

# VIDYA BHAWAN BALIKA VIDYA PITH

शक्तिउत्थानआश्रमलखीसरायबिहार

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## Theory Base of Accounting

*Question 1:*

Why is it necessary for accountants to assume that business entity will remain a going concern?

**ANSWER:**

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.

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*Question 2:*

When should revenue be recognised? Are there exceptions to the general rule?

**ANSWER:**

Revenue should be recognised when sales take place either in cash or credit and/or right to receive income from any source is established. Revenue is **not** recognised, in case, if the income or payment is received in advance or the payment is actually received from the debtors. In a nutshell, revenue will be recognised when the right to receive income is established. For example, Mr. A sold goods in January and received payment in February; then revenue is considered to be recognised in the month of January and not in February. However, if Mr A received cash in advance, i.e. in December and goods are sold in January, then the revenue is recognised in January and **not** in December.

The exceptions to this rule are given below.

**1) Hire purchase**– When goods are sold on hire-purchase system , the amount received in instalments is treated as revenue.

**2) Long term construction contract**– The long term projects like construction of dams, highways, etc. have long gestation period. Income is recognised on proportionate basis of work certified and **not** on the completion of contract.

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*Question 3:*

What is the basic accounting equation?

**ANSWER:**

The basic accounting equation is,

Assets = Liabilities + Capital

It means that all the monetary value of all assets of a firm are equal to the total claims, *viz.* owners and outsiders.

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*Question 4:*

The realisation concept determines when goods sent on credit to customers are to be included in the sales figure for the purpose of computing the profit or loss for the accounting period. Which of the following trends to be used in practice to determine when to include a transaction in the sales figure for the period. When the goods have been:

- a. dispatched    b. invoiced
- c. delivered     d. paid for

Give reasons for your answer.

**ANSWER:**

According to the realisation concept, revenue is recognised when an obligation to receive the amount arises. When the goods are invoiced, it is treated as the transfer of ownership of goods from the seller to the buyer and hence the revenue is recognised.

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*Question 5:*

Complete the following work sheet:

- (i) If a firm believes that some of its debtors may 'default', it should act on this by making sure that all possible losses are recorded in the books. This is an example of the \_\_\_\_\_ concept.
- (ii) The fact that a business is separate and distinguishable from its owner is best exemplified by the \_\_\_\_\_ concept.

- (iii) Everything a firm owns, it also owns out to somebody. This co-incidence is explained by the \_\_\_\_\_ concept.
- (iv) The \_\_\_\_\_ concept states that if straight line method of depreciation is used in one year, then it should also be used in the next year.
- (v) A firm may hold stock which is heavily in demand. Consequently, the market value of this stock may be increased. Normal accounting procedure is to ignore this because of the \_\_\_\_\_.
- (vi) If a firm receives an order for goods, it would not be included in the sales figure owing to the \_\_\_\_\_.
- (vii) The management of a firm is remarkably incompetent, but the firms accountants can not take this into account while preparing book of accounts because of \_\_\_\_\_ concept.

**ANSWER:**

- (i) If a firm believes that some of its debtors may 'default', it should act on this by making sure that all possible losses are recorded in the books. This is an example of the conservatism concept.
  - (ii) The fact that a business is separate and distinguishable from its owner is best exemplified by the business entity concept.
  - (iii) Everything a firm owns, it also owns out to somebody. This co-incidence is explained by the dual aspect concept.
  - (iv) The consistency concept states that if straight line method of depreciation is used in one year, then it should also be used in the next year.
  - (v) A firm may hold stock which is heavily in demand. Consequently, the market value of this stock may be increased. Normal accounting procedure is to ignore this because of the conservatism.
  - (vi) If a firm receives an order for goods, it would not be included in the sales figure owing to the revenue recognition.
  - (vii) The management of a firm is remarkably incompetent, but the firm's accountants cannot take this into account while preparing book of accounts because of money measurement concept
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