CBSE Test Paper 01
Ch-2 Theory Base of Accounting

1. Which principle states that the accounting data should be definite, verifiable and free from the personal bias?
2. The cost of a small calculator is accounted as an expense and not shown as an asset in financial statements of a business entity due to which concept?
3. Omission of paise and showing the round figures in financial statements is based on which concept?
4. The management of a firm is remarkably incompetent but the firms accountants cannot take this into account while preparing book of accounts of which concept?
5. An accountant has recorded advance received against sale of goods as 'advance against sale' and not sales. Is he correct in doing so? If yes name the accounting concept which requires so?
6. Why is it necessary for accountants to assume that business entity will remain a going concern?
7. What is the basic accounting equation?
8. 'Only financial transactions are recorded in accounting'. Explain the statement.
9. What is matching concept? Why should a business concern follow this concept? Discuss.
10. Briefly explain your understanding of IFRS and also give the underlying assumptions in IFRS.

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Answer

1. Principle of Objectivity
2. Convention of Materiality
3. Convention of Materiality
4. The concept of Money measurement.
5. Yes, he is correct as per the revenue recognition concept.
6. Going Concern Concept assumes that the business entity will continue its operation for an indefinite period of time. It is necessary to assume so, as it helps to bifurcate revenue expenditure (i.e. expenditure related to current year), and capital expenditure (i.e. expenditure whose benefits accrue over a period of time). For example, a machinery that costs Rs 1,00,000, having an expected life of 10 years, will be treated as a capital expenditure, as its benefit can be availed for more than one year; whereas, the per year depreciation of the machinery, say Rs 10,000, will be regarded as a revenue expenditure.
7. The basic accounting equation is given below
   Assets = Liabilities + Capital
   or
   Assets = Claim of Outsiders + Owner's Equity or Capital.
8. According to this principle, only those transactions and events are recorded in accounting which are capable of being expressed in terms of money are recorded in the books of accounts, such as the sale of goods or payment of expenses or receipt of income, etc.
   An event may be important for the business (such as dispute among the owners or managers, the appointment of a manager, etc.), but it will not be recorded in the books of accounts simply because it can not be converted or recorded in terms of

money. For instance, strike by workers may adversely affect the business but it cannot be recorded in the books of accounts unless its effect can be measured in terms of money with a fair degree of accuracy.
Another aspect of this principle is that the transactions that can be expressed in terms of money have to be converted in terms of money before being recorded.

It should be remembered that money is the only measurement which enables various things of diverse nature to be added up together and dealt with. The money measurement assumption is not free from limitations. Due to the changes in price, the value of money does not remain the same over a period of time. The value of rupee today on account of rising in price is much less than what it was, say ten years back. As the change in the value of money is not reflected in the book of accounts, the accounting data does not reflect the true and fair view of the affairs of an enterprise. As, such, to make accounting records relevant, simple, understandable and homogeneous, they are expressed in a common unit of measurement,i.e., money.

9. This concept is very important for the correct determination of net profit. According to this principle, expenses incurred in an accounting period should be matched with revenues during that period i.e., when revenue is recognised in a period, then the cost related to that revenue also needs to be recognised in that period to enable calculation of correct profits of the business.
   The matching concept thus, states that all revenues earned during an accounting year, whether received during that year or not and all costs incurred, whether paid during the year or not should be taken into account while ascertaining profit or loss for that year. When some expense, say insurance premium is paid partly for the next year also, the part relating to the next year will be shown as an expense only next year and not this year. This means that that part of the insurance premium against which benefit will be derived or revenue will be earned in future should be shown in the balance sheet as an asset and the rest is treated as an expense during the current year.
   For example, If there is unsold stock at the end of accounting period, then its cost needs to be carried over to next year, so that such cost can be recognised or adjusted with the revenue earned with the sale of such stock.
   Similarly, if a machinery is purchased with useful life of 10 years, then its cost needs

to be spread over these 10 years, so that it gets adjusted with the revenue earned in those 10 years. If revenue is received for which expenses are to be incurred in next year, then such revenue is also carried over to next year to be matched with its cost only.

A business concern should follow this concept otherwise it will be very much difficult to ascertain the profit or loss of a given period of time.

10. **International Financial Reporting Standards (IFRS):-**

Globalisation has unified different economies of the world. Enterprises are carrying on business worldwide. As accounting is the language of business, different enterprises around the world should not be speaking different languages in their financial statements. It will be very difficult to understand and compare these statements.

International Financial Reporting Standards (IFRS) are issued by the International Accounting Standard Board (IASB). IASB replaced International Accounting.Standard Committee (LASC) in 2001.LASC was formed in 1973 to develop accounting standards which have global acceptance and makes different accounting statements of different countries similar and comparable.

Assumptions in IFRS:-

The underlying assumptions in IFRS are as follows:

i. **Measuring Unit Assumption:-** Current purchasing power is the measuring unit which means that assets in the balance sheet are shown at current or fair value and not at historical cost.
ii. **Constant Purchasing Power Assumption:-** It means that the value of capital is to be adjusted for inflation at the end of the financial year.
iii. **Accrual Assumption:-** Transactions are recorded as and when they occur and the date of settlement is irrelevant.
iv. **Going Concern Assumption:-** It is assumed that the life of the business is infinite.