FAQs

WHAT DO YOU MEAN BY REVALUATION OF FIXED ASSETS?

Fixed assets are purchased to be used for longer period. In the subsequent years, the value of asset could be higher or lower than its present book value, due to inflationary condition of the economy. Assets are valued at Historical Cost in the books of accounts. Historical Cost is the original cost of the asset at which it was purchased plus additional costs incurred on the asset. Sometimes, the management of the business, if it thinks fit, revalues the asset to present it at current market value. Once the asset is revalued to its market value, then its value has to be constantly monitored to reflect the changes in the market value. If an asset is revalued at higher cost than its original cost, the excess amount will be treated as profit on revaluation of fixed assets and it is credited to Revaluation Reserve Account. On the other hand, if an asset is revalued at lower cost than its original cost, the balance amount will be treated as loss on revaluation of fixed assets and it is shown in the profit & loss account of that year in which asset was revalued.

What is Balance B/F and Balance B/D?

Balance B/F means balance brought forward and Balance B/D means balance brought down both represents the opening balance. This balance is actually the closing balance of previous period which is transferred to the current accounting period at the start of period.

What is Balance C/F and Balance C/D?

Balance C/F means balance carried forward and Balance C/D means balance carried down both represents the closing balance. This is the differential amount of debit and credit side amounts at the end of period.

What is debit balance?

If all amounts of debit side of an account > all amounts of credit side of an account then the differential amount is called debit balance.

What is credit balance?

If all amounts of debit side of an account < all amounts of credit side of an account then the differential amount is called credit balance.

EXPLAIN DEFERRED EXPENSES?

Deferred Expenses are revenue expenses that provide benefit for more than one year. These are initially shown in balance sheet. Subsequently, these are charged to profit and loss account over the period in which benefit is derived from them.

WHAT IS THE MAIN DIFFERENCE BETWEEN PROFIT & LOSS A/C AND BALANCE SHEET?

Profit and loss account is prepared to know the performance of the business for a particular period of time. At the end of accounting period, a business prepares profit and loss account to ascertain the profit or loss of the business. All ledger accounts of revenue nature are summarized in profit and loss account. Balance Sheet is prepared to know the financial position of a business at a particular point of time. It contained the assets, liabilities and capital

HOW CAN WE DEFINE JOURNAL?

The word "Journal "has been derived from the French word "Jour". Jour means day. So, Journal means daily. Transactions are recorded daily in Journal. As soon as a transaction takes place its debit and credit aspects are analyzed and first of all recorded chronologically in a book together with its short description. This book is known as Journal. The most important function of Journal is to show the relationship between the two accounts connected with the transaction. Journal is also called the "Book of Original Entry" or "Day Book" because it keeps day-to-day record of transactions.

WHAT IS THE DIFFERENCE BETWEEN MERCHANDISES AND ASSETS?

Merchandises are the goods/things which are purchased for the purpose of sale. The things which are sold out are considered as expenses as cost of goods sold while the things which are unsold during the accounting period are treated as current asset. Asset is the broader term means anything which is owned by the business which provide the economic benefit to the business like cash in hand, stock, furniture and machinery etc

WHAT IS THE DIFFERENCE BETWEEN LONG TERM ASSETS AND FIXED ASSETS?

Long Term Assets are those assets which provide benefit to the business for long time. For example, if we invest some money in any scheme (like saving scheme “saving certificates”) for three years, it will be our Long Term Asset. Fixed assets are those assets, which are subject to depreciation. These assets provide benefit for longer period of time but these assets are depreciated with the passage of time. For example furniture, machinery and building etc.

WHY DO WE PREPARE PROFIT AND LOSS A/C?

Profit and loss account is prepared to know the performance of the business. At the end of accounting period, a business prepares profit and loss account to ascertain the profit or loss of the business. All ledger accounts of revenue nature are summarized in profit and loss account.

DEFINE TRIAL BALANCE?

Every business concern prepares Final Accounts at the end of the year to ascertain the result of the activities of the whole year. To ensure correct result, the concern must be free from doubt that the books of accounts have been correctly recorded throughout the year. Trial balance is prepared to test the arithmetical accuracy of the books of accounts. Trial balance serves two main purposes: 1. To check the equality of debits and credits 2. To provide information for use in preparing Final Accounts Thus in the light of above discussion a Trial Balance may be defined as "an information or accounting schedule or statement that lists the ledger account balances at a point in time and compares the total of debit balances with the total of credit balances".

WHAT DO YOU MEAN BY ACCUMULATED DEPRECIATION?

Accumulated Depreciation is the depreciation that has taken place on a particular asset up to the present time. It is the sum of all periodic depreciation to the date of balance sheet. It is a contra asset account which is deducted from the cost of a particular asset for showing the book value of asset in balance sheet.

WHAT DO YOU UNDERSTAND BY “CAPITAL WORK IN PROGRESS”?

If an asset is not completed at that time when balance sheet is prepared, all costs incurred on that asset up to the balance sheet date are transferred to an account called Capital Work in Progress Account. This account is shown separately in the balance sheet below the fixed asset. Capital work in progress account contains all expenses incurred on the asset until it is converted into working condition. All these expenses will become part of the cost of that asset. When an asset is completed and it is ready to work, all costs will transfer to the relevant asset account

WHAT DOES IT MEAN WHEN “SHARES ARE ISSUED AT PREMIUM”?

When a company has a good reputation and earns good profits, the demand of its shares increases in the market. In that case, the company is allowed by the Companies Ordinance 1984, to issue shares at a higher price than their face value. Such an issue is called “Shares Issued at Premium”. The amount received; in excess of the face value of the shares is transferred to an account called “Share Premium Account”. This account is used to

Write off Preliminary Expenses of the company, Write off the balance amount, in issuing shares on discount, Issue fully paid Bonus Shares

WHAT IS THE DIFFERENCE BETWEEN CARRIAGE OUTWARD & CARRIAGE INWARD?

Carriage Outward refers to the expenses incurred in sending sold goods to the customers. In this regard, the distinction between carriage inward and carriage outward should be noted. Carriage Inward indicates the expenses of bringing in goods/raw material purchased by the business and hence debited to Trading A/c. But carriage outward indicates the expenses incurred in sending sold goods and so debited to profit & loss account

WHAT IS DEBIT AND CREDIT?

Increase in asset, expenses and drawings and decrease in capital and income is debit. Decrease in asset, expenses and drawings and increase in capital and income is credit. It will be clearer if you will learn some examples and also solve some examples and practice questions from recommended books.

WHAT IS LIABILITY, CURRENT LIABILITY & LONG TERM LIABILTY?

When a business owes something to third party against the benefits derived by the business from that third party, the business is said liable. The amount by which the business is liable is called the liability. Liability means that something remains to be paid by the business to third party to fully settle his account. The liability may be in the form of a bank loan or it may arise due to credit purchase. Current liability: The liability payable within the next 12 months like amount payable to creditors, short term loans, bank overdraft. Long-term liability: The liability which is payable after 12 months is called long-term liability such as Term finance certificates , a bank loan payable after 2 years or more.

WHAT IS CAPITAL, CAPITAL EXPENDITURE AND REVENUE EXPENDITURE?

CAPITAL: The value invested in the business by the owner in whatever form is called capital. The owner may introduce a capital of Rs. 250,000 which may be in the form of Rs. 200,000 cash and a machinery of Rs. 50,000. The capital of Rs. 250,000 is shown in Balance sheet as credit balance whereas cash and machinery being assets are shown in balance sheet as debit balance. CAPITAL EXPENDITURE: These are expenses whose benefits last for a longer period or the benefits are yet to be enjoyed by the business. For example when a vehicle is purchased by the business, it will benefit the business for the current period and for the years to come. Capital expenditure always results in increase in assets. Therefore amount expended on vehicle is our capital expenditure and vehicle is shown in the balance sheet as an asset. REVENUE EXPENDITURE: These are expenses whose benefits do not last for longer period and are restricted to current period only and no more benefits are to be enjoyed by the business in the coming periods. For example Salaries, utility bills, fuel bills paid, against which the organization enjoyed benefits for only current period.

DIFFERENCEIATE ASSET AND EXPENSE?

Assets are properties and possessions of the business on a particular date which are expected to benefit the future operations of the business. Assets are the economic resources from which we drive the benefits for more than one year. Assets are always shown on the Assets side of the balance sheet. EXPENSE: These are the costs incurred to earn the revenue. As revenue is of the current nature; the benefit of the expense is also restricted to current period. Once the benefit goes beyond the current year it will be treated or its non-current part shall be treated as asset. e.g. if rent is Rs.1,000 per month and we paid total rent Rs.18,000 for one and a half year then Rs.12,000 is expense for the year and next Rs.6,000 are non-current (the benefit is not restricted to current year) and shall be treated as asset in the form of prepaid rent

WHAT IS LEDGER AND LEDGER ACCOUNT?

After recording transaction in journal, it is classified and posted in a specific book called 'ledger'. Ledger contains all heads of accounts of a business. The ledger has accounts having specific heads called 'ledger accounts'. This is an individual account kept in the books of accounts or ledger.

WHAT IS CASH ACCOUNTING AND ACCRUAL ACCOUNTING?

Cash accounting: In cash basis of accounting, revenue is recognized at the time when cash is collected from the customer, rather than when the company sells the goods. Expenses are recognized when payment is made, rather than when related goods are used in the business operations. The cash basis of accounting measures the amount of cash received and paid out during the period, it does not provide a good measure of the profitability of activities undertaken during the period. Accrual accounting: The policy of recognizing revenue in the accounting records when it is earned and recognizing expenses when the related goods are used is called accrual basis of accounting. The purpose of accrual accounting is to measure the profitability of the economic activities conducted during the accounting period. The important concept involved in accrual accounting is the matching principle. Revenue is matched with all of the expenses incurred in generating that revenue thus providing a measure of the overall profitability of the economic activity. Payment of expense has nothing to do with the recording of expense. For example an electricity bill of January paid on 22 of February shall be recorded in the books as an expense on the same date in cash accounting system but in an accrual based system it would be recorded in the books as an expense in the month of January because the benefit against the bill pertains to the month of January

DIFFERENCIATE PURCHASE RETURNS AND SALE RETURNS?

PURCHASES RETURNS: The purchaser after having purchased the goods returns some of the goods to the seller on account of being defective perished or due to any other reason, these are called the purchases returns and are deducted from the gross amount of purchases while preparing profit and loss account. SALES RETURNS: The seller to whom the goods have been returned treats this return as sales return because something has been returned to him which he had sold to purchaser. Similarly this figure should not be part of your revenue and hence is deducted from the gross figure of sales

WHAT IS DEBTOR AND CREDITOR?

Debtors come into existence when credit sale is made. Debtors are the persons or customers to whom goods have been sold on credit basis and from whom the business is to receive money in near future. The accounts of such persons are known as Sundry debtors or Accounts receivables. Creditors come into existence when credit purchase is made. Creditors are the persons or suppliers who supplied the goods on credit basis and to whom the business is to pay money in near future. The accounts of such persons are known as Sundry creditors or Accounts payable.

DISTINGUISH BETWEEN FIXED ASSET AND CURRENT ASSET?

FIXED ASSET are the Assets which have long life (more than one year) and which are bought for use for a long period of time. These are not bought for selling purposes. e.g. land, building, plant and machinery, furniture etc Assets which have short life (less than one year) and which can be converted into cash quickly. e.g. stock, debtors, cash in hand, cash in bank, prepaid expenses

WHAT IS ACCOUNTING CYCLE?

The accounting cycle comprises of the following steps which make up the cycle complete. Recording: First step is to record the transactions in the form of entries passed in a book named journal. Specific ledger accounts are prepared by posting these entries from journal to ledger. This procedure is called classification and posting entries in various accounts. Making of trial balance i.e., taking all the balances of ledger accounts in the trial balance. It contained all the balances of all types of accounts. Preparing profit and loss account/income statement where expenses are compared with revenue to arrive at the profit and loss and preparation of balance sheet where Assets = liabilities + owners equity

WHAT IS DOUBLE ENTRY AND SINGLE ENTRY BOOK KEEPING SYSTEM?

Single entry system is the method of accounting in which just one effect of a transaction is recorded. Like, if a business purchases an asset for cash. It will be recorded in cash account or in asset account; not in both accounts. Double entry system is a method of accounting in which every transaction changes at least two different ledger accounts. In other words, at least two accounts will be involved while recording a transaction.

Like, if a business purchases machinery for cash, it will affect the machinery account as well as cash account. Two effects in this transaction are: machinery account debit and cash account is credit.

WHAT IS PERPETUAL INVENTORY SYSTEM AND PERIODIC INVENTORY SYSTEM?

In perpetual inventory system record of all receipt and issues of materials are maintained properly. When merchandise is purchased its cost is debited to an asset account called inventory. As the merchandise is sold/issued, its cost is removed from inventory account and transferred to the cost of goods sold account. In this system inventory records are kept continuously up-to-date. The inventory on hand and the cost of goods sold for the year are determined under perpetual inventory system. All large business organizations use perpetual inventory systems. In periodic inventory system no proper record of receipt and issues are maintained. In this system the cost of merchandise purchased during the year is debited to purchases account, rather than to the inventory account. When merchandise is sold to a customer an entry is made recognizing the sale revenue, but no entry is made to reduce the inventory account or to recognize the cost of goods sold. Small businesses however use periodic inventory system

WHAT IS TRADE DISCOUNT AND CASH DISCOUNT?

Trade discount: At the time of selling goods to customer the seller allows a discount (concession). It is allowed at a certain percentage of the listed price. For example the listed price of the goods is Rs.30,000 and seller allows a discount of 10% on the listed price to customer. It means the net price of the goods is Rs.27,000 (30,000-3,000).Both buyer and seller will record Rs.27,000 (not Rs.30,000) in their books of accounts. In other words trade discount is not recorded in the books of accounts. Trade discount is given by the seller to his regular customers or the customers who purchased in a bulk quantity. Cash discount: It is discount or allowance given by a creditor to a debtor if the amount due is paid by the debtor before the due date. It is reduction in price offered by seller (creditor) to encourage customers (debtors) to pay their debts within the specified period. For example x sold goods to y (a customer) for Rs.1,000 on credit basis. It means x is creditor and y is debtor X offers discount of 2% to y if y pays the price within 15 days. Y will pay only Rs.980 (1,000-20) to x if pays within the 15 days. Such discount is known as cash discount and is recorded in the books of accounts.

WHAT IS DEPRECIATION?

Assets such as vehicles, machinery, and furniture involve physical deterioration over a period of time called depreciation. In other words, reduction in the asset value is caused by its use in the business is also known as depreciation. Technically, depreciation is the allocation of cost of fixed assets over the useful life of asset.

DISTINGUISH AND DESCRIBE THE TANGIBLE ASSETS & INTANGIBLE ASSETS?

Assets which are not found in physical form but regarded as an asset in the eyes of accounting are called intangible assets. Assets such as furniture, machinery etc., are physically touchable, hence called tangible assets. The concept behind intangible assets is very logical. Hundreds of businessmen in Pakistan would be ready to purchase at a very high cost the brand name Pepsi –cola and sell their own water using that brand name. Should that brand name not be an asset for Pepsi-cola who can charge a million of rupees to others just for allowing them to use it? Of course, it should be. This is the concept behind the intangible assets and that is why patents, trademarks and goodwill are treated as assets

WHAT IS MEANT BY DRAWINGS?

Cash or anything drawn by the owner from the business for his personal use is known as drawings or withdrawals.

DIFFERENTIATE BETWEEN PROVISION AND RESERVE?

PROVISION: When an amount is charged/provided in profit and loss account to meet a current nature liability or expense, it is called provision. The exact amount of expense or liability is not known at the time of making the provision e.g., what amount of debts we won't be able to recover in the current debtors' balance, what amount of tax we shall have to ultimately pay. If we take the example of debtors, make a provision for doubtful debts and deduct it from the debtors' balance in the balance sheet just to show the debtors near to actual i.e., these are the debts we are sure to receive. A reserve is a periodic accumulation of amount to meet a long term plan or say liability. A reserve may be created to purchase a land for the business after five years. The reserve is shown on the liabilities side of the balance sheet