[Frequently Asked Questions]

Introduction to Financial Accounting

Subject:	Business Economics
Course:	B. A. (Hons.), 1st Semester, Undergraduate
Paper No. & Title:	Paper – 103 Fundamentals of Business and Accounting
Unit No. & Title:	Unit – 2 Introduction to Financial Accounting
Lecture No. & Title:	Lecture – 1 Introduction to Financial Accounting

Frequently Asked Questions

Q1. Unpaid salary of Rs. 2,000 of the current year, even though paid in April in the next accounting year is debited to profit and loss account.

A1. (a).This is based on principle of Accrual. According to this concept the expense which is outstanding and due for the payment which is pertaining to the current year should be added to the expense account. It is shown as current year's liability which is not yet paid and will be paid in next accounting year.

(b).This is also based on the principle of 'Matching Cost with Revenue'. According to this concept, revenue and the relevant expense incurred for a particular period should be matched. Thus even though salary is paid in the next year, but as it is incurred to earn revenue in the current year, it should be debited to profit and loss account of the current year.

Q2. Pre-paid expenses should be carried forward to the next accounting year.

A2. This is according to 'Matching Cost with Revenue Concept'. Pre-paid expenses are not incurred to earn income for the current year and as such they should not be debited against income of current year.

Q3. Doctors and lawyers consider only fees received in cash as their income.

A3. This is according to 'Realization Concept'. In certain business or profession it is uncertain that income due will be received. In such business when income is received in cash then only it is considered as income realized.

Q4. Advance of Rs. 2,000 received against an order is not credited to sales account.

A4. This is according to 'Realization Concept'. Advance received against sale is not revenue which is realized. So long as goods are not delivered and sales invoice sent along with it, the advance received should not be credited to Sales Account.

Q5. Accounting transactions should be recorded on the basis of its vouchers.

A5. This is according to principle of Objectivity. Transactions recorded in books of accounts should not be based on the opinion of some individuals but it should be based on verifiable evidence. Vouchers form the basis for verification of the transactions recorded in books of account.

Q6. In case of large contracts, profit is calculated even though they are incomplete at the end of the year.

A6. According to the principle of realization, profit is not recognized till sales take place or contract is completed. But in case of large contracts which last for 3 to 5 years, profit is taken on incomplete contracts.

Q7. Stock is valued at cost or market price whichever is less

A7. In this case 'Principle of Conservatism' is involved. According to this principle, anticipate no profit but provide for all possible losses. Thus in case of stock if market price is less than cost price, then there is a possibility of loss and as such it is valued at market price. But if a market price is more then cost price, then thee is possibility of profit which is not realized and as such it is valued at cost price.

Q8. Stationery purchased during the year is debited to profit and loss account.

A8. According to 'Principle of Materiality' the amount spent on stationery is relatively small in value; the accountant need not spend unnecessary time and money to find out the value of stationery used in the year. Thus, stationery purchased is debited to Profit and Loss Account in the year in which it is purchased.

Q9. Joint life insurance policy is valued at its surrender value.

A9. This is based on the 'Principle of Conservatism'. In fact the amount spent on insurance policy is the total premium paid but if the policy is discontinued and surrendered, and then only surrender value will be available from insurance company. Thus according to the principle of conservatism insurance policy is shown at its surrender value as an asset.

Q10. In balance sheet if investments are shown at cost price, market price is also shown.

A10. This is according to the 'Principle of Full Disclosure'. Investments are shown at cost price but the market price is also disclosed in balance sheet. The users of financial statements can easily come to know the market value of the investments from the balance sheet itself.

Q11. Valuation of stock is done according to FIFO or LIFO method.

A11. According to the 'Convention of Consistency' the stock is valued at FIFO or LIFO or weighted average method. This uniformity is maintained so that it is comparable year after year. If in one year FIFO method is used and in other year LIFO method is used then the comparison is not possible. Therefore any method ones selected by a business unit should follow the same consistently.

Q12. According to Companies Act, items of the value of more than 1% of sales should be shown separately in books of accounts.

A12. According to 'Materiality' if an expense is of small amount, then there is no need to show such expense separately in books of account. According to Companies Act, expense whose value is more then 1% of sales are important or material in nature and as such they should be separately shown in the books of account.

Q13. Huge loss suffered on account of severe fire which occurred after accounting year is shown in accounts.

A13. This statement is based on the 'Convention of Full Disclosure'. All those events which occur in the company and which are necessary for the users of financial information to have knowledge of it must be disclosed in financial statements even if they occur after preparation of financial statements.

Q14. The method of Depreciation remains same year after year.

A14. According to the 'Principle of Consistency' which ever method is used for depreciation ones must be followed year after year the same. This helps in comparison of two periods possible and uniformity is maintained.

Q15. The basis of valuation of stock is stated in the balance sheet.

A15. According to the 'Principle of Full Disclosure', in accounting statements all significant information should be fully disclosed which is of material interest to proprietors, creditors and investors. Therefore, method of valuation of stock is stated in the balance sheet.

Q16. Telephone bill of the month is debited in the month in which it is paid but not on the basis of number of calls made in that month.

A16. According to the principle of Materiality it in inconvenient to debit telephone bills on basis of number of calls made in that month because it is immaterial to note all calls all the time. Only the lump sum expense of the calls made is material in nature and recorded as telephone expenses on the debit side of profit and loss account.