

Allama Iqbal open university AIOU intermediate solved assignment Autumn 2024

Code 1339 Basics of Accounting

Q. 1

Define "Accounting" and describe its cycle.

Ans:

Definition of Accounting:

Accounting is the process of identifying, recording, classifying, summarizing, interpreting, and communicating financial information about an entity to enable users to make informed decisions. It provides a systematic framework to manage, analyze, and report on financial transactions.

Accounting Cycle:

The accounting cycle is the sequence of steps followed in the process of recording and reporting financial information for a specific period. It ensures the financial statements accurately reflect the financial position and performance of an entity. Below are the steps involved:

1. **Identifying and Analyzing Transactions:**

- Recognize financial transactions and determine their relevance to the business.
- Source documents like invoices, receipts, or contracts are analyzed.

2. **Recording Transactions in Journal:**

- Transactions are recorded chronologically in the journal using the double-entry system.

3. **Posting to Ledger Accounts:**

- Journal entries are transferred (posted) to the general ledger, where transactions are organized by accounts.

4. **Preparing a Trial Balance:**

- A trial balance is prepared to check the accuracy of ledger balances (debits = credits).

5. **Adjusting Entries:**

- Adjustments are made for accruals, deferrals, and other adjustments to reflect the true financial position (e.g., depreciation, prepaid expenses).

6. **Preparing Adjusted Trial Balance:**

- A new trial balance is prepared after adjustments, ensuring all accounts are updated.

7. **Preparing Financial Statements:**

- Financial statements, including the ****Income Statement****, ****Balance Sheet****, ****Statement of Cash Flows****, and ****Statement of Changes in Equity****, are created based on adjusted trial balances.

8. **Closing Entries:**

- Temporary accounts (revenues, expenses, and dividends) are closed to the retained earnings account to reset balances for the next accounting period.

9. **Post-Closing Trial Balance:**

- A final trial balance is prepared to ensure all temporary accounts are closed and the ledger is balanced.

10. **Reversing Entries (Optional):**

- At the start of the next period, reversing entries may be made to simplify the recording of future transactions.

This cycle repeats for each accounting period (monthly, quarterly, annually), ensuring systematic and consistent financial reporting.

Q. 2

Differentiate between Accounting Book-Keeping. Also describe their importance.

Ans:

Difference Between Accounting and Bookkeeping:

Aspect	Accounting	Bookkeeping
Definition	The process of summarizing, analyzing, and reporting financial data to aid decision-making.	The process of recording financial transactions in an organized manner.
Scope	Broader scope; includes bookkeeping, financial analysis, and preparation of financial statements.	Narrower scope; focuses solely on recording and organizing transactions.
Objective	To interpret, classify, and communicate financial information.	To maintain accurate and systematic records of financial transactions.
Skills Required	Requires knowledge of financial principles, standards, and regulations.	Requires basic understanding of recording methods and tools.

Aspect	Accounting	Bookkeeping
Decision-Making Role	Involves making strategic decisions based on financial data.	Provides raw data for accounting but does not involve decision-making.
Tools Used	Financial statements, budgets, ratios, and tax reports.	Journals, ledgers, and simple record-keeping tools.

Importance of Accounting:

1. Decision-Making:

- Helps businesses evaluate performance, manage resources, and plan for the future.

2. Legal Compliance:

- Ensures adherence to tax regulations and financial reporting standards.

3. Performance Evaluation:

- Analyzes profitability and overall financial health through financial statements.

4. Investment Decisions:

- Provides valuable insights for investors and stakeholders.

5. Fraud Detection:

- Aids in identifying discrepancies and maintaining financial transparency.

Importance of Bookkeeping:

1. Foundation for Accounting:

- Provides the data required for accounting processes like analysis and reporting.

2. Accuracy in Financial Records:

- Ensures all financial transactions are recorded systematically.

3. Compliance:

- Maintains detailed records to comply with tax and audit requirements.

4. Cash Flow Management:

- Tracks inflows and outflows of money, aiding in effective cash management.

5. Business Growth:

- Offers clarity on financial performance, helping in planning and scaling the business.

In summary, **bookkeeping is the starting point** that feeds into **accounting**, which interprets and communicates the financial health of the organization. Both are essential for efficient financial management.

Q. 3

Describe in detail the rules, merits, and demerits of Double Entry System of book-keeping.

Ans:

Double Entry System of Bookkeeping:

The **Double Entry System** is a method of recording financial transactions where every transaction affects at least two accounts, ensuring that the accounting equation remains balanced. This system is based on the principle that "**every debit must have a corresponding credit**".

Rules of Double Entry System:

1. Personal Accounts:

- **Debit** the receiver.
- **Credit** the giver.

Example: If cash is paid to a supplier, the supplier (personal account) is credited, and cash (asset account) is debited.

2. Real Accounts:

- **Debit** what comes in.
- **Credit** what goes out.

Example: If machinery is purchased for cash, machinery (real account) is debited, and cash (real account) is credited.

3. Nominal Accounts:

- **Debit** all expenses and losses.
- **Credit** all incomes and gains.

Example: If rent is paid, the rent account (expense) is debited, and the cash account is credited.

Merits of Double Entry System:

1. Accuracy and Completeness:

- Ensures both aspects of a transaction are recorded, reducing errors and omissions.

2. Facilitates Financial Statements:

- Provides a systematic foundation for preparing financial statements like the income statement and balance sheet.

3. Fraud Detection:

- Cross-checking through the trial balance helps identify discrepancies and fraud.

4. Systematic Record:

- Provides an organized framework for recording and classifying financial transactions.

5. Universal Acceptance:

- Recognized globally as a standard method of accounting.

6. Aids in Decision-Making:

- Offers detailed and accurate financial information for strategic planning.
-

Demerits of Double Entry System:

1. Complexity:

- Requires specialized knowledge and understanding, which can be challenging for small businesses or individuals without accounting expertise.

2. Costly:

- Implementation and maintenance can be expensive, especially for small businesses that cannot afford trained accountants or software.

3. Time-Consuming:

- Recording each transaction in two accounts and reconciling differences requires significant time and effort.

4. Not Immune to Fraud:

- While it helps in detection, it does not entirely eliminate the possibility of intentional fraud or manipulation.

5. Requires Training:

- The system demands skilled personnel who understand accounting principles and rules.

In conclusion, the **Double Entry System** is a reliable and widely accepted method of bookkeeping that ensures financial accuracy and transparency. Despite its complexity and cost, its merits far outweigh its demerits, making it indispensable for organizations aiming for systematic financial management.

Q. 4

Record the following transaction in the journal. (20)

1st November 2024 Mr. Muhammad Waqar commenced business with Cash of Rs. 15,000,000/- Machinery Rs.20,500,000/-

3rd Purchased Furniture with cash Rs. 350,000/-

5th Purchased goods from Miss Zara Rs.75, 000/-

13th Sold goods to Mr. Majid Rs. 98,000/-

15th Goods returned to Miss Zara a Rs.5, 000/-

20th Machinery Purchased Rs.175, 000/-

22nd Returned goods from Mr. Majid Rs.2, 030/-

25th Paid Utility bills Rs.185, 000/-

26th Paid Rent Rs.80, 000/-

30th Paid salaries Rs. 169,000/-

Ans:

Below is the journal for the transactions mentioned:

Journal Entries

Date	Particulars	Debit (Rs.)	Credit (Rs.)
1st Nov 2024	Cash Account DrDrDr	15,000,000	
	Machinery Account DrDrDr	20,500,000	
	Capital Account CrCrCr		35,500,000

Date	Particulars	Debit (Rs.)	Credit (Rs.)
	(Business commenced with cash and machinery)		
3rd Nov 2024	Furniture Account Dr	350,000	
	Cash Account Cr		350,000
	(Purchased furniture with cash)		
5th Nov 2024	Purchases Account Dr	75,000	
	Miss Zara Account Cr		75,000
	(Purchased goods on credit from Miss Zara)		
13th Nov 2024	Mr. Majid Account Dr	98,000	
	Sales Account Cr		98,000
	(Sold goods on credit to Mr. Majid)		
15th Nov 2024	Miss Zara Account Dr	5,000	
	Purchases Returns Account Cr		5,000
	(Returned goods to Miss Zara)		
20th Nov 2024	Machinery Account Dr	175,000	

Date	Particulars	Debit (Rs.)	Credit (Rs.)
	Cash Account Cr		175,000
	(Purchased machinery with cash)		
22nd Nov 2024	Sales Returns Account Dr	2,030	
	Mr. Majid Account Cr		2,030
	(Returned goods from Mr. Majid)		
25th Nov 2024	Utility Expense Account Dr	185,000	
	Cash Account Cr		185,000
	(Paid utility bills)		
26th Nov 2024	Rent Expense Account Dr	80,000	
	Cash Account Cr		80,000
	(Paid rent)		
30th Nov 2024	Salaries Expense Account Dr	169,000	
	Cash Account Cr		169,000
	(Paid salaries)		

Notes:

1. **Abbreviations:** Dr stands for **Debit**, Cr stands for **Credit**.
2. Transactions follow the **Double Entry System**, ensuring that debits equal credits.

3. All expense accounts (utility, rent, and salaries) are debited as they reduce equity.

Q. 5

(A) Fill in the blanks. (10)

- i. Book-keeping reduces the chances of _____.
- ii. It is not possible for a businessman to _____ all the business transactions.
- iii. Income tax has an important _____ in the modern business environment.
- iv. _____ means disability to pay the debts of creditors.
- v. For any reason if a businessman has to sell business accounting records helps to determine the _____ of the business.

Ans:

Fill in the Blanks:

- i. Book-keeping reduces the chances of **errors and fraud**.
- ii. It is not possible for a businessman to **memorize** all the business

transactions.

iii. Income tax has an important **role** in the modern business environment.

iv. **Insolvency** means disability to pay the debts of creditors.

v. For any reason, if a businessman has to sell business, accounting records help to determine the **value** of the business.

(B) Identify the correct and incorrect statements. (10)

i. It is a legal requirement to maintain accounting records for all business units.

R/W

ii. There is no difference between accounting and bookkeeping. R/W

iii. When the work of bookkeeper ends the work of accountant starts. R/W

iv. The duty of the accountant is just to record all the business transactions. R/W

v. The basic principle of the double-entry system of bookkeeping is to record

the transactions twice in different books. R/W

Ans:

Identify the Correct and Incorrect Statements:

i. It is a legal requirement to maintain accounting records for all business units.

R (Right) – Maintaining accounting records is mandatory in most jurisdictions for compliance with tax and other regulations.

ii. There is no difference between accounting and bookkeeping.

W (Wrong) – Bookkeeping involves recording transactions, while accounting includes analyzing, summarizing, and interpreting financial data.

iii. When the work of the bookkeeper ends, the work of the accountant starts.

R (Right) – Bookkeepers record transactions, and accountants use this data to prepare financial statements and analyses.

iv. The duty of the accountant is just to record all the business transactions.

W (Wrong) – Accountants also analyze, summarize, and interpret financial data, not just record transactions.

v. The basic principle of the double-entry system of bookkeeping is to record the transactions twice in different books.

W (Wrong) – The principle involves recording each transaction in two accounts (debit and credit), not in different books.

Studyvillas.com