Practical Accounting

FAQ

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LEGAL ENTITIES

1. What Are the Different Types of Legal Entities?

a. Sole Proprietorship

A Sole proprietorship is an enterprise owned exclusively by one natural person and in which there is no legal distinction between the owner and the business entity.

Major advantages of sole proprietorship are Tax advantage, ease of creation, low fees for creation and maintenance, & Few government regulations etc. And its disadvantages are unlimited liability, Limited Resources, difficulty in getting capital funding, Harder to sell the business etc.

b. Partnership firm

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. A partnership deed specifies all the conditions for a partnership firm.

A partnership firm is easy to establish and start-up costs are low and more capital is available for the business than a sole proprietorship. But the liability of the partners for the debts of the business is unlimited.

c. Limited Liability Partnership

LLP is a hybrid corporate business form that gives the benefits of limited liability of a company and the flexibility of a partnership. It is Governed by the LLP Act, 2008.

A main benefit of creating an LLP is the flexibility of partnership form of business and the benefit of limited liability.

d. Company

A company is a corporate form of business and is governed by The Companies Act, 2013. Limited Liability, separate legal entity, and the ease to raise funds are major advantages of companies. On the other hand, there is a high set up costs and a long list of compliances.

There are various types of companies which are as follows:

i) Private company

Private company is a company whose article of association restricts the transferability of shares and prevents the public from subscribing to them. There will be a Minimum of two members and maximum limit of 200.

ii) Public company

A public company is a company whose shares can be bought by the general public. There will be a Minimum of seven members and no maximum limit is mentioned.

iii) One-person company

One Person Company means a private company which has only one person as a member. It combines the flexibility of sole proprietorship and the limited liability of companies.

2. What do you mean by unlimited liability?

Unlimited liability arises in case of sole proprietor and partnership firm. This means that the owner (ie.,proprietor or partner) would be personally liable for the debts of the business.

3. What are the various types of business industries?

Manufacturing industry - Manufacturing industries comprises entities which are engaged in production of goods, that is, raw materials will be put into the production process and finished goods will be produced.

Eg. Cloth manufacturing, Furniture manufacturing, etc.

Trading industry - Trading industries comprises entities which are engaged in buying and selling of goods. There is no conversion or value addition of goods happening in such business.

Eg. Textiles shop, Supermarket, etc.

Service industry - Service industries comprises entities which are engaged in providing services.
Eg. Chartered accountants, Lawyers, etc.

ACCOUNTING TERMS

1. What are fictitious assets? Give some examples for it.

The expenses which have already been incurred, the benefit from which is expected to arise over a future period of a few years shall be treated as Fictitious Assets. For example, preliminary expenses which are incurred at the time of establishment of the company.

2. What are current and non-current assets?

Current assets are a company's short-term assets; those that can be liquidated quickly and used for a company's immediate needs. Examples of current assets include cash, marketable securities, inventory, and accounts receivable.

Non-current assets are long-term assets and have a useful life of more than a year. It includes such assets which are used for a longer period in business like building, plant and machinery, vehicle etc.

3. Who is a creditor and a debtor?

A creditor is a person to whom the business owes money. For example, money payable to the supplier of goods or provider of service. Creditors are generally classified as Current Liabilities in the balance sheet.

A debtor is a person who owes money to the business. For example, money receivable from the buyer of goods or recipient of service. Creditors are generally classified as Current assets in the balance sheet.

4. Differentiate between capital receipts and revenue receipts

Capital receipts are receipts that create liabilities or reduce financial assets. For example, Sale of fixed assets, receiving a cash loan from a bank, Receiving cash from selling shares etc..

Revenue Receipts are the money received by a business through normal business operations. These receipts are recurring in nature. Sale of goods, Interest received on loans, rent received, commission received, etc. are some examples of revenue receipts.

5. **What do you mean by cash discount?**

Cash discounts are the discounts given to encourage prompt payment from debtors. Cash Discounts are recorded in the books of accounts, shown as an indirect expense in the profit & loss account. Cash discounts are calculated after deducting the trade discounts.

6. **What is a trade discount?**

Trade discount is the reduction granted by a supplier from the list price of goods or services on business considerations other than for prompt payment. For Example, discount given by the wholesaler for bulk quantity of purchase made by the retailer.

7. **Differentiate between capital expenditure and revenue expenditure**

Capital expenditures are expenses that will be used for revenue generation over a longer period. Eg: Purchase of fixed assets.

Revenue expenditures are typically referred to as ongoing operating expenses, which are short-term expenses that are used in running the daily business operations like maintenance cost, traveling, electricity charges etc.

8. **What are current and non-current liabilities?**

Current liabilities are a company's short-term financial obligations that are due within one year or within a normal operating cycle. Current liabilities include short term borrowings, trade payable, sundry creditors, short term provisions etc.

Non-current liabilities, also known as long-term liabilities, are obligations listed on the balance sheet and are due for more than a year. Non-current liabilities include long term borrowings, for example, a loan taken for 5 years, Debentures issued, etc..

9. What are intangible assets?

An intangible asset is a resource that has no physical presence and has long-term value for a business.

Intangible assets include –

- Patents
- Copyright
- Trademarks
- Brand names
- Goodwill

10. What is the owner's equity?

The owner's equity is a business owner's claim against the assets of the business. It is also called the capital of the business.

RULE OF DEBIT AND CREDIT

1. What are golden rules of accounting?

As per Golden rule of accounting accounts can be divided into three:

1. Personal account - Debit the receiver, credit the giver
2. Real Account - Debit what comes in, credit what goes out
3. Nominal Account - Debit all expenses and losses, credit all incomes and gains

2. What do you mean by the Double entry system of accounting?

Under the Double entry system of accounting every transaction has dual aspects i.e. debit and credit. The receiving aspect is called debit and the giving aspect is called credit and the amounts recorded as debits must be equal to the amounts recorded as credits.

3. Explain the basic accounting equation?

The basic accounting equation is, Assets = Liabilities + Capital. It means that the total monetary value of all assets of a firm is equal to the total claims, viz. owners and outsiders.

4. Explain real and nominal accounts with examples.

Real account is an account that relates to assets or properties or possessions. E.g. land account, building account, Investment account etc.

A nominal account is an account of income and expenses. E.g. purchases account, salary account, commission income etc.

5. What is the Modern approach of accounting?

Under the Modern approach, all accounts can be classified into 5 categories for the purpose of recording the transactions. They are assets, liabilities, capital, income and expenses.

When assets and expenses increase, it should be debited and decreases should be credited.

When capital, liabilities and income increases, it should be credited and decreases should be debited.

ACCRUAL CONCEPT OF ACCOUNTING

1. **What are the two accounting methods?**

   The two main accounting methods are cash accounting and accrual accounting. Cash accounting records revenues and expenses when they are received and paid. Accrual accounting records revenues and expenses when they occur.

2. **What is the accrual concept of accounting and how does it work?**

   Accrual concept states that entries should be recorded at the time when a transaction takes place, irrespective of the time of receipt or payment of money.

   For example, Salary due for the month of May is paid in June. Under the accrual basis of accounting, due entry should be recorded in the month of May in which it is due for payment and not in the month of June during which actual payment is made.

3. **What is cash basis of accounting?**

   Under the cash basis of accounting, entries in the books of accounts are made, when cash is received or paid and not when the receipt or payment becomes due. For example, if office rent for the month of May is paid in June, under the cash basis of accounting, it would be recorded in the books of accounts only in the month of June.

ACCOUNTING CYCLE

1. What do you mean by accounting cycle?

The accounting cycle is a collective process of identifying, analyzing, and recording the accounting events of a company.

2. What are the steps involved in accounting cycle?

Steps in the accounting cycle involve;

1. Recording of transactions
2. Source Documents
3. Journal
4. Ledger
5. Unadjusted Trial balance
6. Adjustment entries
7. Adjusted Trial balance
8. Closing entries
9. Financial statements - P&L, BS & cash flow
10. Analysis of financial statements

SOURCE DOCUMENTS

1. What do you mean by source document?

Documents that provide evidence of the transactions are called the source document or a voucher. Source documents are, first and foremost, important to the bookkeeping and accounting process because they serve as physical evidence that a financial transaction actually occurred.

2. What is a Tax invoice?

The invoice issued by a GST registered dealer showing the details of the GST amount is called a tax invoice. For the seller, the tax invoice is the evidence document for the sales transaction and it is known as a sales invoice. And for the buyer, the tax invoice is the evidence document for the purchase transaction and it is known as a Purchase bill.

JOURNAL

1. What is meant by Journalizing?

Journal is the first place where transactions are recorded and it is also known as Books of original entry. The process of analyzing the business transactions under the heads of debit and credit and recording them in the journal is called journalizing.

2. What would be the journal entries for the following transactions;

a. Salary paid

Salary A/C .....Dr

To Cash/Bank A/C

b. Salary due for the month

Salary A/C ....Dr

To Salary outstanding A/C

c. Outstanding salary paid

Salary outstanding A/C .....Dr

To Cash/Bank A/C

d. Cash paid to a sundry creditor

Sundry Creditor A/C .....Dr

To Cash/Bank A/C

e. Withdrew cash from bank

Cash A/C ....Dr

To Bank A/C

f. Deposited cash into bank

Bank A/C ...Dr

To Cash A/C

g. Bought goods from Govind on credit

Purchase A/C ....Dr

To Govind A/C

h. Bought Fixed Assets from Raneez on credit

Fixed Asset A/C .....Dr

To Raneez A/C

i. Sold goods for cash

Bank A/C ...Dr

To Sales A/C

j. Withdrew cash for personal purpose

Drawings A/C ....Dr

To Cash A/C

k. Commission received

Cash/ Bank A/C .....Dr

To Commission Received A/C

LEDGER

1. What is posting?

The process of transferring the entries from journal to respective ledger accounts is called ledger posting.

2. What is a ledger?

A ledger is a book of final entry. Ledgers may contain detailed transaction information for one account.

TRIAL BALANCE

1. **Is trial balance a financial statement?**

   No, it is a statement that shows the total of debits and credits from the various ledger accounts in one place. In other words Trial Balance is a type of accounting report which is used to check the accuracy of the various debit and credit transactions recorded in the ledgers.

2. **The usual balance of Expenses is…………**

   Debit

3. **The usual balance of Outstanding expense is……..**

   Credit

4. **The usual balance of Income is…………**

   Credit

5. **The usual balance of Drawings is………**

   Debit

6. **The usual balance of Capital is………**

   Credit

7. **The usual balance of Assets is………**

   Debit

8. **The usual balance of Liabilities is………**

   Credit

ADJUSTMENT ENTRIES

1. What is outstanding expense?

An Outstanding Expense is an expense in respect of which the benefit has been received by the business and its due for payment but has not been paid. Examples for Outstanding Expenses - Rent due but not yet paid.

2. Journal entry for Rent due;

Rent A/C .....Dr

To Rent Outstanding A/C

3. How will you treat the outstanding salary of Rs. 50,000 in your final accounts.

Journal entry will be:

Salary A/C ....Dr	50,000	
To Outstanding salary A/C		50,000

The salary account in P&L A/C will be increased by Rs. 50,000 and Outstanding salary will be shown as a current liability in the Balance Sheet.

Again when the outstanding salary is paid off, the entry will be:

Outstanding Salary A/C ....Dr	50,000	
To Bank/Cash A/C		50,000

4. What do you mean by prepaid expense?

Prepaid expense means the expenses that are not due for payment, that is, the benefit for which will receive in the future; but have already been paid.

5. What will be the treatment for prepaid insurance as an adjustment in final accounts?

Deduct the prepaid insurance amount from total insurance paid and show it as a current asset in the Balance Sheet.

6. What will be the journal entries for the following;

a. Due entry for accrued income

Accrued income A/C ...Dr

To Income A/C

b. Rent received in advance

Cash A/C .....Dr

To Rent received in advance A/C

c. The accrued income once received

Cash/ Bank A/c ... Dr

To Accrued Income A/C

d. Insurance for the next month paid

Prepaid insurance A/C

To Cash/ Bank A/C

e. Repairs and maintenance bill are due

Repairs and Maintenance A/C ...Dr

To Repairs and Maintenance payable A/C

f. Bad debts recovered

Cash/Bank A/C ...Dr

To Bad debts recovered A/C

7. What is Scrap Value in accounting?

Scrap Value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected cost of disposal. Scrap value is also known as residual value.

8. What is depreciation?

Depreciation means the reduction in the value of a property or an asset due to wear and tear, accident, fall in market price, passage of time, etc.

The entries for depreciation can be passed in two ways:

1. By creating a provision for depreciation

Depreciation A/C... Dr

To Provision for Depreciation A/C

2. Without creating a provision for depreciation

   Depreciation A/C… Dr.

   To Fixed Assets A/C

9. What are the commonly used methods of depreciation?

- Straight Line Method
- Written down value method

TRADING AND PROFIT & LOSS ACCOUNT

1. **What are the components of the financial statements of a business?**
    a. Trading account
    b. Profit and Loss account
    c. Balance sheet
    d. Cash flow statement

2. **What do you mean by income statement?**

    An income statement shows the revenues, expenses and profitability of a business over a period of time, also known as the profit-and-loss (P&L) statement. It reflects the financial performance of a business.

3. **How will you treat the expenses like bad debts, printing and stationery, office administration etc.**

    These all are indirect expenses, so we can debit these expenses in profit and loss accounts.

4. **What is gross profit?**

    Gross profit is the profit a business makes after deducting the direct costs associated with its operations from the direct incomes.

    Gross Profit = Sales - Cost of Goods sold

5. **What is net profit?**

    Net profit is the net results of the operations of a business computed after deducting all direct and indirect expenses from the incomes received.

    Net Profit = Gross Profit + Non-Operating incomes - Non-Operating Expenses

BALANCE SHEET

1. **What is Balance sheet?**

   The Balance sheet is also known as the statement of financial position. This is the financial statement that contains details of the assets, liabilities and capital of a business at a specific point in time.

2. **Say some examples for non-current assets that show in the asset side of balance sheet.**
   - Furniture
   - Land & Building
   - Plant & machinery
   - Long term investments
   - Goodwill

3. **Say some examples for non-current liabilities that shows in liability side of balance sheet.**
   - Bank loan
   - Debentures
   - Long term lease
   - Long term loans

GST ACCOUNTING

1. What is GST?

GST means Goods and Services Tax. It is an indirect tax charged on the sale of goods or services. It is collected by a GST registered seller from its customer.

2. What are the journal entries for the following transactions?

a. Purchases made by a business in Kerala from a supplier in Bangalore for cash

Purchase A/C ....Dr

Input IGST A/C ...Dr

To Cash A/C

b. Intrastate credit purchases with GST

Purchase A/C ....Dr

Input CGST A/C ...Dr

Input SGST A/C ...Dr

To Sundry Creditor A/C

c. Advertisement expense paid with GST for a company within the same state.

Advertisement A/C ....Dr

Input CGST A/C ...Dr

Input SGST A/C ...Dr

To Cash A/C

e. Sale of goods with GST outside the state

Cash/ Sundry Debtor A/C ...Dr

To Sales A/C

To Output IGST A/C

f. Sale of Goods or Services within the State

Cash/ Sundry Debtor A/C ...Dr

To Sales A/C

To Output CGST A/C

To Output SGST A/C

g. What will be the setoff entry for output CGST

Output CGST A/C ....Dr

To Input CGST A/C

To Input IGST A/C

To CGST Payable A/C

h. What will be the setoff entry for output SGST

Output SGST A/C ....Dr

To Input SGST A/C

To Input IGST A/C

To SGST Payable A/C

i. What will be the setoff entry for output IGST

Output IGST A/C ....Dr

To Input IGST A/C

To Input SGST A/C

To Input CGST A/C

To IGST Payable A/C

j. GST paid to GST department

IGST Payable A/C ...Dr

CGST Payable A/C ...Dr

SGST Payable A/C ...Dr

To Bank A/C

INCOME TAX ACCOUNTING

1. What do you mean by Provision for Taxation?

A Provision for Income Tax is the estimated amount that a business or individual taxpayer expects to pay in the form of Income Taxes for the current year.

2. Find the journal entries for the following

a. Provision for taxation.

Profit and Loss A/C

To Provision for Taxation A/C

b. Income Tax due entry

Provision for Taxation A/c Dr

To Advance Tax A/c

To TDS A/c

To Income Tax Payable A/c (Balance)

c. Income Tax Payment entry

Income Tax Payable A/c Dr

To Bank A/c

ADVANCE TAX

1. What is Advance tax?

Every person whose estimated tax liability for the year is Rs. 10,000 or more, shall pay his tax in advance, in the form of Advance tax. The amount has to be remitted in 4 installments:

Installment	Due date
I Installment	15th June
II Installment	15th September
III Installment	15th December
IV Installment	15th March

2. What is the entry for payment of Advance tax?

Advance tax A/C.... Dr.

To Bank

Advance tax will be shown under current assets in the Balance sheet of the business.

TDS

1. What do you mean by TDS?

TDS stands for **Tax Deducted at Source**. The Income Tax Act specifies certain payments on which a specific percentage has to be retained by the payer as TDS and only the balance amount has to be paid to the payee. The TDS deducted should be deposited by the payer with the Government and the payee, in turn, can claim credit for this TDS. For example, rent, professional charges, contract payments, etc.

2. What are the entries to be passed in the following transactions?

Due entry for payment of expenses on which TDS is applicable in the books of the deductor

Expenses A/C ....Dr

To Deductee A/C

To TDS payable A/C

Making payment of TDS deducted to the Government

TDS payable A/C ....Dr

To Bank A/C

3. Due entry for Income due on which TDS is applicable in the books of the deductee

Deductor A/c.... Dr

TDS Receivable A/c.... Dr

To Income A/c

BANK RECONCILIATION

1. What do you mean by Bank Reconciliation Statement?

A statement that is prepared to reconcile the causes of difference between Bank Balance as per the books of accounts and Bank Balance as per Pass Book/ Bank Statement is known as a Bank Reconciliation Statement.

2. What are some of the reasons for differences between cash book and bank book?

The reason for differences can be classified into two:

1. Timing differences

Eg:

- Cheque issued by the business, but not yet presented to the bank - Bank balance would be reduced in the books of accounts, but pass book balance not reduced.
- Cheque received by the business presented to the bank, but not yet collected by the bank - Bank balance would be increased in the books of accounts, but pass book balance not increased.
- Direct debits made by the bank on behalf of the customer/ interest on OD & bank charges etc.
- Amount directly deposited to bank
- Interest, rent, etc. collected by bank
- Interest and dividends collected by the bank

2. Differences due to errors

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