CA- CPT
Fundamentals of Accounting

1. Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in at least, of a financial character and interpreting the result thereof.

2. An economic event that involves transfer of money or money's worth is **financial transaction**.

3. Accounting Cycle or Generating Financial Information :-
   - Recording (Journal Entry)
   - Classifying (Posting to Ledger)
   - Summarizing (Preparing Financial Statements)
   - Analysis
   - Interpreting
   - Communicating

4. Financial Statements include :-
   - Trial Balance
   - Profit & Loss A/c
   - Balance Sheet
   - Cash Flow Statement

5. Users of Financial Statements
   - Internal Users :- Board of Directors, Partners, Managers, Officers
   - External Users :- Investors, Lenders, Suppliers, Govt. Agencies, Public, Customers,

6. Stewardship Accounting was the root of Financial Accounting System. Steward means person who manages property of other for some consideration.

7. Objectives of Accounting
   - Systematic Recording of Transaction (Journal, Ledger & Trial Balance)
   - Ascertainment of Results (Manufacturing, Trading, P & L A/c)
   - Ascertainment of Financial Position (Balance Sheet)
   - Communicating Information to users (Financial Reports)

8. Functions of Accounting
   - Measurement
   - Forecasting
   - Decision-Making
   - Comparison & Evaluation
   - Control
   - Government Regulation & Taxation

9. Sub Fields of Accounting – Financial Accounting, Management Accounting, Cost Accounting, Social Responsibility Accounting, Human Resource Accounting.

10. Accounting Concepts define the Assumptions on the basis of which financial Statements of business entity are prepared.

11. Accounting principles must satisfy the following conditions:
   - They should be based on real assumptions;
   - They must be simple, understandable and explanatory;
   - They must be followed consistently;

- They should be able to reflect future predictions;
- They should be informational for the users.

12. Accounting Concepts, Principles And Conventions

a. ***Entity concept*** **:** Entity concept states that business enterprise is a separate identity apart from its owner.
b. ***Money measurement concept :*** As per this concept, only those transactions, which can be measured in terms of money are recorded.
c. ***Periodicity concept :*** This is also called the concept of definite accounting period. As per 'going concern' concept an indefinite life of the entity is assumed. According to this concept accounts should be prepared after every period & not at the end of the life of the entity.
d. ***Accrual concept*** **:** Under accrual concept, the effects of transactions and other events are recognised on mercantile basis i.e., when they occur (and not as cash or a cash equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.
e. ***Matching concept*** **:** In this concept, all expenses matched with the revenue of that period should only be taken into consideration. In the financial statements of the organization if any revenue is recognized then expenses related to earn that revenue should also be recognized.

   Periodic Profit = Periodic Revenue – Matched Expenses
f. ***Going Concern concept*** **:** The financial statements are normally prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future.
g. ***Cost concept :*** By this concept, the value of an asset is to be determined on the basis of historical cost i.e acquisition cost.
h. ***Realisation concept*** **:** It closely follows the cost concept. Any change in value of an asset is to be recorded only when the business realises it.
i. ***Dual aspect concept*** **:** This concept is the core of double entry book-keeping. Every transaction or event has two aspects:
   1. It increases one Asset and decreases other Asset;
   2. It increases an Asset and simultaneously increases Liability;
   3. It decreases one Asset, increases another Asset;
   4. It decreases one Asset, decreases a Liability.

   Alternatively:

   5. It increases one Liability, decreases other Liability;
   6. It increases a Liability, increases an Asset;
   7. It decreases Liability, increases other Liability;
   8. It decreases Liability, decreases an Asset.
j. ***Conservatism / Prudence :*** Realisation Concept states that no change should be counted unless it has materialized. Conservatism states that it is not prudent to count unrealized gain but it is desirable to guard against all possible losses. **Prudence principle** is an exception to the consistency.
k. ***Consistency :*** The accounting policies are followed consistently from one period to another; a change in an accounting policy is made only in certain exceptional circumstances.

   An enterprise should change its accounting policy in any of the following circumstances only:
   i. To bring the books of accounts in accordance with the issued Accounting Standards.
   ii. To compliance with the provision of law.
   iii. When under changed circumstances it is felt that new method will reflect more true and fair picture in the financial statement.
l. ***Materiality:*** Materiality principle permits other concepts to be ignored, if the effect is not considered material. According to materiality principle, all the items having significant economic effect on the business of the enterprise should be disclosed in

the financial statements and any insignificant item which will only increase the work of the accountant but will not be relevant to the users' need should not be disclosed in the financial statements. Materiality principle is an **exception to the Full disclosure principle.**

13. Fundamental accounting assumptions (as per AS-1):
    a. Going Concern
    b. Consistency
    c. Accrual

    If nothing has been written about the fundamental accounting assumption in the financial statements then it is assumed that they have already been followed in their preparation of financial statements.

14. **Substance Over Form :** If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form.

15. Basic Accounting Equation :
    Equity (E) + Liabilities (L) = Assets (A) or Equity (E) = Assets (A) – Liabilities (L)
    Or, Equity + Long Term Liabilities + Current Liabilities = Fixed Assets + Current Assets
    Or, Equity + Long Term Liabilities = Fixed Assets + (Current Assets – Current Liabilities)
    Or, Equity = Fixed Assets + Working Capital – Long Term Liabilities

16. Accounting Standard in India are issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI).

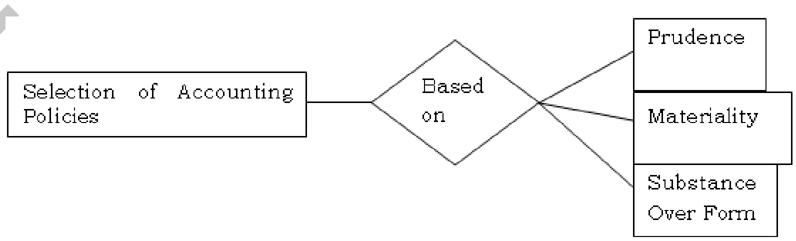
17. 32 AS are issued by ICAI and 31 AS are in force.

18. Accounting Standards (ASs) provide framework and standard accounting policies so that the financial statements of different enterprises become comparable.

19. Accounting standards cannot override the statute (Law). The standards are required to be framed within the ambit of prevailing statutes (Law).

20. Accounting Policies refer to specific accounting principles and methods of applying these principles adopted by the enterprise in the preparation and presentation of financial statements. Like method of depreciation, valuation of inventories, valuation of investments etc.

21. Selection of Accounting Policies



22. It is essential to standardize the accounting principle and policies in order **to ensure Transparency, Consistency, and Comparability.**

23. A change in accounting policies should be made in the following conditions:
    (a) It is required by some statute or for compliance with an Accounting Standard.
    (b) Change would result in more appropriate presentation of financial statement.

24. Measurement Discipline deals with
    a. Identification of objects & events
    b. Selection of scale
    c. Evaluation of dimension of measurement scale

25. Generally accepted Measurement Bases or Valuation Principles are
    a. Historical Cost- It means Acquisition Cost.
    b. Current Cost – It means cash or cash equivalent that would have to be paid if the same or an equivalent asset was acquired currently.
    c. Realisable Value – It means cash or cash equivalents that could currently be **obtained by selling** the asset in an orderly disposal.
    d. Present Value – Devalued amount of future receivable money.

26. GOLDEN RULES OF ACCOUNTING
    a. Personal account - *Debit* the receiver & *Credit* the giver
    b. Real account - *Debit* what comes in & *Credit* what goes out
    c. Nominal account - *Debit* all expenses and losses & *Credit* all incomes and gains.

26. Asset Liability, Income Expense Approach
    a. Increases in assets are debits; decreases are credits
    b. Increases in liabilities are credits; decreases are debits
    c. Increases in owner's capital are credits; decreases are debits
    d. Increases in expenses are debits; decreases are credits
    e. Increases in revenue or incomes are credits; decreases are debits

27.

Sl. No.	*Title of Account*	*Traditional Approach*	*Accounting Equation Approach*
(a)	Purchases	Real	Asset
(b)	Adjusted Purchases	Nominal (Expense)	Temporary Capital (Expense)
(c)	Sales	Real	Temporary Capital (Revenue)
(d)	Bank Deposit	Personal	Asset
(e)	Rent	Nominal (Expense)	Temporary Capital (Expense)
(f)	Rent Outstanding	Personal	Liability
(g)	Rent received in advance	Personal	Liability
(h)	Closing Stock	Real	Asset
(i)	Investment	Real	Asset
(j)	Sales Tax Payable	Personal	Liability
(k)	Discount Allowed	Nominal (Expense)	Temporary Capital (Expense)
(l)	Capital	Personal	Capital
(m)	Drawings	Personal	Temporary Capital (Drawings)
(n)	Interest receivable	Personal	Asset
(o)	Prepaid salary	Personal	Valuation (Asset)
(p)	Bad debts recovered	Nominal (Gain)	Temporary Capital (Gain)
(q)	Depreciation	Nominal (Expense)	Temporary Capital (Expense)
(r)	Personal Income Tax	Personal (Drawing)	Temporary Capital (Drawings)

28. Financial Books
    a. Principle Books : Cash Book, Ledger
    b. Subsidiary Books : Journal, Purchase Book, Sales Book, Purchase Return/ Return Outward Book, Sales Return /Return Inward Book, Bills Receivable Book, Bills Payable Book etc.

29. Total amount of Purchase in Purchase Book is debited to the Purchase Account.

30. Total amount of Sales in Sales Book is credited to the Sales Account.

31. Cash Sales are entered in Cash Book and not in Sales Book.

32. Credit Note : It is issued in regard of Sales Return.

33. Debit Note : It is issued in regard of Purchase Return.

34. Cash Book is both a Principal Book & a Subsidiary Book.

35. Kinds of Cash Book:
    a. Simple Cash Book – It is one column book.
    b. Two Column Cash Book – Cash and Discount columns are maintained.
    c. Three Column Cash Book – Cash, Discount & Bank column are maintained.

36. Petty Cash Book : It is prepared to record small payment which are repeated frequently like postage, taxi fare, cartage etc.

37. Balance left with petty cashier is Asset of the entity.

38. The basic considerations in distinction between capital and revenue expenditures are:
    a. Nature of business
    b. Recurring nature of expenditure
    c. Purpose of expenses
    d. Effect on revenue generating capacity of business
    e. Materiality of the amount involved

39. Capital expenditure contributes to the revenue earning capacity of a business over more than one accounting period whereas revenue expense is incurred to generate revenue for a particular accounting period.

40. Installation charges of machinery purchased is **capital expense.**

41. Expense incurred on trial run of machine is **capital expenditure**.

42. Repair of second hand machinery before put to use is **capital expense.**

43. Annual maintenance fee of machine is **revenue expense**.

44. Cost of ring & pistons of an engine changed to get better fuel efficiency is **capital expense.**

45. Interest on term loan for purchase of machinery where the commercial production has not begun till the last day of accounting year is **capital expense.**

46. Premium received on issue of shares is **capital receipts.**

47. Scrap value of machinery is **capital receipt**.

48. Insurance claim for machinery damaged by fire is **capital receipt.**

49. Cash received from debtors is **revenue receipt**.

50. Fine imposed is **revenue expenditure**.

51. Purchase of goodwill is **capital expense**.

52. Import duty on purchase of material is **revenue expense**.

53. Loss on sale of machinery is **revenue loss.**

54. Festival advance to employee is **prepaid expense**.

55. Cost incurred on dismantling a machine worn out part is **revenue expense**.

56. Amount spent on repainting an old building for first time on purchase is **capital expense**.

57. Amount spent on annual repainting of building is **revenue expense.**

58. **Deferred revenue expenditure** is that expenditure for which payment has been made or a liability incurred but which is carried forward on the presumption that it will be of benefit over a subsequent period or periods.

59. So, long as deferred revenue expenditure is not written off, this is shown on the assets side of the balance sheet under the head “Miscellaneous Expenditure.

60. Receipts which are obtained in course of normal business activities are Revenue Receipts (e.g. receipts from sale of goods or services, interest income etc.).Receipts which are not revenue in nature are Capital Receipts (e.g. receipts from sale of fixed assets or investments, secured or unsecured loans, owners’ contributions etc.).

61. A contingent asset may be defined as a possible asset that arises from past events and whose existence will be confirmed only after occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

62. As per the concept of prudence as well as the present accounting standards, an enterprise should not recognise a contingent asset. A contingent asset is usually disclosed in the report of the approving authority (Board of Directors in the case of a company, and the corresponding approving authority in the case of any other enterprise), if an inflow of economic benefits is probable.

63. A contingent liability is a possible obligation arising from past events and may arise in future depending on the occurrence or non-occurrence of one or more uncertain future events. A contingent liability may also be a present obligation that arises from past events.

64. A liability is defined as the present financial obligation of an enterprise, which arises from past events. On the other hand, in the case of contingent liability, either outflow of resources to settle the obligation is not probable or the amount expected to be paid to settle the liability cannot be measured with sufficient reliability.

65. Present obligations that are recognised as liabilities in the balance sheet, enterprises are required to disclose contingent liability in their balance sheets by way of notes.

66. Provision means “any amount written off or retained by way of providing for depreciation, renewal or diminution in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy”.

67. In the financial statement contingent assets and liabilities are **not recognized.**

68. In the financial statement provisions are **recognized and adjusted.**

69. The trial balance checks the **arithmetical accuracy** of the books of account.

70. When a transaction is recorded in contravention of account principles it indicates **error of principle.**