CBSE Test Paper 04

Ch-2 Theory Base of Accounting

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1. Which principle states that personal transactions are distinguished from business transactions of an accounting period in Business
2. Vardhman Ltd gets a contract of Rs.200 crore to build a hospital to be completed in 4 years. The management of the company wants to ascertain profit or loss on this contract only when the contract is completed. Is the management correct?
3. The fact that all anticipated losses should be recorded but all anticipated profits should be ignored is best exemplified by which principle?
4. A company purchased goods for Rs.10,00,000 and sold 80% of such goods during the year. The market value of remaining goods was Rs.1,80,000. The company valued the closing stock at 2,00,000 i.e. ,cost. Is the treatment correct?
5. Rajnish, proprietor of RYZ & Co purchased an LCD TV and installed it at his residence and made the payment by issuing a cheque from the account of RYZ & Co. The accountant debited the fixed assets account, Is he correct in doing so?
6. State which financial statements are prepared under IFRS.
7. Explain verifiable objective concept or objectivity principle.
8. What do you understand by accounting standards? Give any three point highlighting the nature of accounting standards.
9. Double entry system of accounting is based on the principle of 'dual aspect'. Explain any three features of double entry system of accounting and also give any three benefits?
10. Discuss the concept based on the premise 'do not anticipate profits but provide for all losses'.

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Answer

1. Principle of separate Entity

2. No, management is not correct.

3. The fact that all anticipated losses should be recorded but all anticipated profits should be ignored is best exemplified by 'Conservatism or prudence principle'.

4. No, the principle of conservatism is being violated, here the closing stock should have been valued at 1,80,000.

5. No, the accountant is not correct, because as per business entity concept, business is separate and distinct from its owners.

6. **IFRS Based Financial Statements :**

   International Financial Reporting Standards (IFRS) can be referred as principle-based standards, interpretations, and the framework espoused by the IASB (International Accounting Standards Board). The various standards that form an integral part of IFRS are known by the older name of International Accounting Standards.

   The IFRS financial statement forms include the following:

   - A Statement of Financial Position
   - A Statement of Comprehensive Income that includes an income statement in addition to an individual statement of comprehensive income, which brings together Profit or Loss on the Income statement to total comprehensive income
   - A Statement of Changes in Equity
   - A Cash Flow Statement or Statement of Cash Flows
   - Notes, comprising a summary of the significant accounting policies

7. The objectivity principle states that accounting information and financial reporting should be independent and supported with unbiased evidence. This means that

accounting information must be based on research and facts, not merely a preparer's opinion. The objectivity principle is aimed at making financial statements more relevant and reliable.

The concept of relevance implies that financial statements can have predictive value and feedback value. This means the financial statements are accurate and can be used to predict future company performance.

The concept of reliability implies that financial information can be verified by many sources with evidence and that all financial information is presented. In other words, the favorable and unfavorable financial information is presented in the financial statements.

The two concepts of relevance and reliability encompass the objectivity principle. By making financial statements more relevant and reliable, the objectivity principle makes the financial information more usable for investors and creditors.

8. **Accounting Standards:** Accounting standards may be defined as written statements, issued from time to time by institutions of accounting professionals, specifying uniform rules or practices for drawing the financial statements.

   Kohler defines accounting standard as "a code of conduct imposed on accountants by custom, law or professional body."
   Nature of Accounting Standards: Following points highlight the nature of accounting standards.

   i. Accounting standards are a framework of practices and guidelines which facilitates reliability and comparability to financial statements.
   ii. Accounting standards bring uniformity in accounting practices of various businesses.
   iii. Accounting standards design and mould the business environment by prescribing and recommending accounting practices.

9. **Double Entry System:-**
   Double entry system is based on the principle of 'dual aspect' which states that every transaction has two aspects i.e. debit and credit.

The basic principle followed is that every debit must have a corresponding credit. Thus, one account is debited and the other is credited.
It is a complete system as both the aspects of a transaction are recorded in the books of accounts. The system is accurate and more reliable as the possibilities of frauds and misappropriations are minimised.
The system of double entry can be implemented by big as well as small organisations.
Features of the Double Entry System:-
Features of the double entry system are as follow

i. It maintains a complete record of each transaction.
ii. In this system, one aspect is debited and another aspect is credited as per the rules of debit and credit.
iii. It recognises the two side aspects of every transaction i.e.debit and credit.
iv. The total of all debits is always equal to the total of all credits. It also helps in establishing the arithmetical accuracy of accounting records by preparing the trial balance.

Advantages of the Double Entry System
The main advantages of the double entry system are:-

i. **Complete Record of Transaction:-** Under the double entry system both sides of a transaction are recorded, which results in presenting correct income or loss, assets and liabilities.
ii. **Scientific System:-** Double entry system is a scientific system of recording business transactions. Two sides of a transaction are recorded on the basis of scientific and logical rules which leave little room for errors.
iii. **Calculation of Profit or Loss:-** The profit earned or loss suffered during a period can be found out by preparing the profit and loss account.
iv. **Check on the Accuracy of Accounts:-** The accuracy of the accounting work can be established by the use of this system, by preparing the trial balance.
v. **Ascertainment of Financial Position:-** The financial position of the business can be ascertained at the end of the accounting period by preparing the balance sheet.

10. The concept of conservatism (also called 'prudence') provides guidance for recording transactions in the books of accounts and is based on the policy of playing safe.

This principle states that 'Do not anticipate profits but provide for all possible losses'. In other words, we should make provisions for probable future expenses and ignore any future probable gain, until it actually happens. It is the prudence principle which ensures that the financial statements present a realistic picture of the working affairs of the business and does not present a picture which will mislead the users of accounting information.
For example, Closing stock is valued at lower of cost or net realisable value, making provisions for doubtful debts or making provisions for any future likely obligation or liability,Joint life policy is shown at surrender value as against the amount paid, Provision for pending suit against the firm, which may either be decided in its favour. This principle ignores anticipated future profits or revenue until they actually materialise.
This approach of providing for the losses but not recognising the gains until realised is called conservation approach.
However, excess use of this concept may have two effects i.e. Profit and loss account will disclose lower profits in comparison to the actual profits and Balance sheet will disclose understatement of assets and overstatement of liabilities in comparison to the actual values.

The above-mentioned effects will result in creation of secret reserves which is in direct conflict with the convention of full disclosure.