Accounting

1. Cost of goods sold = Opening Stock + Net Purchases – Closing Stock + Direct Expenses.
2. Scrap or waste material is measured at net realisable value and not at cost value.
3. AS-2 states that inventories should be valued at lower of historical cost or net realisable value
4. The journal is called the book of original entry, subsidiary book or book of prime entry.
5. When the payment side of the cash book is undercast results in undercasting of overdraft balance, hence the overdraft balance as per cash book will be less than the overdraft balance as per pass book.
6. A three-columnar cash book also records bank and discount transactions.
7. Cash A/C will always show debit balance.
8. A bank reconciliation Statement is a statement and not an account.
9. Cost of production = Prime cost + manufacturing cost + opening WIP – Closing WIP + Administrative Expenses.
10. The retail method is often used in the retail trade for measuring inventories of large numbers of rapidly changing items that have similar margins and for which it is impracticable to use other costing methods.
11. Since the provision for bad debts is a credit balance account, if the actual bad debts exceed the provision created, then there will be debit balance of provision for bad debts account.
12. Only those expenses which relate to and specifically attributable to the asset are capitalised.
13. Overstatement of closing stock results in overstatement of profit and overstatement of opening stock results in understatement of profit.
14. An error in casting the subsidiary books is an error of commission.
15. Net Profit = Gross Profit – Administration and other expenses.
16. Gross Profit = Sales – cost of goods sold.
17. Sales = Gross Profit + Opening Stock + Direct expenses + Purchases – Closing Stock
18. Revenue expenditure is an expenditure whose benefit expires within the current accounting period and is in the nature of recurring and is therefore written off of P/L A/C.
19. A capital expenditure is a non-recurring expenditure whose benefit lasts for more than one accounting period.
20. Deferred revenue expenditure is a revenue expenditure whose benefit lasts for more than one accounting periods and is therefore written off during the periods over which the benefit lasts.
21. Cost concept and Business entity concepts are related to balance sheet.
22. Realisation and matching concepts are related to P/L account.
23. In contract accounting, there is a reasonable certainty that the project would be completed and the return consideration is realised. In fact, return consideration may begin as soon as the work begins. So, revenue may be recognised at work-in-progress.
24. Contingency: A condition or situation the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.
25. Trade discounts recorded in invoices only and books are maintained at net invoice price only. (List price – discount)
26. Closing entries must be made after the adjusting entries but before the reversing entries.
27. Account types
    a. Drawings A/C : Personal A/C
    b. Capital A/C : Personal A/C
    c. Sales A/C : Nominal A/C
    d. Outstanding salaries A/C : Representative personal A/C
    e. Outstanding rent A/C : Personal A/C
    f. Patents A/C : Real A/C

28. Purchase of fixed assets on credit is originally recorded in Journal proper.
29. FIFO and Weighted average methods are recommended for stock valuation for normal inventory.
30. The perpetual inventory system is called product costing system. In such system, the cost of each product is accumulated as it flows through the production process.
31. The value of inventory far in excess of the normal requirement of a firm is shown under non-current assets.
32. Inventory valuation (AS-2) should be applied in accounting for inventories other than:
    a. Work-in-progress arising under construction contracts, including directly related service contracts.
    b. Wok-in-progress arising in the ordinary course of business of service providers.
    c. Shares, debentures and other financial instruments held as stock-in-trade.
    d. Producers' inventories of livestock, agricultural and forecast products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well-established practices in those industries.
33. Only those expenses which relate to and specifically attributable to the asset are capitalised.
34. An error in casting the subsidiary books is an error of commission.
35. Drawings = Opening capital + Profit – Closing Capital
36. Capital = Total assets – Outside liabilities
37. Additional capital brought during the year = closing capital – opening capital – net profit during the year.
38. Credit sales = closing debtors + receipts from debtors – opening debtors
39. Credit purchases = closing trade creditors + payment to trade creditors – opening trade creditors
40. closing creditors = opening creditors + purchases during the year – Payment to creditors
41. purchases made during the year = closing stock + sales – opening stock
42. Net Sales = Credit sales + Cash Sales
43. Ex-ante income = Original expectation of expected future cash flows at the end of the period less original expectation of expected future benefits at the beginning of the period.
44. Ex-post income = Revised expectation of expected future cash flows at the end of the period less original expectation of expected future benefits at the beginning of the period.
45. Under the cash basis of accounting, revenue is recognized when cash is collected for sale of goods and services.
46. Payment received from debtors = opening debtors + credit sales – closing debtors.
47. Profit = closing capital – opening capital – additional capital
48. closing inventory = opening inventory + purchases + gross profit (mark-upon cost) – sales
49. opening inventory = sales + closing inventory – freight in – Purchases – Gross profit
50. Material used = opening raw material + Purchases – Closing raw material
51. Cost of goods manufactured = material used in production + manufacturing costs + opening WIP – Closing WIP
52. Goodwill is represented by the capacity of a business to earn excess profits.
53. some of factors contributing to value of goodwill are:
    a. Favourable location of the business
    b. Efficient management
    c. High quality of products and services that contribute to increased customer satisfaction
    d. Superior technology
54. Simple profit method
    a. Goodwill = Expected average annual profits X No. of years of purchase
55. Acquiring patent rights or copyrights used for the purpose of the business can be written off in equal instalments over a period of 14 years over the unexpired life of the patents rights or copyrights whichever is less.
56. Patents and copyrights acquired after April 01, 1998 can be depreciated at 25% under section 32 of the income Tax act

57. Acquisition of know-how to be used for the purposes of business can be amortised over 6 years.
58. Tax liability will appear as an expense in the P/L A/C, the provision for income tax will be shown in the balance sheet as a current liability and the Advance Tax will be shown as an advance on the asset side of the balance sheet.
59. A company may pay dividends from any or all of the three following sources:
    a. Profits of the current year.
    b. Undistributed profits of previous year.
    c. Money provided by the Central or any State government for the payment of dividends in pursuance of a guarantee given by the government concerned.
60. Bounties and subsidies received from any government or any public authority should be added with the gross profit in calculating managerial commission.
61. Commission to managerial staff =

$$\frac{\text{(Profit before commission) X (Rate of commission)}}{\text{(100 + Rate of commission)}}$$

    e.g. If gross profit is P and expenses are E then managerial commission on net profit after charging his commission is calculated as P – E = X (1 + C) where X is net profit and C is commission in decimal form.
62. A special auditor to conduct special audit of a company is appointed by the Central Government
63. According to Schedule VI of the Companies Act, 1956, the following assets is/are shown under the head 'Investments' in the balance sheet of a company.
    a. Investments in the capital of partnership firms.
    b. Investments in trust securities.
    c. Investments in shares.
    d. Investments in debentures.
64. Sinking fund is created out of profit. It is the part of profit and should be listed under the heading "Reserves and Surplus" and not under "unsecured loans".
65. As per the Companies Act, the item "Proposed additions to reserves" should be included in Reserves and surplus
66. Profit and loss appropriation account depicts appropriation of net profit. Interim dividend is appropriation of net profit. It appears in Profit and loss appropriation account.
67. Unearned income / revenue is a current liability till it is earned. Once it is earned, it becomes income.
68. Under Simple Profit Method, (I) Average of the adjusted profits of the chosen period and (II) the number of years of purchase are to be considered to calculate goodwill of a business.
69. Dividend is payable only on paid-up capital. It is not payable on calls-in-advance amount, dividend declared should be regarded as current liability. Dividend cannot be paid out of capital. Interim dividend can be declared by the directors without any approval of shareholders.
70. Under Hybrid system of accounting for revenue and expenses, accrual basis for expenses and cash basis for revenue is used
71. A purchase day book is used to record all credit purchases of goods only
72. Cash book subsidiary books serves the purpose of ledger, in addition to the recording of accounting transactions
73. Account Rules:
    a. Real Account :Debit what comes in and credit what goes out
    b. Personal Account :Debit the receiver and credit the giver
    c. Nominal Account :Debit all expenses and losses and credit all incomes and gains
74. The Trial Balance shows both debit and credit balances of all real, personal and nominal accounts.
75. Under the periodic system, the cost of goods sold is computed by subtracting the ending inventories which are determined by the physical count from the sum of the opening inventory plus purchases. Thus, it is computed as a residual amount.

76. In relation to price, the phrase mark-up means the selling price raised above the original selling price
77. Cost of conversion is made of direct wages plus production overhead plus direct expenses.
78. Under the delivery method, the revenue recognized in the period in which goods are delivered or services are actually provided.
79. Goodwill as per annuity method = super profit X Present value of annuity of Re.1
80. According to the Companies Act, 1956, the period to which the accounts of a company relate is known as financial year should not exceed 15 months.
81. When the auditor is having reservations in respect of some material matters then he will give a qualified report.
82. The fund available with a company after paying all claims including tax and dividend is called retained earnings.
83. Annual financial statements of a company should be signed by the manager or secretary of the company (if any) and by not less than two directors of the company, one of whom shall be a managing director where there is one.
84. At the time of finalization of accounts, entries passed for outstanding expenses, depreciation and interest on capital are referred to as adjustment entries
85. Balance appearing on the credit side of a trial balance can be an income or Profit or Gain, an outstanding expense, a liability or an income received in advance.
86. A person who is carrying on profession is required to get his accounts audited, if his gross receipts exceed Rs.10 lakhs in a year
87. Net worth is arrived after deducting all outside liabilities both current and non-current from total assets of the concern.
88. In an Annual General Meeting, submission of funds flow statement is not mandatory. But submission of Balance Sheet, Profit & Loss account, Directors' report and Auditors' report are mandatory.
89. Normal profit = Average capital employed × Normal rate of return
90. goodwill of the company by using the capitalization method = Total value of the business – Net tangible assets
91. Adjustments for preparation of financial statements:

Adjustments	Treatment	Reasons
1. Closing stock a. If it is given as an adjustment (not included in trial balance) b. If it is shown as debit balance in trial balance c. If market value of stock is also given	 i. credit P/L a/c. ii. show current asset in BS, i. show only as a current asset in BS. i. Take cost or market value whichever is less.	 i. Since it is an adjustment double effect is to be given as per double entry concept It is included in trial balance means it is already adjusted in cost of goods sold.
2. Bad debts recovered	Credit to P/L a/c	Since it is debited to P/L a/c in the year of occurrence, it should be taken as income in year of recovery.
3. Income tax provision a. Relating to current year. b. Relating to previous year 4. Live Stock	 i. Dr. to P/L a/c ie above the line ii. show as a current liability in BS i. It is a charge against P/L appropriation a/c	 It is not an appropriation of profits hence it should be debited to P/L a/c. All previous year expenses are

	show as fixed asset in BS	to be debited and revenues are to be credited to P/L appropriation a/c. As per schedule VI of the companies act.
5. Investments	Cost value is to be shown in the BS.	Market value is to be shown in the inner column for information. [schedule VI requirement]
6. Secured Loans a. Interest due and accrued b. Interest due but not accrued	i. Both are to be debited P/L a/c. ii. Interest due and accrued is to be added to loan amount in BS. iii. Interest due but not accrued is to be added to current liabilities in BS	As per schedule VI of the companies act.
7. Depreciation Change of method of calculation of depreciation	i. Debited to P/L a/c ii. Reduced from fixed assets in BS i. Effect due to change in the method of depreciation up to the beginning of the year of change (i.e. prior period adjustment) is to be debited / credit to P/L appropriation a/c.	As per Accounting Standard guidelines
8. Insurance Period	i. Out of total insurance paid only the proportionate amount pertaining to that particular year is to be debited to P/L a/c. ii. Amount prepaid will be shown as current asset in BS.	Since it does not belong to the current year.
9. Outstanding Expenditure	i. Debited to P/L a/c ii. Shown as current liability in BS	Since it is an expenditure pertaining to that particular year.
10. Manager's and Managing Director's Salary	i. It should be debited to P/L a/c but not to P/L appropriation a/c. ii. It should be shown separately in P/L a/c without clubbing with Administrative salaries.	Since it is a charge against the profits of the company.
11. Dividends	Debited to P/L appropriation a/c. It should be calculated on the paid-up amount of the capital. Ie., issued and called up capital minus calls in arrears.	
12. Provision for doubtful debts and bad debts	i. Bad debts a/c is to be debited to P/L a/c. ii. For calculation of provision for	

	doubtful debts, first reduce bad debts given as adjustments from debtors and then calculate provision for doubtful debts iii. Debit the same to P/L a/c. iv. In the BS the presentation should be: Debtors XXX Less: Bad Debts XXX Less: Provision for doubtful debts XXX Balance XX	
13. compulsory transfer of profits to reserves	i. Transfer 2.5% of current year profits to reserves ii. transfer 5% iii. Transfer 7.5% iv. Transfer 10% This transfer is to be made through P/L appropriation a/c.	If dividend proposed > 10% but < 12.5% of the paid-up capital If dividend proposed > 12.5% but < 15% of the paid-up capital If dividend proposed > 15% but < 20% of the paid-up capital If dividend proposed > 20% of the paid-up capital
14. Goods sent to customers on "Sale or return basis"		Should be taken as closing stock only when the confirmation from the customer is received treating the same as sale.
15. Calls-in-arrears	Deduct from called up amount of share capital on the liabilities side of the BS.	As per schedule VI of the companies act.
16. Auditor's fees	Should be clearly mentioned wherever possible as fees, paid i. As auditor ii. As advisor in respect of a. Taxation matter b. Company law matter c. Management services iii. In any other manner	As per schedule VI of the companies act.
17. Sundry debtors	In the BS wherever information is available it should be mentioned as sundry debtors a. Debts outstanding for a period exceeding six months b. Other debts c. Amounts due from directors should be separately shown.	As per schedule VI of the companies act.
18. Miscellaneous Expenses	The following expenses to the extent not written-off should be presented as miscellaneous expenses in the BS	As per schedule VI of the companies act.

	i. Preliminary expenses ii. Expenses including brokerage, commission on underwriting of shares, debentures. iii. Discount on issue of shares/debentures iv. Interest paid out of capital during construction. The total of above expenses should not be debited to P/L a/c, whereas they can be written-off i.e. debited to P/L a/c on a fixed percentage basis.	
19. Railway sidings, patents, trade marks and designs and live stock	All these will appear as fixed assets in the BS	As per schedule VI of the companies act.
20. Importance of Period – The year of accounting	Expenditure / Revenue to be taken into P/L a/c should relate to the year of accounting. Income / Expenditure relating to prior year or future year or of capital nature should be excluded.	

92. Accounting for Intangible Assets
    a. Intangible are non-physical but valuable resources like goodwill, patents and copyrights owned by the firm.
    b. Four types of intangible assets:
        i. Goodwill: represents the extraordinary profit earning capability of the enterprise due to reputation, brand name, location, management.
        ii. Rights: example, Patents, Copyrights, Trademarks, Licenses, Secret Processes, Franchises etc.
        iii. Deferred Revenue Expenditures: Expenditure for which the payment is incurred in one year and the benefits arising out of the asset would be for a number of years. Example, R&D costs.
        iv. Debit balance or deficit in the P/L a/c representing accumulated losses.
93. Methods of valuing Goodwill
    a. Simple Profit Method
        i. The avg. annual profit expected to accrue in the future.
        ii. The number of years of purchase of goodwill.
    b. Super profit method: This method finds super profits that a business can earn which are multiplied by an agreed number of years of purchase to arrive at the value of goodwill.
    c. A
94. Accounting for Shares
    a. Total capital of the company divided into units of small denominations are called shares.
    b. The companies act provides for two classes of shares: Equity and Preference shares. Equity shareholders enjoy the voting rights but the company has no obligation to pay the dividends t them at a fixed rate every year. Even at the time of winding up of the company, they receive their share capital after payment to preference shareholders.
    c. Share capital is the capital raised by the company by the issue of shares.

i. Authorised or nominal share capital: it is the maximum amount up to which a company is authorised to issue shares to the public without altering the memorandum of association.
ii. Issued Capital: the nominal value of the shares which are offered to the public for subscription.
iii. Subscribed Capital: the nominal value of the shares taken up by the public.
iv. Called-up Capital: It is that part of the subscribed capital which has been called up.
v. Paid-up Capital: It is that part of the called up capital which has been paid-up by the shareholders.

d. If the company asks the subscribers to pay minimum amount along with application and the rest in two or more instalments then the first instalment is called application money; second instalment is called share allotment money; third instalment is called share first call and fourth instalment is called share second call or final list.
e. Call-in-arrears: when the shareholder does not pay his dues on allotment or on calls. This is transferred to a common a/c called calls in arrears account.
f. Forfeiture and Reissue of shares: The shares can be forfeited in case of non-payment of allotment or call money and these can be reissued.
g. Methods of valuation of shares:
   i. Intrinsic value method: the net assets of the company including goodwill and non-trading assets are divided by the number of shares issued to arrive at the value of each share.
   ii. Return on capital employed method

$$= \frac{\text{return on capital employed x paid-up value of shares}}{\text{Normal rate of return}}$$

   iii. Valuation on the basis of dividend

$$= \frac{\text{Expected rate of dividend x paid-up value of shares}}{\text{Normal rate of dividend}}$$

h. Value of preference shares: the value of non-participating preference shares would be face value plus the arrear, if any. As the participating preference shareholders have a right to participate in the surplus, the value would be face value + Arrears in preference dividend + surplus of each preference share.

95. Fixed assets of the company must be, as far as possible, classified as:
   a. Goodwill
   b. Land
   c. Buildings
   d. Leasehold
   e. Railway sidings
   f. Plant and machinery
   g. Furniture and fittings
   h. Development of property
   i. Patents, trade marks and designs
   j. Livestock
   k. Vehicles.

96. Accounting of fixed assets

Assets	Cost of purchase of Asset
Land	Purchase price + brokerage commission + legal fees + cost of grading or of tearing down existing structures
Self-Constructed Assets	All the costs incurred in construction like the cost of materials, direct labor, and indirect costs incurred during the construction period like the interest related to borrowings made to finance the project.

Buildings	Construction cost + cost of permanent fixtures in the building + stamp fees for executing deeds + architect fees + engineers fee + other administrative overheads
Plant and Machinery	Purchase price + all costs of installation like transportation, erection, labor, testing expenditure
Assets acquired for Non-monetary consideration	Recorded at its fair value, i.e. the amount for which the asset could be exchanged between a buyer and a seller.
Basket purchase (when a business entity acquires in one transaction several capital assets that are to be appear in more than one BS category they are called Basket items)	Low cost items are charged immediately as expenses. Repairs and maintenance expenses are capitalized. Expenses for replacement may either be taken as an asset or an expense.

97. Generally accepted principles are:
    a. Opening inventory is debited to the trading account.
    b. Closing inventory is credited to the trading account.
    c. Purchases less returns are debited to trading account.
    d. Sales less returns are credited to the trading account.
    e. All expenses relating to the trading and manufacturing account are debited to the trading a/c.
    f. The balance being gross profit is transferred to the P/L a/c.
98. Methods of charging depreciation
    a. Straight line method
       Depreciation = Asset value – Salvage value
       Estimated useful life in years
    b. Written down value method / Diminishing balance method
       Where s = scrap value; c= original cost of the asset
    c. Sum of the years digits method
       If the asset has 5 years economic useful life the numbers 1, 2, 3, 4, 5 are added up and the resulting sum becomes the denominator and the number of years remaining becomes the numerator. The depreciation for the first year would be 5/15 x cost of acquisition of asset.
    d. Units-of-Production method
       The depreciation rate is determined by dividing the net acquisition or construction costs (acquisition or construction costs – salvage value) / estimated number of units that are likely to be produced during its useful economic life.