NCERT Solutions for Class 11

Accountancy

Chapter 2 – Theory Base of Accounting

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

Ans: Going Concern is critical for accountants since it leads to the adoption of other business concepts and assumptions, such as the Accrual Concept. The concept of a going concern. There are three basic accounting assumptions to consider.

The first assumption is that the firm is a going concern, which indicates that members may come and go, but the company will continue to exist indefinitely. The business is carried on to continue it in the long run, rather than to close it down immediately.

Other assumptions and principles must be based on this fundamental assumption. There is no room for the accrual notion of consistency in accounting if the going concern assumption is not established. There will be no depreciation accounting or anything like that. Banks will be hesitant to lend to a company that is projected to cease operations shortly.

The treatment will be different if a company is about to close shortly. Assets, for example, will be valued at market value rather than cost. As a result, a corporate entity's assumption of going concern is critical.

2. When should revenue be recognized? Are there exceptions to the general rule?

Ans: Accounting practices are recognized by generally accepted accounting rules when they are either realizable or realized, whichever comes first. It is necessary to recognize revenue. Revenue should be recognized once it is realizable or realized, whichever comes first, according to generally accepted accounting principles. This recognition is based on the accrual accounting concept.

For example, Ram sells an item to Shyam in April, and Shyam receives money in July. Ram, on the other hand, can recognize the payment in April if the invoices are properly transferred. If the advance payment to Ram had been made in March, however, the money would have served as a liability for his business because he was obligated to provide Shyam with rapid delivery of goods. As a result, the revenue in this scenario will be utilized only in April, when the products are delivered. This general norm is subject to three exceptions:

When a business engages in the Instalment / Hire Purchase system, revenue is recognized as and when the installment is due and received.

In circumstances when revenue is recognized by a firm or business at multiple stages of production, such as in the building industry.

When a business uses the cash foundation of accounting, revenue is recognized only when cash is received.

3. What is the basic accounting equation?

Ans: The accounting equation is a crucial aspect of the balance sheet that serves as the foundation for the bookkeeping method of double entry.

Every subsequent debit must be matched by an equal credit, according to the basic accounting equation. It can be written like this:

$$\text{Assets} = \text{Capital} + \text{Liabilities}$$

As a result, the company's total assets equal the shareholder's funds plus all other obligations.

4. The realization concept determines when goods sent on credit to customers are to be included in the sales figure to compute the profit or loss for the accounting period. Which of the following tends to be used in the 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 your reasons.

Ans: Option B, i.e. invoiced, is the right answer among the possibilities listed above.

According to the realization idea, revenue should be recognized just once when it is realizable or realized, whichever comes first. As a result, the invoicing of goods can be used by an organization to determine and acknowledge a transaction because the invoicing of transactions implies that the items' ownership has been properly transferred. As a result, after invoicing is completed, the concerned firm will not need to retain the payment.

5. Complete the following worksheet:

(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 coincidence is explained by the _________ concept.

(iv)The ___________ concept states that if the 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 that 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 firm's **accountants cannot take this into account while preparing a book of accounts because of ____________concept.**

Ans: (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 coincidence is explained by the dual aspect concept.

(iv) The consistency concept states that if the 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 that is heavily in demand. Consequently, the market value of this stock may be increased. Normal accounting procedure is to ignore this because of conservatism.

(vi) If a firm receives an order for goods, it would not be included in the sales figure owing to the realization.

(vii) The management of a firm is remarkably incompetent, but the firm's accountants cannot take this into account while preparing a book of accounts because of the money measurement concept.

6. The accounting concepts and accounting standards are generally referred to as the essence of financial accounting. Comment.

Ans: Financial accounting begins with the process of recording a transaction and continues with stages such as e categorizing, measuring, summarising, and generating final accounts, among others. The primary goal of financial accounting is to offer information to a variety of users. Reliability, comparability, comprehension, and relevance are all attributes that must be present in the data that is disseminated. As a result, to assure the quality of accounting processes, a set of principles and guidelines must be followed to provide a consistent method of recording transactions. As a result, the use of accounting concepts such as the Matching Concept, Conservatism Concept, and Dual Aspect Concept must be ensured. For example, there are a variety of methodologies for estimating stock and depreciation that can be used by different businesses. Due to the problem of inconsistency and incomparability of financial results among different company entities, external users misinterpret financial data.

7. Why is it important to adopt a consistent basis for the preparation of financial statements? Explain.

Ans: Financial statements are prepared to provide information on the growth or fall of business activities over time, as well as results comparisons, such as intra-firm (inside the same organization) or inter-firm comparisons (comparison between different firms). Only when accounting policies are uniform and consistent can comparisons be made.

To maintain consistency in the creation of the accounts in establishing the financial status of the firm, consistent practice for the compilation of financial statements must be established. Consistent accounting practices make decision-making and comparison easier. For example, to compare the financial results of both years, an organization that uses the Straight Line Method of depreciation must keep to it and not use the Written Down Value of depreciation any time during that period.

8. Discuss the concept based on the premise 'do not anticipate profits but provide for all losses'.

Ans: The conservatism accounting concept establishes the premise that entities should not expect profits but should account for any losses. This approach enables organizations to foresee and positively prepare for all possible losses. As a result, this notion enables businesses to deal effectively with ambiguous and unexpected events. As a result of these factors, businesses are expected to assess and predict bad debts, and to offer payment discounts as a result. Furthermore, the cost price or the market price, whichever is lower, is used to determine the organization's inventory. For example, the stock is valued at a lower cost or market price. If the market price is less than the cost price, a loss should be recorded; however, if the former is greater than the latter, the profit should be held until the stock is sold. Numerous provisions, such as the provision for debtor discount, are retained based on the conservative principle.

9. What is the matching concept? Why should a business concern follow this concept?

Ans: According to the matching principle, a company's costs and revenues can be recorded in the books in the same accounting period that they occur. The matching principle states that a company's costs and revenues can be recorded in the books in the same accounting period in which they are incurred. The revenues should be recognized when they are either realized or realizable, whichever comes first. When expenses are accrued or paid in the same accounting period, they must be accounted for.

This also enables the company to correctly calculate the cost of items sold at the end of the accounting period, when the cost of unsold goods is subtracted from the total cost of production. As a result, when such expenses and revenues are properly recognized, the business can establish the profit or loss for the accounting period. As a result, if a company's accounting methods do not follow the matching idea, the profit or loss will be over-or under-estimated. Similarly, other expenses like depreciation must be recorded to calculate the profit or loss of the business at the end of the accounting period. For example, if a year's insurance premium is paid on July 1 and accounts are closed on March 31 every year, the current year's insurance premium will be determined for nine months (i.e. from July to March) and computed as Rs 1200 – Rs 900 = Rs 300. As a result of the matching principle, the expense of Rs 900 will be used to determine profit, rather than Rs 1200, because the benefit is only Rs 900 in the current accounting period.

This idea is used by business entities to determine the genuine profit or loss during an accounting period. It is possible that the business will pay or receive payments that do not belong to the same accounting period during the same accounting period. This results in either an overcasting or undercasting of profit or loss, which may or may not understand the true efficiency of the business and its activities during the accounting period in question.

10. What is the money measurement concept? Which one factor can make it difficult to compare the monetary values of one year with the monetary values of another year?

Ans: According to the money measurement idea, all transactions that can be recorded in monetary terms should be recorded in the account books. For example, 12 television sets for Rs 10,000 each are purchased, resulting in a total of Rs 1,20,000 being recorded in the books. Money serves as a common denomination for all transactions and helps in the conversion of several measuring units into a single unit, such as rupees. As a result, the money measurement concept provides for consistency in accounting records. On the other hand, the use of money as a unit of measurement makes it difficult to compare monetary values from one period to another. As a result, qualitative variables like employee skills, the durability of the products and goods produced, the effectiveness of the administrations, and so on are left out of this notion.

The main disadvantage of this idea is that it only analyses historical expenditures, that is, costs incurred at the time they were purchased. As a result, it does not take into account the company's purchasing power, and as a result, it might potentially harm a company's financial outcomes.