Solutions Academy

CA FOUNDATION · PAPER 1 · ACCOUNTING

Repeated Theory Questions

5-MARK THEORY, WITH MODEL ANSWERS

Pichhle attempts me baar-baar poochhe gaye theory questions

33 QUESTIONS · 6 CHAPTERS

All 33 questions come from Chapters 1 to 6.
Theory is normally asked from these chapters.

The questions in this booklet are ICAI's own, taken from past examination attempts.

Solutions Academy has only grouped them by chapter and typeset them for easy reading. We claim no authorship of the questions.

Solutions Academy, Sikar ki taraf se – bilkul muft

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CHAPTER 1 THEORETICAL FRAMEWORK

18 questions · concepts, conventions, policies, standards, capital and revenue, provisions

1 Limitations of Financial Statements

Financial statements are useful but have certain limitations:

- **Historical information:** They mainly report past transactions and may not reflect current market values.
- **Non-monetary factors ignored:** Employee skill, reputation, management quality and customer loyalty are generally not measured.
- **Use of estimates:** Depreciation, provisions and bad-debt estimates involve judgement.
- **Possibility of manipulation:** Different accounting choices can affect reported profit and financial position.
- **Qualitative information is limited:** Statements do not fully explain all business risks, competition or future prospects.

Conclusion: Financial statements should therefore be interpreted together with notes, policies and other relevant information.

2 Bookkeeping and Accounting

Bookkeeping is the systematic recording of financial transactions in books of original entry and ledgers. It is mainly concerned with recording.

Accounting is broader. It includes recording, classifying, summarising, analysing and interpreting financial information and communicating it to users.

Differences:

- Bookkeeping is the basic recording stage; accounting includes recording plus analysis and interpretation.
- Bookkeeping produces basic ledger balances; accounting produces financial statements and useful information.
- Bookkeeping is mainly clerical; accounting involves greater judgement and decision support.

Conclusion: Bookkeeping is a part of the wider accounting process.

3 Change in Accounting Policy Having a Material Effect on Financial Statements

If a change in accounting policy has a material effect, the change should be properly disclosed so that users can understand its impact.

The financial statements should disclose, as applicable:

- the nature of the change;
- the reasons for the change;
- the amount by which items in the current period are affected; and
- the relevant impact on prior periods where retrospective treatment is required/appropriate under the applicable accounting framework.

Example: If inventory valuation changes from one permitted method to another and the change materially increases closing inventory and profit, the nature and financial effect of the change must be disclosed.

Purpose: Proper disclosure preserves comparability and helps users assess the effect of the policy change.

4 Capital Expenditure and Revenue Expenditure

Capital expenditure is expenditure incurred to acquire or improve a long-term asset or increase its earning capacity. It normally provides benefits over more than one accounting period. Examples: purchase of machinery, installation cost and major improvement.

Revenue expenditure is expenditure incurred for the normal running and maintenance of the business, with benefits generally consumed in the current accounting period. Examples: wages, rent, routine repairs and electricity.

Differences:

- Capital expenditure creates/enhances a long-term asset; revenue expenditure maintains operations.

- *Capital expenditure is generally shown as an asset and charged over time where applicable; revenue expenditure is normally charged to profit and loss.*
- *Capital expenditure benefits several periods; revenue expenditure generally benefits the current period.*

5 Provision and Contingent Liability

A provision is a liability of uncertain timing or amount that is recognised when the applicable recognition criteria are met, such as when there is a present obligation from a past event, an outflow is probable and a reliable estimate can be made.

A contingent liability is generally a possible obligation depending on uncertain future events, or a present obligation that is not recognised because the recognition criteria are not met.

Difference: *Provision is recognised in the financial statements when required; contingent liabilities are generally disclosed in notes unless the possibility of outflow is remote.*

Example: *A probable, reliably estimable warranty obligation may be provided for; a disputed claim whose outcome is uncertain may be disclosed as a contingent liability.*

6 C.A. Society

A C.A. Society may be understood as a professional society/association of Chartered Accountants formed to promote professional development and common interests.

Its important functions can include:

- *promoting professional knowledge and ethical standards;*
- *conducting seminars, workshops and continuing education;*
- *providing a forum for discussion of accounting, auditing and taxation matters;*
- *encouraging professional networking and sharing of knowledge; and*
- *supporting members through publications and professional activities.*

Note: *If your syllabus uses "C.A. Society" to mean a specific organisation or uses "Co-operative Society" instead, the exact name should be matched to your prescribed textbook.*

7 Cash Basis and Mercantile System

Under the cash basis, income and expenses are generally recognised when cash is actually received or paid.

Under the mercantile (accrual) basis, income is recognised when earned and expenses when incurred, subject to the applicable accounting rules, irrespective of the exact date of cash receipt/payment.

Example: *If* ***₹10,000*** *of rent for December is paid in January, cash basis records it in January; under accrual accounting it is treated as December expense.*

Comparison: *Cash basis is simpler but may not show outstanding and prepaid items fully; accrual accounting generally gives a better matching of income and expenses and a more complete view of liabilities and assets.*

8 Money Measurement Concept and Matching Concept

Money Measurement Concept: *Only transactions and events that can be measured reliably in monetary terms are recorded in accounting. For example, purchase of machinery is recorded, while employee morale is normally not recorded because it cannot be reliably expressed in money.*

Matching Concept: *Expenses relating to a period should be recognised in the same period as the revenue they help generate, subject to the applicable accounting framework.*

Example: *If goods sold in March include their related cost, that cost is recognised as part of the cost of sales for the period.*

Importance: *Together, these concepts help make financial statements measurable and meaningful for determining periodic profit.*

9 Objectives and Advantages of Accounting Standards

Objectives:

- *establish uniform accounting principles;*
- *improve comparability between financial statements;*

- *reduce alternative and inconsistent accounting treatments;*
- *improve reliability and transparency; and*
- *provide guidance for recognition, measurement, presentation and disclosure.*

Advantages:

- *greater consistency in financial reporting;*
- *better comparability across companies and periods;*
- *improved credibility for investors, lenders and other users;*
- *reduced scope for arbitrary accounting treatment; and*
- *easier interpretation and analysis of financial statements.*

10 Accounting Policy — Meaning and Conditions for Change

An accounting policy is a specific principle, basis, convention, rule or practice applied by an entity in preparing and presenting financial statements.

An enterprise should change an accounting policy only when:

- *the change is required by a statute or by an applicable accounting standard; or*
- *the change results in financial statements providing more reliable and relevant information about the effects of transactions and other events.*

A change should not be made merely to increase or decrease reported profit. Its nature and financial effect should be properly disclosed when material.

11 Cash Basis of Accounting and Going Concern Concept

Cash Basis: *Transactions are generally recognised when cash is received or paid. It is simple and useful for certain small entities or purposes, but it may not present outstanding assets and liabilities as fully as accrual accounting.*

Going Concern Concept: *Financial statements are normally prepared on the assumption that the entity will continue its operations for the foreseeable future and has neither the intention nor the necessity to liquidate or materially curtail its operations.*

Importance: This assumption affects asset valuation, depreciation and classification of liabilities. If the going-concern assumption is no longer appropriate, the basis of preparation and relevant disclosures need careful consideration.

12 Accounting Standards — Objectives and Limitations

Objectives:

- promote uniformity and consistency;
- improve comparability;
- improve reliability and transparency;
- reduce ambiguity in accounting treatment; and
- guide recognition, measurement, presentation and disclosure.

Limitations:

- standards cannot cover every unusual transaction;
- professional judgement is still required;
- some standards involve estimates and assumptions;
- compliance may increase complexity and cost; and
- a standardised treatment may not capture every entity's unique circumstances.

Conclusion: Standards improve reporting quality but do not eliminate the need for judgement and disclosure.

13 Generally Accepted Valuation Principles

The valuation of accounting items should follow the applicable accounting framework and established principles. Important ideas include:

- **Historical cost:** Assets are commonly initially recorded at acquisition cost where applicable.
- **Prudence/conservatism:** Avoid overstatement of assets and income and understatement of liabilities and expenses, within the applicable framework.

- **Consistency:** Apply the same valuation methods consistently unless a justified change is permitted or required.
- **Matching/accrual:** Recognise related income and expenses in the appropriate period.
- **Going concern:** Valuation normally assumes continued operation unless that assumption is inappropriate.

Note: Modern standards also require specific measurement bases such as fair value or net realisable value in situations where prescribed.

14 Fundamental Accounting Assumptions and Accounting Policies — Distinction

Fundamental accounting assumptions are basic assumptions underlying financial statements. Commonly discussed assumptions are going concern, consistency and accrual.

Accounting policies are the specific principles, bases, conventions, rules and practices selected and applied by an enterprise in preparing financial statements.

Difference:

- Assumptions are broad underlying bases; policies are specific choices and practices.
- Fundamental assumptions are generally presumed unless stated otherwise; accounting policies may require selection among permitted alternatives.
- Changes in policies require justification and appropriate disclosure under the applicable framework.

15 Change in Accounting Policy Having a Material Effect — Explain with Example

A material change in accounting policy can affect reported profit, assets, liabilities or equity. Therefore, the entity must apply the change according to the applicable accounting standard and disclose its nature and material financial effect.

Example: Suppose a company changes its inventory-costing policy from Method A to Method B, and closing inventory under Method B is **₹2,00,000** higher. If this materially increases reported profit, the company should disclose the nature of the change and its financial effect as required.

Purpose: Users can then compare the current figures with previous periods and understand that the change, rather than only business performance, affected the results.

16 Circumstances in Which an Enterprise Can Change Its Accounting Policy

An enterprise should change its accounting policy only in limited circumstances, mainly:

1. **Required by law/statute:** A legal or regulatory requirement makes the change necessary.
2. **Required by a new or revised accounting standard:** The applicable framework requires the entity to adopt a different treatment.
3. **More reliable and relevant information:** The change results in financial statements providing more reliable and relevant information about transactions and events.

Not a valid reason: A policy should **not** be changed merely to manipulate profit, smooth earnings or achieve a preferred result.

Disclosure: Material changes and their effects should be disclosed as required by the applicable framework.

17 Money Measurement Concept and Periodicity Concept

Money Measurement Concept: Accounting records those transactions and events that can be expressed reliably in monetary terms. It provides a common measurement unit for accounting information. Non-quantifiable qualities such as employee morale are generally not recorded.

Periodicity Concept: Although a business may continue for many years, its performance is divided into accounting periods, such as a month, quarter or year, so that profit and financial position can be reported periodically.

Example: Annual accounts determine the profit earned during a particular financial year rather than waiting until the business finally closes.

Importance: Periodicity makes timely reporting possible, while money measurement makes diverse transactions comparable in accounting terms.

18 Difference Between Provision and Contingent Liability

Provision and contingent liability differ as follows:

- **Nature:** A provision is a recognised liability of uncertain timing or amount; a contingent liability is generally a possible obligation or an unrecognised present obligation depending on uncertainty.
- **Recognition:** Provision is recognised when the applicable recognition criteria are met; contingent liability is generally not recognised.
- **Measurement:** Provision is measured at the best estimate/amount required under the applicable standard; contingent liability is not recognised as a liability.
- **Disclosure:** Provision is presented in the financial statements as required; contingent liability is generally disclosed in notes unless the chance of outflow is remote.

Example: A probable and reliably estimable warranty obligation may be provided for, while a disputed lawsuit with uncertain outcome may be disclosed as a contingent liability.

CHAPTER 2 ACCOUNTING PROCESS

6 questions · journal, ledger, subsidiary books, trial balance, GST in the books

19 Rules of Posting Journal Entries into Ledger

The principal rules are:

- The account debited in the journal is debited in the ledger, with the name of the corresponding credit account in the particulars column.
- The account credited in the journal is credited in the ledger, with the name of the corresponding debit account.
- The date and relevant journal reference are entered.
- Narration is normally not copied into the ledger.
- For compound entries, each debit and credit component is posted to its respective account.
- After posting, ledger accounts are balanced where required.

Example: Cash received from Ravi: Cash A/c is debited and Ravi A/c is credited.

20 Subsidiary Books Normally Used in a Business

Common subsidiary books are:

1. **Cash Book** – cash and bank transactions.
2. **Purchases Book** – credit purchases of goods.
3. **Sales Book** – credit sales of goods.
4. **Purchases Returns Book** – goods returned to suppliers.
5. **Sales Returns Book** – goods returned by customers.
6. **Bills Receivable Book** – bills received.
7. **Bills Payable Book** – bills accepted/payable.
8. **Journal Proper** – transactions not recorded in the specialised books.

Benefit: They divide work, save time and facilitate checking and posting.

21 Features of GST

GST (Goods and Services Tax) is a comprehensive indirect tax on the supply of goods and services. Major features include:

- **Destination-based tax:** Tax revenue generally accrues to the place of consumption.
- **Value-added mechanism:** Input tax credit generally avoids cascading, subject to conditions.
- **Dual structure in India:** Central and State/Union Territory components operate as prescribed.
- **Taxable supply:** The central concept is supply of goods/services rather than only manufacture or sale.
- **Technology-based compliance:** Registration, returns, invoices and credits are supported through electronic systems.

Result: GST aims to create a more integrated indirect-tax system and reduce cascading.

22 Advantages of Subsidiary Books

Subsidiary books provide several advantages:

- **Division of work:** Different books can be assigned to different staff.
- **Time saving:** Repetitive transactions are recorded in specialised books.
- **Easy posting:** Periodic totals can be posted to ledger accounts where appropriate.
- **Better control:** Errors can be located more easily by checking individual books.
- **Detailed information:** Transactions of the same type are available together.
- **Convenience:** Large volumes of transactions can be handled systematically.

23 Trial Balance

A trial balance is a statement showing the debit and credit balances/totals of ledger accounts at a particular date.

Objectives:

- check the arithmetical accuracy of ledger posting to a considerable extent;
- provide a basis for preparing financial statements;
- summarise ledger balances; and
- assist in locating certain errors.

Limitations: Agreement of a trial balance does **not** prove complete accuracy because errors such as omission of a transaction, compensating errors, wrong classification or some errors of principle may remain undetected.

Conclusion: Trial balance is a checking device, not conclusive proof of error-free accounts.

24 Principal Book of Account and Rules for Posting into Ledger

The ledger is the principal book of account in which transactions relating to each account are classified and accumulated. It provides the balances required for preparing the trial balance and financial statements.

Rules for posting:

- *Debit the ledger account that is debited in the journal and credit the account that is credited.*
- *In the debit side particulars, refer to the corresponding credit account.*
- *In the credit side particulars, refer to the corresponding debit account.*
- *Enter date, amount and relevant reference correctly.*
- *Post every component of compound journal entries to the appropriate ledger account.*
- *Balance the account where necessary.*

CHAPTER 3 BANK RECONCILIATION STATEMENT

1 question · why the two balances differ

25 Causes of Difference between Cash Book and Pass Book

The balances may differ because of timing and recording differences, such as:

- *cheques issued but not yet presented for payment;*
- *cheques deposited but not yet collected/credited by the bank;*
- *bank charges, interest or commission entered by the bank but not yet recorded in the cash book;*
- *direct deposits or collections by the bank not yet recorded in the cash book;*
- *standing instructions such as insurance payments made by the bank;*
- *dishonour of cheques recorded by the bank first; and*
- *errors in the cash book or pass book.*

Result: *A bank reconciliation statement is prepared to explain and reconcile these differences.*

CHAPTER 4 INVENTORIES

3 questions · cost of stock, valuation methods, inventory systems

26 Adjusted Selling Price Method for Determining Cost of Stock

The adjusted selling price (retail) method estimates inventory cost from its selling/retail value by removing the appropriate gross profit margin and adjusting for mark-ups/mark-downs.

Basic procedure:

- *Determine the retail/selling value of closing stock.*
- *Adjust retail value for mark-ups and mark-downs, where required.*
- *Calculate the cost-to-retail percentage from opening inventory and purchases.*
- *Apply the cost-to-retail percentage to the adjusted retail value of closing inventory.*

Formula: *Estimated cost of closing stock = Adjusted retail value × Cost-to-retail percentage.*

Use: *It is useful where a large number of similar items are held and individual cost records are difficult to maintain.*

27 Principal Methods of Ascertaining Cost of Stock

Important inventory-costing methods include:

- **Specific identification:** *Actual cost of each identifiable item is assigned to that item; suitable for unique/high-value items.*
- **FIFO (First-In, First-Out):** *The earliest goods purchased are assumed to be issued/sold first.*
- **Weighted average cost:** *Averages the cost of available units, weighted by quantities.*
- **Retail/adjusted selling price method:** *Cost is estimated from retail value using an appropriate cost-to-retail percentage.*

Important principle: *Inventory is generally measured in accordance with the applicable accounting standard, normally at the lower of cost and net realisable value under the relevant framework.*

28 Periodic Inventory System and Perpetual Inventory System

Periodic inventory system: Inventory records are updated mainly at intervals. Closing inventory is determined by physical count, and cost of goods sold is generally calculated at the end of the period.

Perpetual inventory system: Continuous records of receipts, issues and balances are maintained, so book inventory is updated after each transaction, subject to periodic verification.

Differences:

- Periodic: stock information is available mainly periodically; perpetual: continuously.
- Periodic requires stronger dependence on physical stock-taking; perpetual maintains continuous book records.
- Perpetual helps management monitor stock levels and detect discrepancies sooner.

CHAPTER 5 DEPRECIATION AND AMORTISATION

1 question · what decides the depreciation charge

29 Factors Taken into Consideration for Calculation of Depreciation

The main factors are:

- **Cost of the asset:** Purchase price plus directly attributable costs necessary to bring the asset into use.
- **Residual/scrap value:** Estimated amount recoverable at the end of useful life.
- **Useful life:** Expected period or usage over which the asset will provide benefits.
- **Method of depreciation:** Such as straight-line or written-down-value method.
- **Pattern of use and obsolescence:** Intensity of use, technological change and legal or contractual limits may affect useful life.

Formula (straight-line basis): Annual depreciation = (Cost − Residual value) ÷ Useful life.

CHAPTER 6 BILLS OF EXCHANGE AND PROMISSORY NOTES

4 questions · parties, renewal, retirement, accommodation bills

30 Accommodation Bill and Renewal of Bill

An accommodation bill is a bill drawn, accepted or endorsed without a genuine trade transaction, usually to provide temporary financial assistance to a party. The parties agree in advance how the proceeds will be shared or repaid.

Renewal of a bill means cancelling the old bill before maturity and replacing it with a new bill for the amount due, usually after accounting for interest.

Typical treatment:

1. The old bill is cancelled.
2. Any interest due is recorded.
3. The new bill is drawn and accepted.
4. The new bill is recorded in the respective books.

Example: If a debtor cannot pay a **₹20,000** bill at maturity, the bill may be renewed for **₹20,000** plus agreed interest.

31 Bill of Exchange and Promissory Note

A bill of exchange is a written, unconditional order signed by the drawer directing the drawee to pay a certain sum to a specified person or order, on demand or at a determinable future time.

A promissory note is a written, unconditional promise made by the maker to pay a certain sum to a specified person or order, on demand or at a determinable future time.

Key differences:

- Bill: an order to pay; note: a promise to pay.
- Bill normally has drawer, drawee and payee; note has maker and payee.
- Acceptance is required for a bill drawn on a drawee; a note does not require such acceptance.

- A bill may be drawn by a creditor; a note is made by the debtor.

32 Bill of Exchange — Various Parties

The main parties to a bill of exchange are:

- **Drawer:** The person who draws/makes the bill and orders payment.
- **Drawee:** The person on whom the bill is drawn; after acceptance, he becomes the acceptor.
- **Acceptor:** The drawee who accepts the bill and undertakes to pay at maturity.
- **Payee:** The person to whom payment is to be made.
- **Endorser:** A holder who transfers the bill by endorsement.
- **Endorsee:** The person to whom the bill is transferred by endorsement.
- **Holder:** The person legally entitled to possess the bill and receive payment.

33 Retirement of Bill of Exchange

Retirement of a bill means payment of the bill by the acceptor before its due date, with the consent of the holder.

Accounting treatment:

1. The acceptor pays the amount before maturity.
2. The holder allows a rebate for the unexpired period, if agreed.
3. The holder records the rebate as a loss/expense and receives cash.
4. The acceptor records the rebate received as a gain/income and settles the bill.

Example: Bill amount **₹50,000** is retired early and rebate allowed is **₹500**. The holder receives **₹49,500**; **₹500** is recorded as rebate/loss by the holder.

Exam me — paanch baatein

1 — ANSWER FIRST

Start with the answer, not with a build-up. Line one is the definition or the rule; the explanation comes after it. The examiner should know your answer before the end of the first line.

2 — WRITE IN POINTS, NOT PARAGRAPHS

Four to six short points for a 5-mark answer. One idea per point, one or two lines each. A solid block of writing hides your marks inside it.

3 — NAME THE STANDARD, THE SECTION, THE CONCEPT

Write the name you know — the accounting standard, the concept, the section. Naming it shows you studied it; describing it without a name reads like a guess.

4 — ADD ONE SMALL EXAMPLE OR FORMULA

A one-line example, or the formula, after your points. It is short to write and it is often what separates a 3 from a 4.

5 — CLOSE WITH ONE LINE

Finish with a single sentence that ties the points back to the question. Then stop — extra length does not add marks, but it does eat the time your next question needs.