- (a) Balance Sheet
- (b) Income Statement
- (c) Statement of Owners’ Equity
- (d) Statement of cash flows

(b) Income Statement

MCQs 16

The information needed to determine whether a company is using accounting methods similar to those of its competitors would be found in the?

- (a) Auditor's report
- (b) Balance sheet
- (c) Management discussion and analysis section
- (d) Notes to the financial statements

(d) Notes to the financial statements

MCQs 17

Which accounting document keeps track of the cash receipts and cash payments of a business during a specific period?

- (a) Balance sheet
- (b) Income statement
- (c) Financial report
- (d) Cash flow statement

(d) Cash flow statement

The Qualitative Characteristics of Financial Statements

The IASB's Framework suggests that financial statements should have certain qualitative characteristics. The framework splits qualitative characteristics into two categories:

1. Fundamental Qualitative characteristics

2. Enhancing Qualitative characteristics

1. Fundamental Qualitative characteristics

Relevance: Accounting information should be relevant to the information needs of its users

Faithful representation or Reliability: Accounting information should be prepared in such a way that users could rely upon it. To ensure reliability, the information should reflect the underlying economic realities and should be capable of being verified independently. **Completeness, neutrality and free of errors** should be considered

2. Enhancing Qualitative characteristics

Comparability: Users must be able to compare financial statements over a period of time **within organization** and also be able to compare financial statements of **different entities** to be able to assess their relative **financial position and performance**

Verifiability: Verification can be **direct and indirect**. Direct verification means verifying an amount or other representation through direct observation like counting cash in hand. Indirect verification means checking the inputs to a model, formula or other technique

2. Enhancing Qualitative characteristics

Timeliness: Accounting information should be produced in time for it to be used effectively. The information should be made available when the need arise

Understandability: Accounting information should be capable of being understood by the recipient without difficulty. To ensure a thorough understanding of information, the preparer should take note of avoiding the use of unexplained terminology and should good report statement layout

MCQs 18

Which one of the following is not a qualitative characteristic of useful accounting information?

- (a) Relevance
- (b) Reliability
- (c) Cash-basis accounting
- (d) Comparability

(c) Cash-basis accounting

MCQs 19

Which of the following is not a useful characteristic of accounting information as per ASB Statement of Principles?

- (a) Relevance
- (b) Profitability
- (c) Comparable
- (d) Complete

(b) Profitability

Business and its Classification

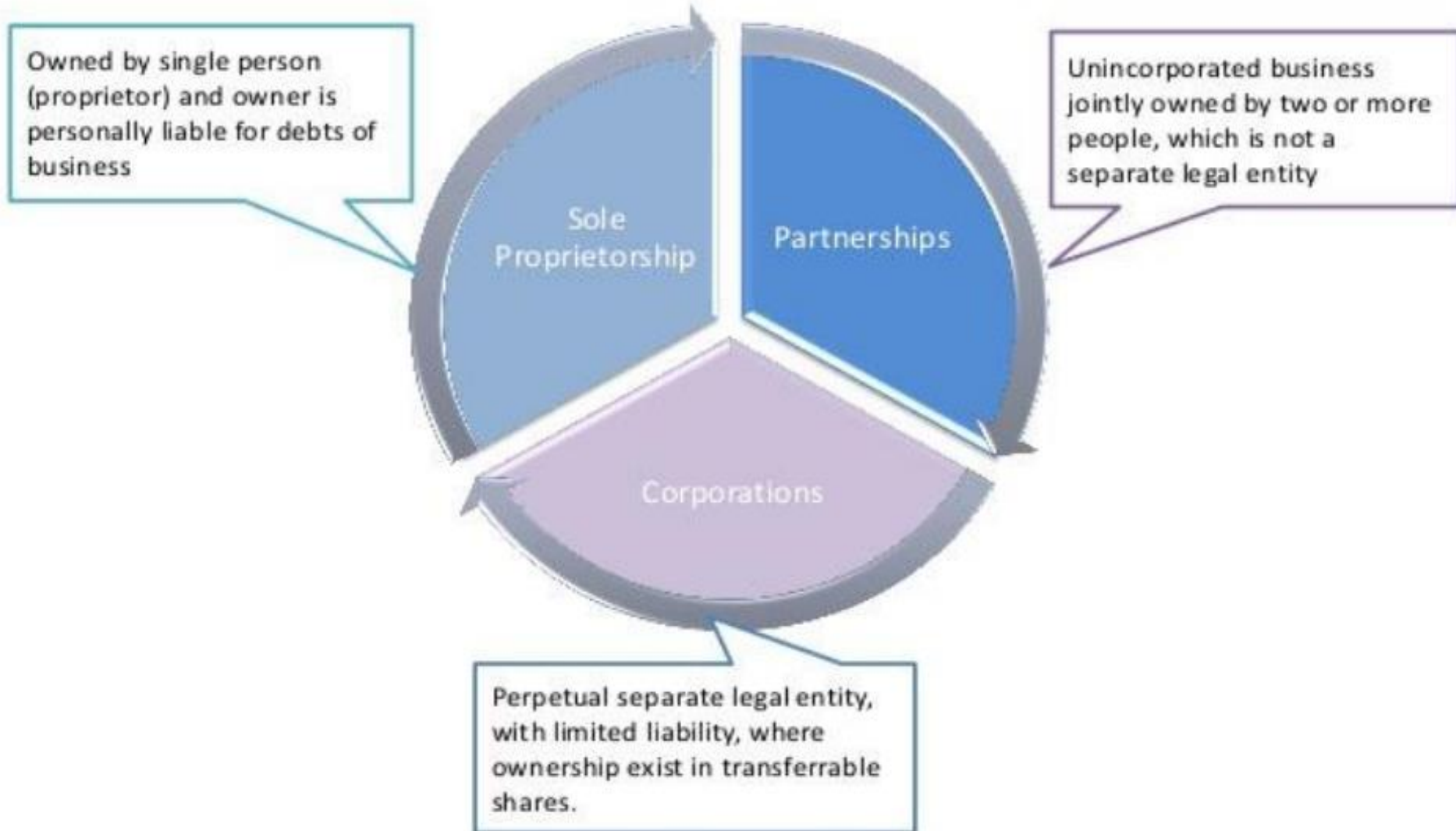
The word “business” means the state of being busy

A 'business' is also a very general term, but it does not extend as widely as the term 'enterprise' as it would not include none profit making organization.

1. Profit-making organizations

2. Non-profit-making organizations

1. Profit-making organizations



2. Non-profit-making organizations

Some organisations exist, not with the main intention of making profits in the long term, but with the objective of providing facilities to their members or others who may benefit from their activities. These organisations are often clubs and societies etc.

MCQs 20

Which one of the following is not a profit-making organisation?

- (a) Partnership
- (b) Local government
- (c) Sole trader
- (d) Limited company

(b) Local government

MCQs 21

Which one of the following is not a non-profit-making organisation?

- (a) Public limited company
- (b) Charity
- (c) Clubs
- (d) Central government

(a) Public limited company

MCQs 22

All of the following are advantages for choosing a proprietorship for a business except?

- (a) A proprietorship is a simple form of business to set up
 - (b) A proprietorship gives the owner control of the business
 - (c) Transfer of ownership is easily achieved through stock sales
 - (d) Proprietorship receives more favorable tax treatment
- (c) Transfer of ownership is easily achieved through stock sales**

Test 1

1. Which one of the following statement completely and correctly describes accounting?
 - (a) Recording, classifying and summarizing economic activities in systematic way
 - (b) Recording, classifying and summarizing all activities in useful manner
 - (c) Accounting is the systematic process of recording social activities only
 - (d) Recording, classifying and summarizing economic activities in informal manner
2. Financial accounts differ from management accounts in that they?
 - (a) Are prepared monthly for internal control purposes
 - (b) Contain details of costs incurred in manufacturing
 - (c) Are summarized and prepared mainly for external users of accounting information
 - (d) Provide information to enable the trial balance to be prepared
3. Which of the following is not a user of Management Accounting Information?
 - (a) Store manager
 - (b) Creditor
 - (c) Chief executive officer
 - (d) Chief financial officer
4. Which one of the following gives the best definition of the objective of accounting?
 - (a) To calculate the amount of dividend to pay to shareholders
 - (b) To record, categorize and summarize financial transactions
 - (c) To provide useful information to users
 - (d) To calculate the taxation due to the government

5. Which of the following is not an information need for the investor/owner group?
 - (a) Taking buy/sell decisions
 - (b) Measuring performance, risk and return
 - (c) Taking decisions regarding holding investments
 - (d) Assessment of repayment ability of an entity

6. The question of whether the results of certain transactions should be reported separately in the financial statements refers to?
 - (a) Disclosure
 - (b) Recognition
 - (c) Reporting
 - (d) Measurement

7. Which of the following provides information about the financial information's, obligations and activities on the economic entity that is intended for use primarily by external decision makers?
 - (a) Management accounting
 - (b) Financial accounting
 - (c) Tax accounting
 - (d) Environmental accounting

8. Which of the following user groups are most interested in the cash position of a business?
 - (a) Investors
 - (b) Government
 - (c) Suppliers
 - (d) Customers

9. Which of the following statement is true about purpose of accounting?
 - (a) The purpose of accounting provide information to manager
 - (b) Accounting purpose gives quantitative information to economic decision makers
 - (c) Provision of base for decision making is purpose of accounting
 - (d) All of above statement are true regarding purpose of accounting

10. Which of the following forms of business would result in the termination of the business if the ownership changes?
 - (a) Partnership
 - (b) Sole proprietorship
 - (c) Limited liability company
 - (d) Both a and b

The separate entity convention

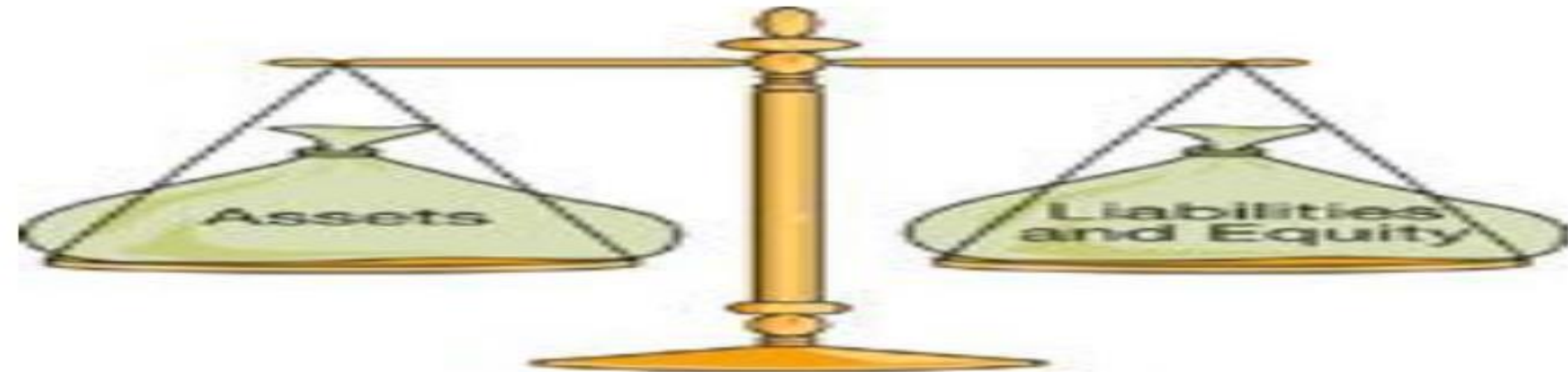
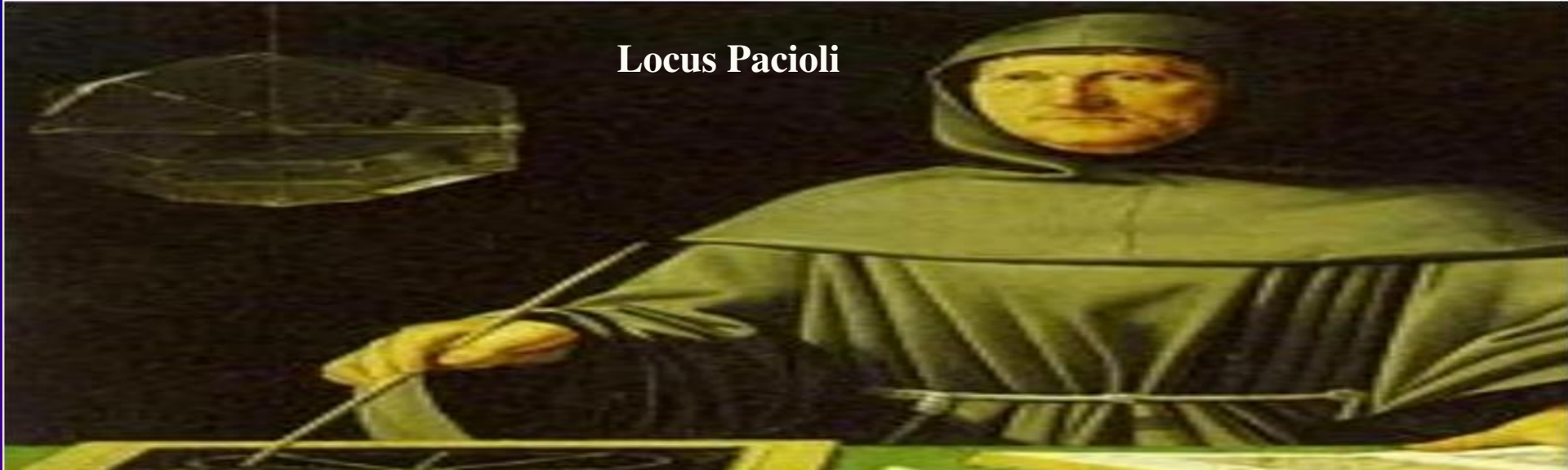
According to the standard, “every economic unit, regardless of its legal form of existence, is treated as a separate entity from parties having economic interest in it”.

A business entity is an economic unit which owns its assets and has its own obligations

Financial statements always treat the business as a separate entity

The Accounting Equation

Locus Pacioli





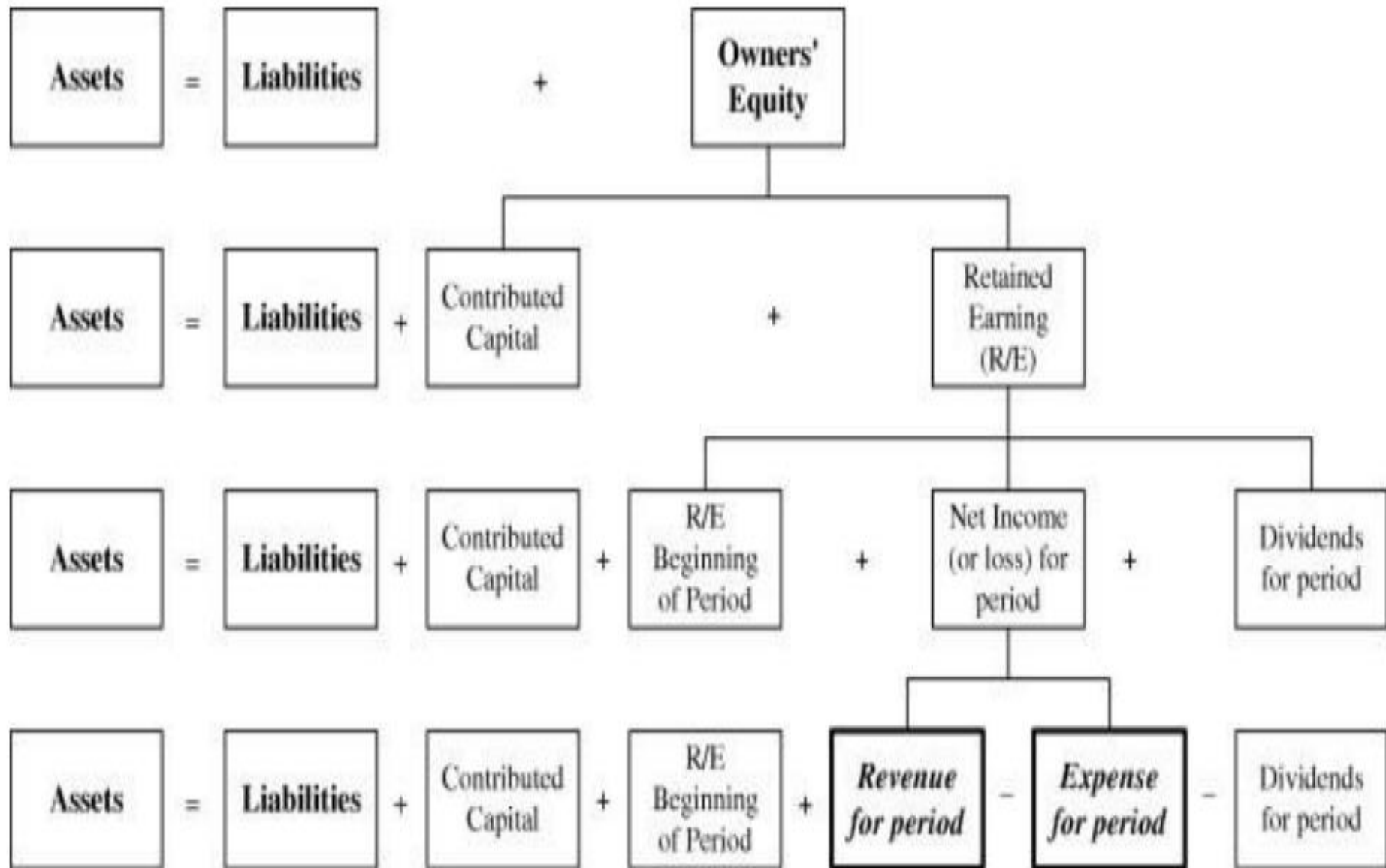
The Accounting Equation

A	=	L	+	OE
Assets		Liabilities		Owners Equity
OE	=	A	-	L
Owners Equity		Assets		Liabilities
L	=	A	-	OE
Liabilities		Assets		Owners Equity



$$\text{Assets} = \text{Liability} + \text{SHE} + \text{Revenue} - \text{Expense}$$

Note: Drawing/Dividend is also contra to Equity



Calculation of Capital

$$\text{Closing Capital} = \text{Opening Capital} + \text{Additional investment} + \text{Profit} - \text{Drawing}$$

Opening Capital	*****
Additional Investment	*****
Profit	*****
Drawing	(*****)
Closing Capital	*****

Drawing	***	Balance b/d	***
Losses	***	Re-investments	***
Balance c/f	***	Profit	***

$$\text{Profit} = \text{Closing Capital} - \text{Opening Capital} - \text{Additional investment} + \text{Drawing}$$

$$\text{Profit} = \text{Closing Capital} - \text{Opening Capital} - \text{Increase in Net Assets}$$

MCQs 23

The accounting equation at the start of the month was:

Assets £14,000 less liabilities £6,250. During the month the following transactions took place: the business purchased a fixed asset for £3,000, paying by cheque, a profit of £3,500 was made and creditors of £2,750 were paid by cheque. Calculate the capital at the start of the month?

- (a) £7,750
- (b) £11,500
- (c) £5,500
- (d) £8,250

(a) £7,750

MCQs 24

A sole trader has opening capital of £20,000 and closing capital of £9,000. During the period, the owner introduced capital of £8,000 and withdrew £16,000 for her own use. Calculate her profit or loss during the period?

- (a) £21,000 loss
- (b) £3,000 profit
- (c) £3,000 loss
- (d) £21,000 profit

(c) £3,000 loss

MCQs 25

The profit of a business may be calculated by using which one of the following formula?

(a) Opening capital - Drawings + Capital introduced - Closing capital

(b) Opening capital + Drawings - Capital introduced - Opening capital

(c) Closing capital + Drawings - Capital introduced - Opening capital

(d) Closing capital - Drawings + Capital introduced - Opening capital

**(b) Opening capital + Drawings - Capital introduced -
Opening capital**

MCQs 26

The accounting equation can change as a result of certain transactions.

Which one of the following transactions would not affect the accounting equation?

- (a) Selling goods more than their cost
 - (b) Purchasing a fixed asset on credit
 - (c) The owner withdrawing cash
 - (d) Debtors paying their accounts in full, in cash
- (d) Debtors paying their accounts in full, in cash**

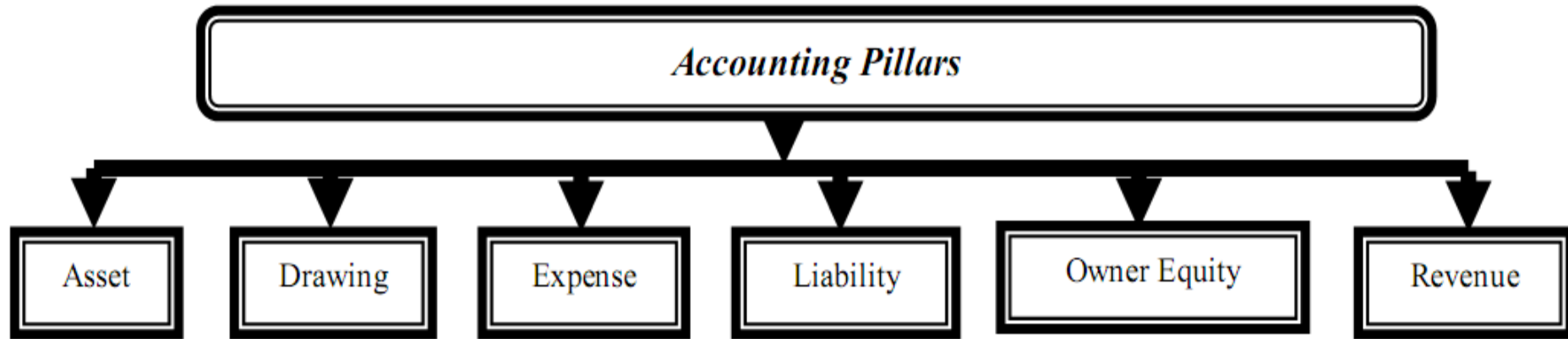
MCQs 27

Andy introduces \$150,000 into a new business and obtains a loan of \$100,000. assets of the business are worth:

- A \$50,000
- B \$100,000
- C \$150,000
- D \$250,000

(c) \$ 250,000

Accounting Pillars



Assets

- ❖ All Economic Resources of business organization. Assets are defined in Statement of Financial Accounting Concept 6 (SFAC 6); *as future economic benefits obtained or controlled by a particular entity as a result of past transactions or events (Para. 25)*
- ❖ A **resource having economic value** that an individual, corporation or country **owns or controls** with the expectation that it will provide **future benefit**
- ❖ It has four types, Tangible Assets, Intangible Assets, Natural Resources and Financial Assets

Types of Assets

Tangible assets: Machinery, Furniture, Building, Equipment, Plant, Car, Inventories, Fixture and Fittings, Computer, Books etc. etc.

Intangible assets: Patents, Goodwill, Copy Rights, Trade Mark etc. etc.

Natural resources: Land, Mines, Coal, Forest etc. etc.

Financial assets: Cash, Note Receivables, Marketable Securities, Bank, Prepaid items, etc. etc.

Balance Sheet Classification of Assets

- ❑ Assets in the statement of financial position are divided into two groups, current assets and non-current assets
- ❑ Current Assets are items owned by the business with the **intention of turning them into cash within one year** and Commonly current assets are showing in balance sheet by liquidity order

Current assets: Cash in hand, Cash at Bank, Marketable Securities, Note Receivable, Account Receivable, Inventory, Prepaid, Raw materials and Finished goods held for sale to customers etc. etc.

Balance Sheet Classification of Assets (Cont...)

❑ Non-current assets on the other hand, asset acquired for continuing use within the business, with a view to earning income or making profits from its use of **more than one year**

- Tangible non-current assets usually known as
- Property, plant and equipment (PP&E)
- Intangible non-current assets
- Investments (long term)

Non-current assets: Machine, Equipment, Factory premises, Office furniture, Computer equipment, Company cars, Delivery vans, Investments, Plant and machinery, Office building, Warehouse and Lorries etc. etc.

Liabilities

- ✓ All Economic Obligations of business organization
- ✓ Liabilities are defined by SFAC 6 as *future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events (Para. 35)*
- ✓ Liabilities are typically divided into two categories: short-term or current liabilities and long term liabilities

Balance Sheet Classification of Liabilities

- ❖ Current liabilities are debts of the business that must be paid within a **fairly short period** of time. By convention, a '**fairly short period of time**' is taken as **one year**

Current Liabilities: Account Payable, Bank Overdraft/Overdrawn, Trade payables, Accrued expenses, Taxation payable, Note Payable and Outstanding or Payables, etc. etc.

- ❖ A non-current liability is a debt which is not payable within the 'short term' and so any liability which is not current must be long-term . By convention '**non-current**' means **more than one year**

Non-current Liabilities: Bank Loan, Debenture, Bonds, Loan notes and Mortgage Loan etc. etc. etc.

MCQs 28

A motor trader has a van for sale. How will this be shown in the accounts?

- (a) Non-current asset
- (b) Current asset
- (c) Non-current liability
- (d) Current liability

(b) Current asset

MCQs 29

Which of the following is not the classification of current assets with respect to the company's act?

- (a) Cash in hand
- (b) Bank at bank
- (c) Marketable Securities
- (d) Premises

(d) Premises

Classify the following items as Current assets, Non-current assets, Current liability or Non-current liability

A personal computer (PC) used in the accounts department of a retail store	
A personal computer (PC) on sale in an office equipment shop	
Wages due to be paid to staff at the end of the week	
A van for sale in a motor dealer's showroom	
A delivery van used in a grocer's business	
Obtained a bank loan for five year	
Prepaid insurance at the end of year	
Accrued expenses	

Categorize the following as Current assets, Tangible non-current assets, Intangible non-current assets, Investments,, Current liabilities or Non-current liabilities

Shares in PTCL, intended to be held long term	
Machinery used in production	
Stock for resale	
An overdraft	
A mortgage loan	
Trade payables	
Trade receivables	
Goodwill	
Prepayments	
Accrued expenses	

Equity/ Capital/ Shareholder's Equity/ Stockholder's Equity

- Investment in the business by owner
- According to SFAC 6 the residual interest in the net assets of an entity that remains after deducting its liabilities (Para. 49)

Drawings

- ✓ Deinvestment in the business by owner
- ✓ Drawing is defines as withdrawal by owner in the form of cash and other assets for their personal use. This will be deducted to owner personal account
- ✓ This is the case only sole proprietorship and partnership. There is no drawing account in case of corporation. Drawing decrease owner equity in the business

MCQs 30

Capital is?

- (a) The amount borrowed to set up a business
- (b) The amount owed by a business to its proprietor (s)
- (c) The value of the assets in a business
- (d) The total amount invested in a business by all the providers of capital

(b) The amount owed by a business to its proprietor (s)

State whether the following are Current assets, Non-current assets, Liabilities, Capital or Drawings

A delivery van	
Money owed to a supplier	
A mortgage owed to a bank	
Money put into the business bank by the owner of the business	
Profit made by a business	
Money owed by a customer	
Unsold goods	
Money taken from the business bank account by the owner of a business	

Expenses

- All Outflows of the business for earning
- According to SFAC 6 as *outflows from delivering or producing goods, rendering services or carrying out other activities that constitute the entity's ongoing major operations (Para. 80).*
- Expenses are **economic costs that a business incurs** through its operations to earn revenue

Wages, Salaries, Rent, Octri, Fright, Carriage, Stationery, Repairs, Carriage, Discount, Transportation, Commission and all accounts have debit balance (Dr) etc. etc.

Revenue

- All inflows of the business
- Revenue = Cost + Profit or (Loss)
- According to SFAC 6 as *inflow from delivering or producing goods, rendering services or other activities that constitute the entity's ongoing major or central operations (Para. 78)*

Sales, fees etc. and all accounts have credit balance like commission (Cr) etc.

MCQs 31

What is the definition of profit earned in a period?

- (a) Income less expenditure
- (b) Income less expenditure less drawings
- (c) The balance on the capital account
- (d) The total of assets less liabilities

(a) Income less expenditure

MCQs 32

Which of the following is correct?

- (a) Profit does not alter equity
- (b) Profit increases equity
- (c) Equity can only come from profit
- (d) Profit reduces equity

(b) Profit increases equity

Four effects of Accounting

Assets

(1) Increase



(2) Decrease



(3) Conversion in Assets



Equities

(1) Increase



(2) Decrease



(4) Conversion in Equities



MCQs 33

Balakot Services Corporation had the following accounts and balances:

Accounts payable	Rs. 12,000	Equipment	Rs. 14,000
Accounts receivable	2,000	Land	14,000
Buildings	?	Unearned service revenue	4,000
Cash	6,000	Total stockholders' equity	?

If the balance of the Buildings account was Rs. 30,000 and the equipment was sold for Rs. 14,000, what would be the total of stockholders' equity?

- (a) Rs. 26,000 (b) Rs. 36,000 (c) Rs. 46,000 (d) Rs. 50,000

(d) Rs. 50,000

For each of the following transactions indicate the effects on the Accounting Equation of the Company i.e. (Increase, Decrease, Conversion or No Effect)?

(1) The owner invests personal cash in the company?

Assets	Liabilities	Owner's Equity

(2) The owner withdraws company's assets for personal use?

Assets	Liabilities	Owner's Equity

(3) The company purchases equipment with its cash?

Assets	Liabilities	Owner's Equity

(4) The company repays the bank loan by introducing reinvestment of owner in the company?

Assets	Liabilities	Owner's Equity

From the list of accounts below, determine which assets are and which equities are. List the assets under the Asset Column and the equities under the equities Column. Then add each column and complete the Fundamental Accounting Equation?

Accounts		Asset	Equities
Cash	Rs. 5,000		
Accounts Receivable	10,600		
Building	35,000		
Accounts Payable	5,000		
Inventory	200		
Computer Equipment	18,000		
Bank Loan	6,000		
Mortgage Payable	10,000		
Owner Equity	47,800		
TOTAL	Rs. 137,600		

Test 2

1. The extended balance sheet equation, which is the basis of double-entry bookkeeping is?

- (a) Assets + Expenses = Liabilities + Revenue - Capital
- (b) Assets - Expenses = Liabilities - Revenue - Capital
- (c) Assets - Expenses = Liabilities + Revenue + Capital
- (d) Assets + Expenses = Liabilities + Revenue + Capital

2. Balakot Services Corporation had the following accounts and balances:

Accounts payable	Rs. 12,000	Equipment	Rs. 14,000
Accounts receivable	2,000	Land	14,000
Buildings	?	Unearned service revenue	4,000
Cash	6,000	Total stockholders' equity	?

If the balance of the buildings account was Rs. 30,000, what would be the total of stockholders' equity?

- (a) Rs. 26,000
- (b) Rs. 18,000
- (c) Rs. 46,000
- (d) Rs. 50,000

3. Which of the following transactions would have no impact on stockholders' equity?

- (a) Purchase of land on credit
- (b) Dividends to stockholders
- (c) Net loss
- (d) Investment in cash by stockholders

4. The favorable balance of profit and loss account should be?

- (a) Added in liabilities
- (b) Subtracted from current assets
- (c) Added in capital
- (d) Subtracted from liabilities

5. Find out the missing value liabilities of an accounting equation with the help of given data?

Furniture	Rs. 90,000
Cash	Rs.100, 000
Debtors	Rs.10,000
Other Assets	Rs. 1,000
Owner's equity	Rs. 90,000

(a) Rs. 201,000 liabilities (b) Rs. 111, 000 liabilities (c) Rs. 290, 000 liabilities (d) Rs. 291, 000 liabilities

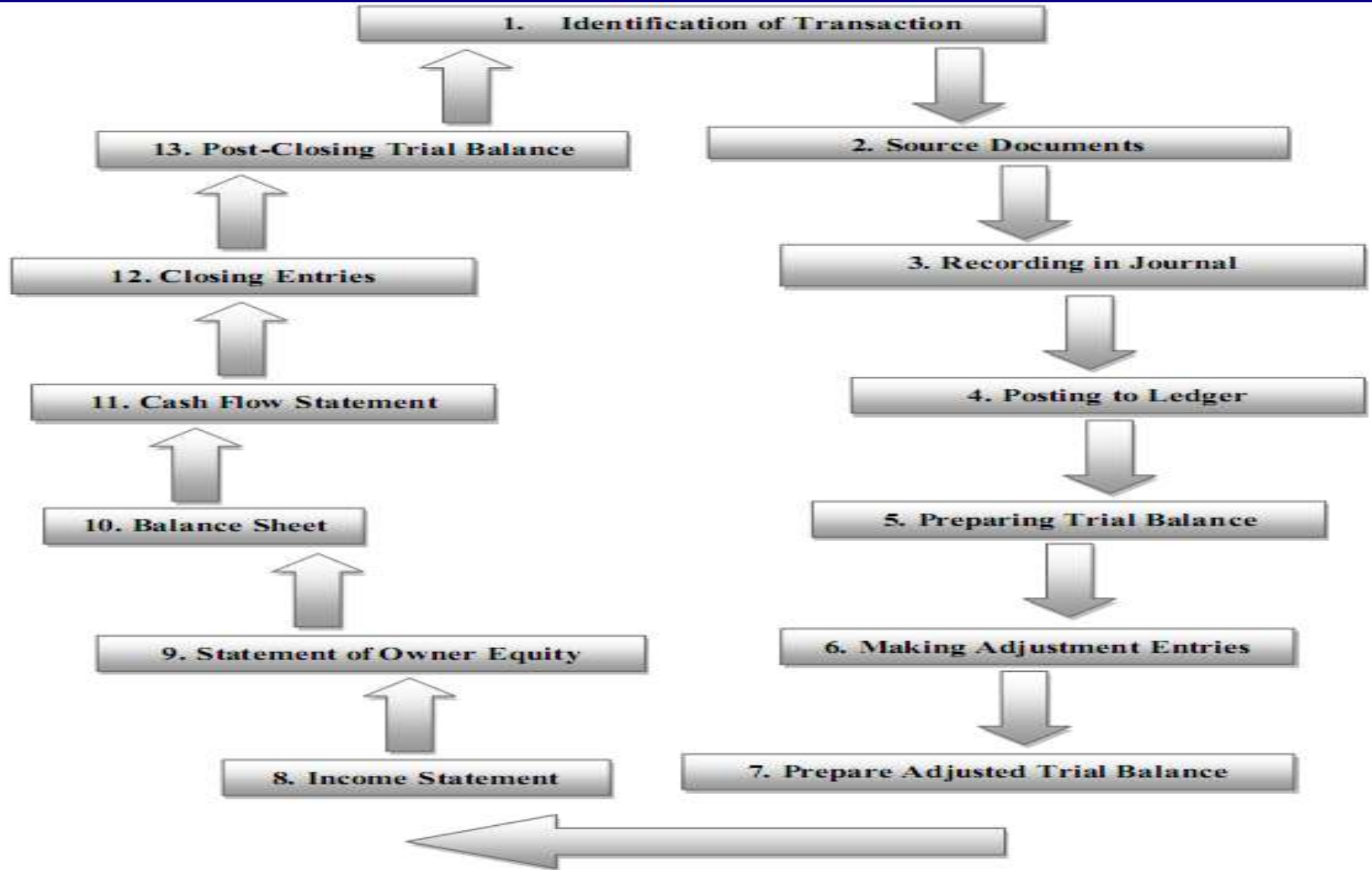
6. During a reporting period, a company's total assets decrease by Rs. 650. Liabilities increase by Rs. 300. Contributed capital increases by Rs. 200. What is the effect on the amount of retained earnings?

(a) Increases by Rs. 150 (b) Decreases by Rs. 1,150
(c) Decreases by Rs. 150 (d) Increases by Rs. 1,150

7. Amir Dressing Shop at start of the year with total assets of Rs. 60,000 and total Liabilities of Rs. 40,000. During the year the business recorded Rs. 105,000 in revenues, Rs. 55,000 in expenses, and drawing of Rs. 10,000. Owner's equity at the end of the year was?

(a) Rs. 60,000 (b) Rs. 50,000 (c) Rs. 40,000 (d) Rs. 45,000

Accounting Cycle

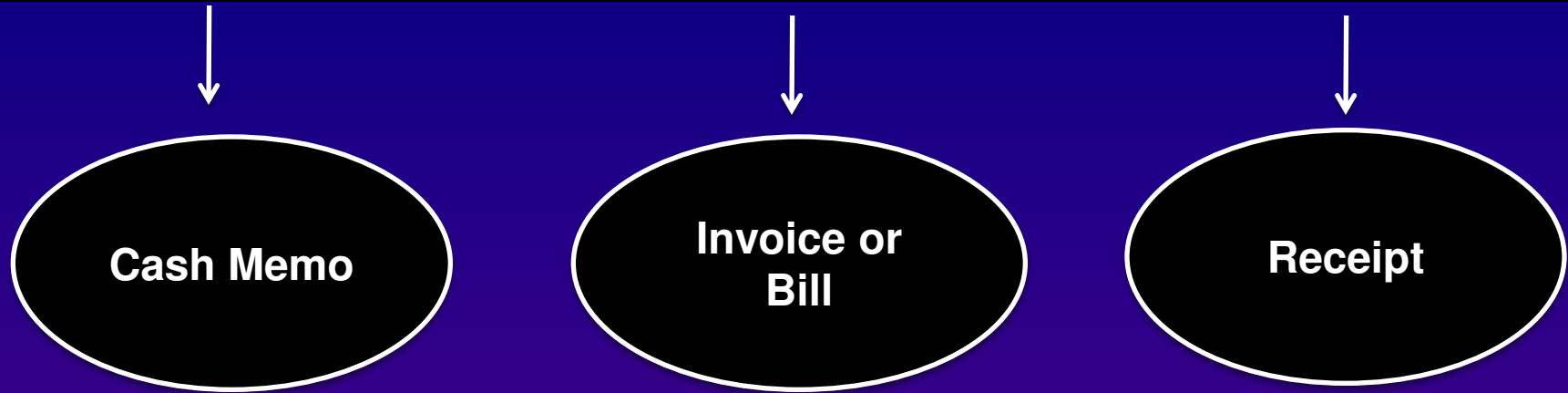


Identification of Transactions

In accounting, only business transaction or economic activities are recorded. A transaction is a particular type of event, which can be expressed in terms of money and brings changes in the financial position of a business unit.

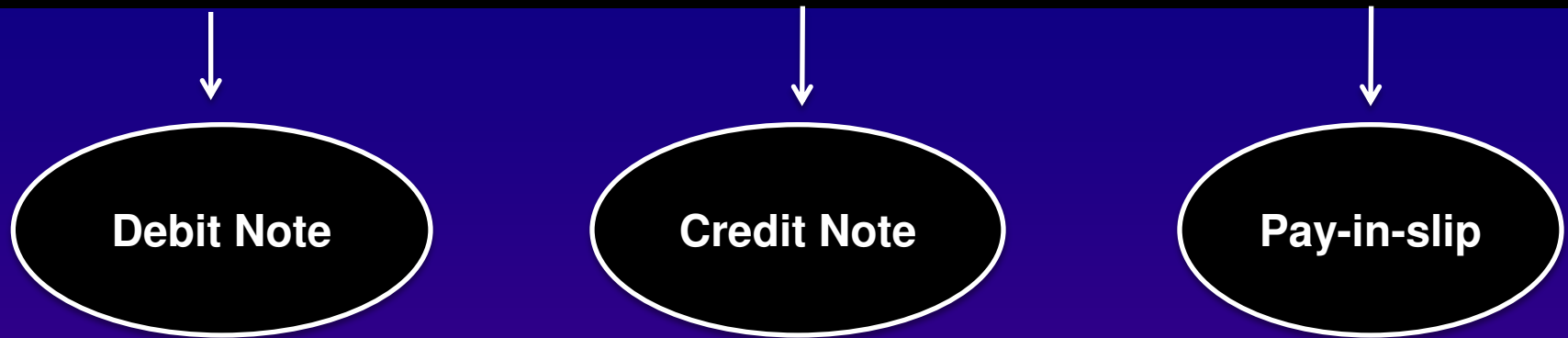


Source Documents



- When a trader sells goods for **cash**, he gives a cash memo and when a trader purchases goods for cash, he receives a cash memo
- When a trader sells goods on **credit**, he prepares a sale invoice
 - When a trader receives **cash from a credit customer**, he issues a receipt

Source Documents (Cont...)



A debit note is prepared by the **buyer** and it contains the date of the **goods returned**, name of the supplier, details of the goods returned and reasons for returning the goods

A credit note is prepared by the **seller** and it contains the date on which **goods are returned**, name of the customer, details of the goods received back, amount of such goods and reasons for returning the goods

Pay-in-slip is a form available in banks and is used to **deposit money** into a bank account

Bookkeeping Vs. Accounting

Bookkeeping is a small part of the field of accounting. Bookkeeping is recording phase of accounting system.

Accounting is broad subject. Greater understanding of recording obtained from bookkeeping and an ability to analyze and interpret the information provided by bookkeeping records.



MCQs 34

Which one of the following gives the best definition of bookkeeping?

- A To calculate the amount of dividend to pay to shareholders
- B To record, categorise and summarise financial transactions
- C To provide useful information to users
- D To calculate the taxation due to the government

(b)

MCQs 35

Which ONE of the following is NOT a purpose of bookkeeping?

- A maintain ledger accounts for every transaction
- B provide financial information to users of such information
- C prepare a trial balance
- D record every financial transaction individually

(b)

Systems or Basis of Accounting

Cash Basis

Events are recorded when actual cash / check is received or paid.

Accrual Basis

Income is recorded when it is earned and expense is recorded when they incurred



MCQs 36

The accounting system, in which accounting entries are made on the basis of amount having become due for payment or receipt, is known as?

- (a) Cash system of accounting
- (b) Current accounting period
- (c) Accrual system of accounting
- (d) None of the given options

(c)

Methods of Recording

That means, only one aspect of transaction i.e. either cash receipt or the fact that money is receivable from someone is recorded.

Single Entry

The accounting system that records both the aspects of transaction in books of accounts

Double Entry

MCQs 37

Which one of the following system of recording transaction has a dual aspect concept of accounting?

- (a) Cash system of accounting
- (b) Single entry system
- (c) Double entry system
- (d) Accrual system of accounting

(c)

Double Entry Book-Keeping

- Locus Pacioli, an Italian wrote a first book on double entry system in 1494
- The concept of double entry is based on the fact that every transaction has two aspects i.e. receiving a benefit and giving a benefit
- Each transaction is recorded in terms of accounting alphabetic i.e. debit (Dr) and credit (Cr)
- Debit' (derived from Latin word **Debere** which means to owe) and 'Credit' (derived from Latin word **Credere** which means that which one believes in, including persons, like creditor) are denoted by 'Dr' and 'Cr' respectively. The ultimate result of the system is that for every Debit (Dr) there is an equal Credit (Cr)



MCQs 38

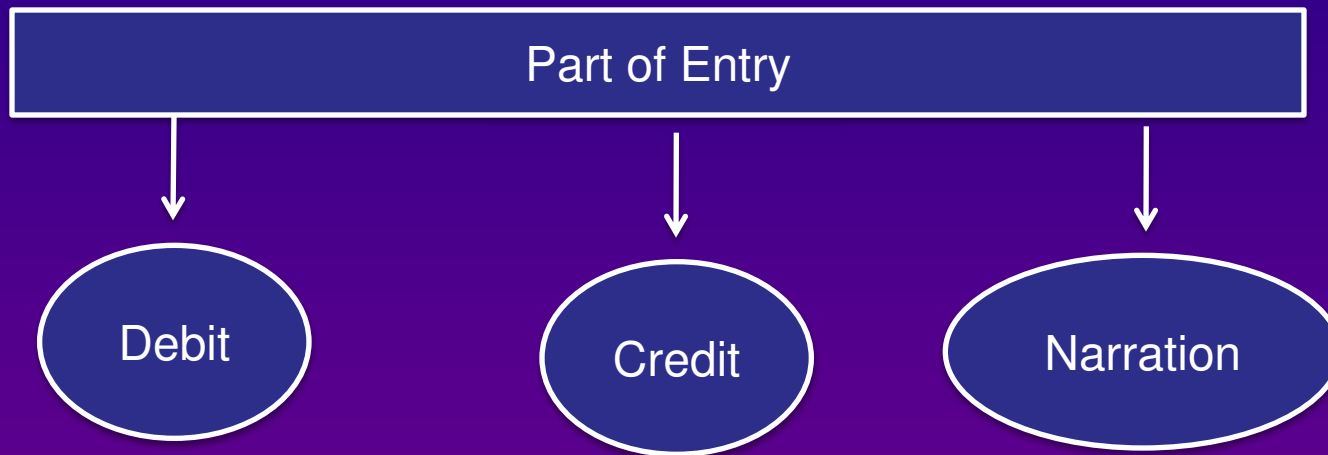
Commercial Accounting is done through?

- (a) Single entry book-keeping
- (b) Double entry book-keeping
- (c) Both 'Single entry' and 'Double entry' book-keeping
- (d) None of given option

(b)

Entry

Single record of the business transaction is called entry. Following are three parts of entry



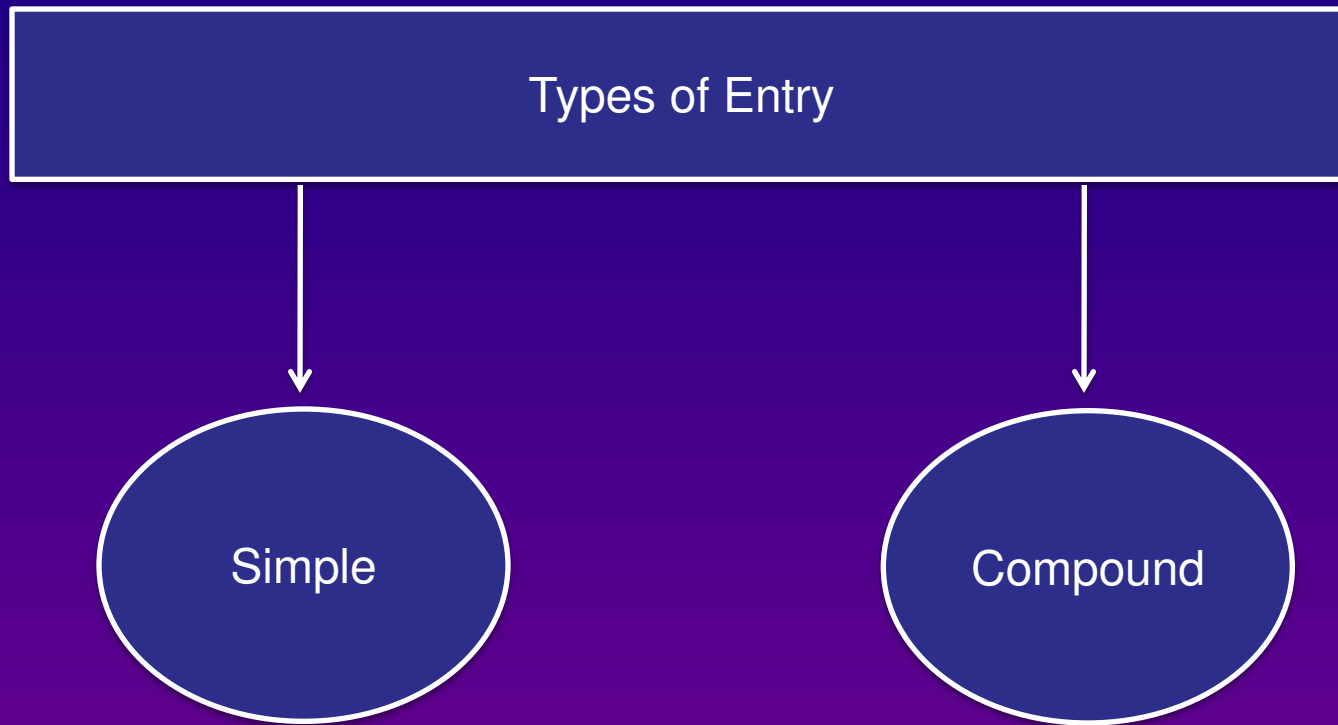
MCQs 39

Which of the following presents key aspects of the process of accounting in the correct chronological order?

- (a) Communicating, recording, and identifying
- (b) Recording, identifying, and communicating
- (c) Recording, totaling, and identifying
- (d) Identifying, recording, and communicating

(d)

Types of Entry



MCQs 40

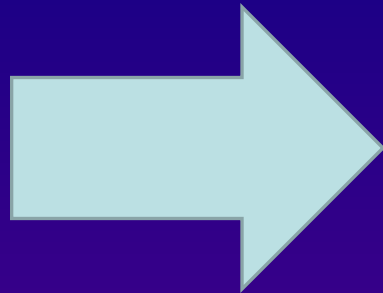
A Journal entry which requires more than two accounts is called?

- (a) Double entry
- (b) Compound entry
- (c) Combined entry
- (d) None

(b)

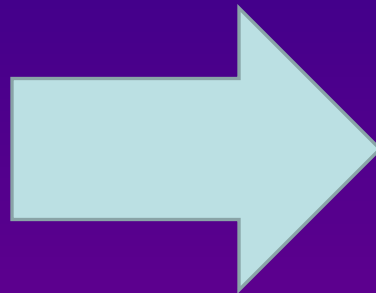
Golden Rules

Assets
Drawing
Expenses



Increase will be Debited (Dr)
Decrease will be Credited (Cr)

Liabilities
Owner Equity
Revenue



Increase will be Credited (Cr)
Decrease will be Debited (Dr)

Double-Entry Accounting

Balance Sheet Accounts

Asset

Debit	Credit
Increase (+)	Decrease (-)

Liability

Debit	Credit
Decrease (-)	Increase (+)

Owner's Equity

Debit	Credit
Decrease (-)	Increase (+)

Income Statement Accounts

Revenue

Debit	Credit
Decrease (-)	Increase (+)

Expense

Debit	Credit
Increase (+)	Decrease (-)

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Application of Golden Rules

Assets

Increase in asset will be recorded Dr and decrease will be recorded Cr

General Journal

Date	Account Title and Explanations	Ref	Amount (Rs)	
			Debit	Credit
	Machinery Cash (Machinery purchased on cash)		100,000	100,000

Application of Golden Rules

Drawing

It is essential to remember that Drawing always Debited and the asset which is taken by owner will Credited

General Journal

Date	Account Title and Explanations	Ref	Amount (Rs)	
			Debit	Credit
	Drawing Cash (Cash withdrew by owner)		5,000	5,000

MCQs 41

If the owner of a business withdraws cash for his personal use, the journal entries will be

- A Dr Capital Cr Drawings
- B Dr Cash Cr Drawings
- C Dr Drawings Cr Capital
- D Dr Drawings Cr Cash

(d)

MCQs 42

Goods withdrawn by a proprietor for his personal use are entered into the books of accounts as:

- A Dr Drawings Cr Purchases
- B Dr Purchases Cr Drawings
- C Dr Capital Cr Drawings
- D Dr Purchases Cr Sales

(a)

Application of Golden Rules

Expenses

It is important to understand that all Expenses must be Debited to their name.

General Journal

Date	Account Title and Explanations	Ref	Amount (Rs)	
			Debit	Credit
	Wages Cash (Wages paid to workers)		1,000	1,000

Application of Golden Rules

Liabilities

Decrease will be recorded Debited and increase will be Credited.

General Journal

Date	Account Title and Explanations	Ref	Amount (Rs)	
			Debit	Credit
	Machinery		120,000	
	Account Payable-Ahmed			120,000
	(Machinery purchased on account)			
	Account Payable-Ahmed		100,000	
	Cash			100,000
	(Paid to Ahmed on account of machinery)			

MCQs 43

The correct entries needed to record the return of office equipment that had been bought on credit from Ali, and not yet paid for, are

Debit

- (a) Office equipment
- (b) Office equipment
- (c) Ali
- (d) Cash

Credit

- Sales
- Ali
- Office equipment
- Office equipment

(c) Ali

Office equipment

MCQs 44

Of the following account types, which would be increased by a debit?

- (a) Liabilities and expenses
- (b) Assets and equity
- (c) Assets and expenses
- (d) Equity and revenues

(c) Assets and expenses

Application of Golden Rules

Owner Equity

When Owner increases his Equity it is recorded as Credit, and when owner reduced his equity it will be Debit with specified term Drawing

General Journal

Date	Account Title and Explanations	Ref	Amount (Rs)	
			Debit	Credit
	Cash Owner Equity (Started business with cash)		1,000,000	1,000,000

Application of Golden Rules

Revenue

It is important to note that all Revenues items must be credited with its names

General Journal

Date	Account Title and Explanations	Ref	Amount (Rs)	
			Debit	Credit
	Cash		20,000	
	Sales			20,000
	(Cash Sales)			

MCQs 45

X receives goods from Y on credit and X subsequently pays by cheque. A then discovers that the goods are faulty and cancels the cheque before it is cashed by Y. How should X record the cancellation of the cheque in his books?

Debit

- (a) Creditors
- (b) Creditors
- (c) Bank
- (d) Returns outwards

Credit

- Returns outwards
- Bank
- Creditors
- Creditors

(c)

MCQs 46

According to the rules of debit and credit for balance sheet accounts?

(a) Increase in assets, liabilities and owner equity recorded by debit

(b) Decrease in asset and liability are recorded by credit

(c) Increase in asset and owner's equity are recorded by debit

(d) Decrease in liability and owner's equity are recorded by debit

(d) Decrease in liability and owner's equity are recorded by debit

MCQs 47

Which of the following account/s will be affected under the rule of accrual accounting, when furniture is purchased on cash?

- (a) Only cash account
- (b) Only furniture account
- (c) Cash & furniture account
- (d) Only purchases account

(c) Cash & furniture account

MCQs 48

Which of the following is the correct entry to record the purchase on credit of stocks intended for resale?

	Debit	Credit
(a)	Stock	Debtor
(b)	Stock	Creditor
(c)	Purchases	Creditor
(d)	Creditor	Purchases

(c) Purchases Creditor

Contra Accounts

Asset							
+	-						
<table border="1"> <thead> <tr> <th>Contra</th> <th>Asset</th> </tr> <tr> <th>-</th> <th>+</th> </tr> </thead> <tbody> <tr> <td> </td> <td> </td> </tr> </tbody> </table>		Contra	Asset	-	+		
Contra	Asset						
-	+						

- | | | | |
|-----------------------------------|----------------------|---------------------------------|------------|
| 1. Purchase Return | Return Outward | Contra Expense | Cr Balance |
| 2. Sales Return | Return Inward | Contra Revenue | Dr Balance |
| 3. Accumulated Depreciation | | Contra Fixed Assets | Cr Balance |
| 4. Provision for Bad Debts | | Contra Account Receivable | Cr Balance |

General Journal

Book of Original Entry

Book of Prime Entry

General Journal					
Date		Account Titles and Explanation	Ref	Amount (Rs)	
Year	Date			Debit	Credit
		Debit elements of entry		Dr amount	
		Credit elements of entry			Cr amount
		(Narration is brief description)			
		Total		*****	*****

Test 3

1. Which one of the following statements is correct?
- (a) Assets and liabilities normally have credit balances (b) Liabilities and revenues normally have debit balances
(c) Assets and revenues normally have credit balances (d) Assets and expenses normally have debit balances
2. The correct entries needed to record the return of office equipment that had been bought on credit from P Young, and not yet paid for, are:

Debit

Credit

- | | |
|----------------------|------------------|
| (a) Office equipment | Sales |
| (b) Office equipment | P Young |
| (c) P Young | Office equipment |
| (d) Cash | Office equipment |

3. Which of the following is the correct entry to record the purchase on credit of inventories intended for resale?

Debit

Credit

- | | |
|-----------------|------------|
| (a) Inventories | Receivable |
| (b) Inventories | Payable |
| (c) Purchases | Payable |
| (d) Payable | Purchases |

4. The payment to a creditor will?
- (a) Increase one asset and decrease another (b) Decrease an asset and decrease owner's equity
(c) Decrease an asset and decrease a liability (d) Increase an asset and increase a liability
5. Which of the following items should be expensed as incurred?
- (a) Broker's fees on the purchase of a long-lived asset
(b) Repair of damage occurring during installation of new equipment
(c) Freight charges on the purchase of equipment
(d) Normal installation fees on the purchase of equipment
6. The journal entry to record the withdrawal of cash by the owner, to pay a personal utility bill would include?
- (a) Debit to capital, and a credit to cash (b) Debit to utilities expense and a credit to cash
(c) Debit to drawing and a credit to cash (d) Debit to drawing and a credit to utilities expense
7. Which one of the following system of recording transaction has a dual aspect concept of accounting?
- (a) Cash system of accounting (b) Single entry system
(c) Double entry system (d) Accrual system of accounting

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