Khandelwal Vaish Girls Institute of Technology

Internal Examination 2017 - 18

Accounting

MBA Semester I

Question Paper & Answer Key

MM: 30 Time : 02:30 hours

1. **What is accounting? Explain its concept and convention.** (4)

Ans. **Definition and Meaning: The American Institute of Certified Public Accountants defines accounting as:** The art of recording, classifying, summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of financial character, and interpreting the results there of.

Accounting not only records financial transactions and conveys the financial position of a business enterprise; it also analyses and reports the information in documents called "financial statements."

Recording every financial transaction is important to a business organization and its creditors and investors. Accounting uses a formalized and regulated system that follows standardized principles and procedures.

Accounting Concepts

- **Business entity concept:** A business and its owner should be treated separately as far as their financial transactions are concerned.
- **Money measurement concept:** Only business transactions that can be expressed in terms of money are recorded in accounting, though records of other types of transactions may be kept separately.
- **Dual aspect concept:** For every credit, a corresponding debit is made. The recording of a transaction is complete only with this dual aspect.
- **Going concern concept:** In accounting, a business is expected to continue for a fairly long time and carry out its commitments and obligations. This assumes that the business will not be forced to stop functioning and liquidate its assets at "fire-sale" prices.
- **Cost concept:** The fixed assets of a business are recorded on the basis of their original cost in the first year of accounting. Subsequently, these assets are recorded minus depreciation. No rise or fall in market price is taken into account. The concept applies only to fixed assets.
- **Accounting year concept:** Each business chooses a specific time period to complete a cycle of the accounting process—for example, monthly, quarterly, or annually—as per a fiscal or a calendar year.
- **Matching concept:** This principle dictates that for every entry of revenue recorded in a given accounting period, an equal expense entry has to be recorded for correctly calculating profit or loss in a given period.
- **Realization concept:** According to this concept, profit is recognized only when it is earned. An advance or fee paid is not considered a profit until the goods or services have been delivered to the buyer.

Accounting Conventions: There are four main conventions in practice in accounting: conservatism; consistency; full disclosure; and materiality.

- **Conservatism** is the convention by which, when two values of a transaction are available, the lower-value transaction is recorded. By this convention, profit should never be overestimated, and there should always be a provision for losses.
- **Consistency** prescribes the use of the same accounting principles from one period of an accounting cycle to the next, so that the same standards are applied to calculate profit and loss.
- **Materiality** means that all material facts should be recorded in accounting. Accountants should record important data and leave out insignificant information.
- **Full disclosure** entails the revelation of all information, both favorable and detrimental to a business enterprise, and which are of material value to creditors and debtors.

2.

From the following Trial Balance prepare Trading and Profit and Loss Account for the year ended 31st December, 2009 and Balance Sheet as on the date:

	Dr. (Rs.)	Cr (Rs.)
Drawings	10000	
Stock as on 1-1-2009	46000	
Purchase and Purchase returns	150000	600
Cash in hand	3400	
Bank balance	22660	
Freehold Premises	38600	
Trade expenses	840	
Printing, Stationery and advertising	1640	
Professional charges	280	
Commission received		3300
Investment as on 1st Jan. @10%	4000	
Interest on Deposits		200
Sundry debtors and creditors	36000	29000
Wages	25000	
Salaries	14000	
Rent Rates and Insurance	4000	
Capital		114700
Income Tax	1600	
Discount allowed and received	6300	4600
Sales Returns and Sales	500	208000
Bills Receivables and Bills Payables	3200	10000
Office Furniture	3050	
Bad Debts Provision		670
	371070	371070

Adjustments:

- Provide for wages Rs.5000.
- Write off 5% depreciation on freehold premises and 10% on office furniture.
- Insurance to the extent of Rs.200 belongs to 2010.
- Closing stock as on 31.3.2010 is Rs.52000.

- Charge interest on capital @ 5%. (4)

Ans.

Trading and Profit and Loss A/c for the year ending 31st Dec., 2009

Dr. Cr.

Particulars		Rupees	Particulars		Rupees
Opening Stock		46,000	Sales	208000	207500
Purchases	150000		Less Sales Returns	500	
Less Purchase Returns	600	149400	Closing Stock		52000
Wages A/c	25000				
Add Outstanding Wages	5000	30000			
Gross Profit c/f		34100			
		259,500			259,500
Trade Expenses		840	Balance b/f		34100
Painting, Stationery & Advt.		1640	Commission Received		3300
Professional Charges		280	Interest on Deposit	200	
Salaries		14000	Add Accrued Interest	200	400
Discount		6300	Discount received		4600
Rent, Rates & Insurance	4000				
Less Prepaid	200	3800			
Interest on Capital		5735			
Depreciation on Premises		1930			
Depreciation on Furniture		305			
Net Profit		7570			
		42400			42400

Balance Sheet as on 31st December, 2009

Particulars		Rupees	Particulars		Rupees
Capital	114700		Freehold Premises	38600	36670
Add Profit	7570		Less Depreciation	1930	
Add Interest on Capital	5735		Office Furniture	3050	
	128005		Less Depreciation	305	2745
Less Drawings	10000		Closing Stock		52000
Less Income Tax	1600	116405	Debtors	36000	
Sundry Creditors		29000	Less Prov. for Debtors	670	35330
Bills Payable		10000	Bills Receivables		3200
Outstanding Wages		5000	Investments	4000	
			Add accrued interest	200	4200
			Prepaid Insurance		200
			Bank		22660
			Cash		3400
		160405			160405

Notes: 1. Income Tax payment is the personal responsibility of the proprietor, hence treated as drawings.

2. Implied adjustment. In the Trial Balance investments of Rs.4000 is given on which interest is receivable @ 10% p.a. Interest for the whole year comes to Rs.400 and there is only Rs.200 received during the year. It means Rs.200 is still receivable on account of interest (accrued interest).

3. (4)

Following are the comparative Balance Sheets of Good Luck Co. as at 31st December:

Liabilities	*2003* *Rs.*	*2004* *Rs.*	*Assets*	*2003* *Rs.*	*2004* *Rs.*
Share Capital	10,00,000	11,00,000	Goodwill	50,000	40,000
Debentures	5,00,000	3,00,000	Land & Buildings	4,20,000	6,60,000
General Reserve	2,00,000	2,00,000	Plant and Machinery	6,00,000	8,00,000
Profit & Loss	1,10,000	1,90,000	Stock2,50,000	2,10,000	
Income Tax Provisions	40,000	1,10,000	Debtors	3,00,000	2,40,000
Creditors	50,000	40,000	Cash	3,00,000	24,000
Bills Payable	20,000	30,000	Preliminary Expenses	30,000	20,000
Provision for Doubtful Debts	30,000	24,000			
	19,50,000	19,94,000		19,50,000	19,94,000

Additional Information :

(*a*) During the year 2004, a part of machinery costing Rs. 7,500 (Accumulated depreciation thereon being Rs. 2,500) was sold for Rs. 3,000.

(*b*) Dividend for Rs. 1,00,000 was paid during the year ended 31st December 2004.

(*c*) Income Tax Rs. 50,000 was paid during the year 2004.

(*d*) Depreciation for the year 2004 was provided as follows :

	Rs.
Land and Buildings	10,000
Plant and Machinery	50,000

You are required to prepare :

(*i*) A schedule of change in Working Capital and

(*ii*) A Statement showing the Sources and Application of Funds.(*CA M.Com. Utkal, Poona*)

SOLUTION :

SCHEDULE OF CHANGES IN WORKING CAPITAL

Items	*2003*	*2004*	*Changes in Working Capital*	
			Increase *Dr.*	*Decrease* *Cr.*
Current Assets :	*Rs.*	*Rs.*	*Rs.*	*Rs.*
Closing Stock	2,50,000	2,10,000	—	40,000
Debtors, less Provision	2,70,000	2,16,000	—	54,000
Cash	3,00,000	24,000	—	2,76,000
	8,20,000	4,50,000		

Current Liabilities :				
Creditors	50,000	40,000	10,000	—
Bills Payable	20,000	30,000	—	10,000
	70,000	70,000		
Working Capital	7,50,000	3,80,000		
Net Decrease in Working Capital	—	3,70,000	3,70,000	—
	7,50,000	7,50,000	3,80,000	3,80,000

FUNDS FLOW STATEMENT

Sources	*Rs.*	*Applications*	*Rs.*
Funds from Operations (3)	3,82,000	Payment of Dividend	1,00,000
Sale of Machinery	3,000	Payment of Income Tax	50,000
Issue of Share Capital	1,00,000	Purchase of Land and Buildings (2)	2,50,000
Decrease in Working Capital	3,70,000	Purchase of Plant and Machinery (1)	2,55,000
		Redemption of Debentures	2,00,000
	8,55,000		8,55,000

Workings :

(1) PLANT AND MACHINERY ACCOUNT

	Rs.		*Rs.*
To Balance b/d	6,00,000	By Bank (Sales)	3,000
To Bank (Purchase) (Balancing figure)	2,55,000	By Profit & Loss A/c (Loss on Sale)	2,000
		By Profit & Loss A/c (Depreciation)	50,000
		By Balance c/d	8,00,000
	8,55,000		8,55,000

(2) LAND AND BUILDING ACCOUNT

	Rs.		*Rs.*
To Balance b/d	4,20,000	By Profit & Loss A/c (Depreciation)	10,000
To Bank (Purchase) (Balancing figure)	2,50,000	By Balance c/d	6,60,000
	6,70,000		6,70,000

(3) ADJUSTED PROFIT AND LOSS ACCOUNT

	Rs.		*Rs.*
To Depreciation :			
Machinery	50,000	By Balance b/d	1,10,000
Land & Buildings	10,000	By Funds from Operations	3,82,000
To Dividends	1,00,000		
To Income Tax Provision (4)	1,20,000		

To Loss on Sale of Machinery	2,000		
To Goodwill Written Off	10,000		
To Preliminary Expenses Written Off	10,000		
To Balance c/d	1,90,000		
	4,92,000		4,92,000

(4) INCOME TAX PROVISION ACCOUNT

	Rs.		Rs.
To Bank (Payment)	50,000	By Balance b/d	40,000
To Balance c/d	1,10,000	By Profit & Loss A/c (Balancing figure)	1,20,000
	1,60,000		1,60,000

4. **The following is the Balance Sheet of a company as on 31st March:** (4)

Liabilities	*Rs.*	*Assets*	*Rs.*
Share Capital	2,00,000	Land and Buildings	1,40,000
Profit & Loss Account	30,000	Plant and Machinery	3,50,000
General Reserve	40,000	Stock	2,00,000
12% Debentures	4,20,000	Sundry Debtors	1,00,000
Sundry Creditors	1,00,000	Bills Receivable	10,000
Bills Payable	50,000	Cash at Bank	40,000
	8,40,000		8,40,000

Calculate :

(1) Current Ratio
(2) Quick Ratio
(3) Inventory to working Capital
(4) Debt to Equity Ratio
(5) Proprietary Ratio
(6) Capital Gearing Ratio
(7) Current Assets to Fixed Assets

SOLUTION :

(1) Current Ratio $= \frac{\text{Current assets}}{\text{Current Liabilities}}$

$$= \frac{\text{Rs. } 3,50,000}{\text{Rs. } 1,50,000} = \mathbf{2.33 : 1}$$

(2) Quick Ratio $= \frac{\text{Liquid Assets}}{\text{Liquid Liabilities}}$

$$= \frac{\text{Rs. } 1,50,000}{\text{Rs. } 1,50,000} = \mathbf{1 : 1}$$

(3) Inventory to Working Capital $= \frac{\text{Inventory}}{\text{Working Capital}}$

$$= \frac{\text{Rs. } 2,00,000}{\text{Rs. } 2,00,000} = \mathbf{1 : 1}$$

(Working Capital = Current Assets – Current Liabilities
= Rs. 3,50,000 – Rs. 1,50,000 = Rs. 2,00,000)

(4) Debt to Equity Ratio $= \frac{\text{Long Term Debts}}{\text{Shareholders' Fund}}$

$$= \frac{Rs.\ 4{,}20{,}000}{Rs.\ 2{,}70{,}000} = \mathbf{1.56 : 1}$$

(Or)

$$= \frac{\text{Long Term Debts}}{\text{Shareholders' Fund + Long Term Debts}}$$

$$= \frac{Rs.\ 4{,}20{,}000}{Rs.\ 2{,}70{,}000 + 4{,}20{,}000} = \mathbf{0.6 : 1}$$

(5) Proprietary Ratio $= \frac{\text{Shareholders' Fund}}{\text{Total Assets}}$

$$= \frac{Rs.\ 2{,}70{,}000}{Rs.\ 8{,}40{,}000} = \mathbf{0.32 : 1}$$

(6) Capital Gearing Ratio $= \frac{\text{Fixed Interest Bearing Securities}}{\text{Equity Share Capital}}$

$$= \frac{Rs.\ 4{,}20{,}000}{Rs.\ 2{,}00{,}000} = \mathbf{2.1 : 1}$$

(7) Current Assets to Fixed Assets Ratio $= \frac{\text{Current Assets}}{\text{Fixed Assets}}$

$$= \frac{Rs.\ 3{,}50{,}000}{Rs.\ 4{,}90{,}000} = \mathbf{0.71 : 1}$$

5. On 1st July, 2008 a company purchased a machine for Rs 3,90,000 and spent Rs 10,000 on its installation. It decided to provide depreciation @ 15% per annum, using written down value method. On 30th November, 2011 the machine was dismantled at a cost of Rs 5,000 and then sold for Rs 1,00,000.

   On 1st December, 2011 the company acquired and put into operation a new machine at a total cost of Rs 7,60,000. Depreciation was provided on the new machine on the same basis as had been used in the case of the earlier machine. The company closes its books of account every year on 31st March. Prepare Machinery Account and Depreciation Account for four accounting years ended 31st March. 2012. (4)

Solution :

Machinery Account

Date	Particulars	₹	Date	Particulars	₹
2008			2009		
July 1	To Bank	3,90,000	March, 31	By Depreciation A/c (for 8 months @ 15% p.a)	40,000
" "	To Bank (installation expenses)	10,000	" "	By Balance b/d	3,60,000
		4,00,000			4,00,000
2009			2010		
Apr.1	To Balance b/d	3,60,000	March. 31	By Depreciation A/c (on ₹ 3,60,000 @ 15%)	54,000
			" "	By Balance c/d	3,06,000
		3,60,000			3,60,000
2010			2011		
April 1	To Balance b/d	3,06,000	Mar. 31	By Depreciation A/c (on ₹ 3,06,000 @ 15%)	45,900
			" "	By Balance c/d	2,60,100
		3,06,000			3,06,000
2011			2011		
Apr. 1	To Balance b/d	2,60,100	Nov. 30	By Depreciation A/c (on ₹ 2,60,000 @ 15% for 8 months)	26,010
Nov. 30	To Bank (dismantling Charges)	5,000	" "	By Bank (sale proceeds)	1,00,000
Dec. 1	To Bank (total cost of new machine)	7,60,000	" "	By Profit and Loss A/C	
			" "	(loss on disposal of machine)	1,39,090
			2012		
			Mar. 31	By Depreciation A/c (on ₹ 7,60,000 for 4 months @ 15% p.a.)	38,000
			" "	By Balance c/d	7,22,000
		10,25,000			10,25,100
2012					
Apr. 1	To Balance b/d	7,22,000			

Dr. **Depreciation Account** Cr.

Date	Particulars	₹	Date	Particulars	₹
2009 Mar. 31	To Machinery A/c	40,000	2009 Mar. 31	By Profit & Loss A/c – transfer	40,000
2010 Mar. 31	To Machinery A/c	54,000	2010 Mar. 31	By Profit & Loss A/c – transfer	54,000
2011 Mar. 31	To Machinery A/c	45,900	2011 Mar. 31	By Profit & Loss A/c – transfer	45,900
2011 Nov. 30	To Machinery A/c	26,010	2012 Mar. 31	By Profit & Loss A/c – transfer	64,010
2012 Mar. 31	To Machinery A/c	38,000			
		64,010			64,010

Working Notes:

	₹
Written down value of machine on 1st April, 2011	2,60,100
Less: Depreciation for 8 months	26,010
Written down value of machine on 30th November, 2009	2,34,090
Add: Dismantling charges	5,000
	2,39,090
Less: Sales proceeds of machine	1,00,000
Loss on disposal of machine	1,39,090

6. **What is zero base Budgeting? Explain it in detail.** (3)

Ans. **Zero Based Budgeting Meaning and Definition:** Zero based budgeting in management accounting involves preparing the budget from the scratch with a zero-base. It involves re-evaluating every line item of cash flow statement and justifying all the expenditure that is to be incurred by the department.

Thus, zero-based budgeting definition goes as a method of budgeting whereby all the expenses for the new period are calculated on the basis of actual expenses that are to be incurred and not on the incremental basis which involves just increasing the expenses incurred in the previous year at some fixed rate. Under this method, every activity needs to be justified, explaining the revenue that every cost will generate for the company.

Contrary to the traditional budgeting in which past trends or past sales/expenditure are expected to continue, zero-based budgeting assumes that there are no balances to be carried forward or there are no expenses that are pre-committed. In the literal sense, it is a method for building the budget with zero prior bases. Zero-based budgeting lays emphasis on identifying a task and then funding these expenses irrespective of the current expenditure structure.

Zero Based Budgeting Steps

- Identification of a task

- Finding ways and means of accomplishing the task
- Evaluating these solutions and also evaluating alternatives of sources of funds
- Setting the budgeted numbers and priorities

Zero Based Budgeting Example: Let us take an example of a manufacturing department of a company ABC that spent $ 10 million last year. The problem is to budget the expenditure for the current year. There are multiple ways of doing so:

- The board of directors of the company decides to increase/decrease the expenditure of the department by 10 percent. So the manufacturing department of ABC Ltd will get $ 11 million or $ 9 million depending on the management's decision.
- The senior management of the company may decide to give the department the same amount as it got in the previous year without hiring more people in the department, or increasing the production etc. This way, the department ends up getting $ 10 million.
- Another way is, as, against the traditional method, management may use zero-based budgeting in which the previous year's number of $ 10 million is not used for calculation. Zero-based budgeting application involves calculating all the expenses of the department and justifying each of these. This reflects the actual requirement of the manufacturing department of company ABC which may be $ 10.6 million.

Zero Based Budgeting Advantages:

- **Accuracy**: Against the regular methods of budgeting that involve just making some arbitrary changes to the previous year's budget, zero-based budgeting makes every department relook each and every item of the cash flow and compute their operation costs. This to some extent helps in cost reduction as it gives a clear picture of costs against the desired performance.
- **Efficiency**: This helps in efficient allocation of resources (department-wise) as it does not look at the historical numbers but looks at the actual numbers
- **Reduction in redundant activities**: It leads to the identification of opportunities and more cost-effective ways of doing things by removing all the unproductive or redundant activities.
- **Budget inflation**: Since every line item is to be justified, zero-based budget overcomes the weakness of incremental budgeting of budget inflation.
- **Coordination and Communication**: It also improves coordination and communication within the department and motivates employees by involving them in decision-making.

Although zero-based budgeting merits make it look like a lucrative method, it is important to know the disadvantages listed as under:

Zero Based Budgeting Disadvantages:

- **Time-Consuming:** Zero-based budgeting is a very time-intensive exercise for a company or a government-funded entries to do every year as against incremental budgeting, which is a far easier method.

- **High Manpower Requirement:** Making an entire budget from the scratch may require the involvement of a large number of employees. Many departments may not have an adequate time and human resource for the same.
- **Lack of Expertise**: Explaining every line item and every cost is a difficult task and requires training the managers.

Conclusion: Zero-based budgeting aims at reflecting true expenses to be incurred by a department or a state [in the case of budget making by the government]. Although time-consuming, this is a more appropriate way of budgeting. At the end of the day, it is a company's call as whether it wants to invest time and manpower in the budgeting exercise to provide more accurate numbers or go for an easier method of incremental budgeting.

7. **Write short note on Price Level Change Accounting.** (3)

Ans. **Meaning Of Accounting For Price Level Changes**: The general tendency in changes of prices of goods and services over a time is called price level. The rise in general price level is called inflation. During the period of inflation, purchasing power of money declines. The fall in the general price level is called deflation. During the period of deflation, purchasing power of money increases. Price level change means increase or decrease in the purchasing power of money over a period of time. The accounting which considers price level changes is called accounting for price level changes.

Accounting for price level changes is a system of maintaining accounts in which all items in financial statements are recorded at current values. This system of accounting ascertains profit or loss and presents financial position of the business on the basis of current prices. Accounting for price level changes is also called inflation accounting

Objectives of accounting for Price Level Changes: Historical cost accounting financial statements are prepared on the assumption that monetary unit is stable. But in reality, monetary unit is never stable and most of the countries have been facing high rates of inflation. Therefore, financial statements prepared under historical cost accounting do not reflect current economic realities. They fail to give realistic and correct picture of the state if affairs of a concern. To overcome the limitation of historical cost accounting, there is a need to consider the effects of changes in value of money as a result of changes of price of goods and services. Following are the objectives of accounting for price level changes.

- To show the true result of the operations i.e. real profit or loss.
- To show the true financial position in current values.
- To show the realistic value of fixed assets in financial statement.
- To provide sufficient depreciation to generate funds for the replacement of fixed assets.
- To indicate the real capital employed.
- To make distinction between holding gain or loss and operating gain or loss.
- To make accounting records reliable for the various users.

Methods of accounting for Price Level Changes: There are many methods of adjustments for the effects of changes in prices. The generally accepted methods of accounting for price level changes are as under:

- Current purchasing power method or general purchasing power method (CPP or GPP)
- Current cost accounting method(CCA method)
- A hybrid method i.e mixture of CPP and CCA method.

8. **What is IFRS? Explain its features.** (4)

Ans. **International Financial Reporting Standards**, usually called the **IFRS Standards**, are standards issued by the Foundation and the International Accounting Standards Board (IASB) to provide a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries. They are progressively replacing the many different national accounting standards. They are the rules to be followed by accountants to maintain books of accounts which are comparable, understandable, reliable and relevant as per the users internal or external. IFRS, with the exception of IAS 29 Financial Reporting in Hyperinflationary Economies and IFRIC 7 Applying the Restatement Approach under IAS 29, are authorized in terms of the historical cost paradigm. IAS 29 and IFRIC 7 are authorized in terms of the units of constant purchasing power paradigm.

IFRS began as an attempt to harmonize accounting across the European Union but the value of harmonization quickly made the concept attractive around the world. However, it has been debated whether or not de facto harmonization has occurred. Standards that were issued by IASC (the predecessor of IASB) are still within use today and go by the name **International Accounting Standards**(IAS), while standards issued by IASB are called IFRS. IAS were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC). On 1 April 2001, the new International Accounting Standards Board (IASB) took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs). The IASB has continued to develop standards calling the new standards "International Financial Reporting Standards".

Features of IFRS: IFRS financial statements come in various shapes and sizes, but they all have certain features in common. Information in IFRS financial statements has these characteristics:

- **Relevance:** So that it makes a difference to the decisions about a company made by users of the statements.
- **Faithful representation:** Financial statements are complete and free from bias and error.
- **Comparability:** You can compare financial statements from one period to the next or for two companies in the same industry so that you can make informed decisions about the companies.

- **Verifiability:** Different people could reach the same decision based on the information, but not necessarily reach complete agreement.
- **Timeliness:** You make information available to users in good time. Historical information quickly becomes out of date.
- **Understandability:** You present and classify information clearly and concisely to make it understandable to users.