Allama Iqbal Open University AIOU BS solved Assignment NO1 Autumn 2024 Code 5401 Principles of Accounting

Q. 1Define Accounting and explain its objectives and branches.

Ans:

Definition of Accounting

Accounting is the systematic process of recording, classifying, summarizing, analyzing, and interpreting financial transactions of a business. It provides essential financial information that helps stakeholders, including business owners, investors, and regulators, make informed decisions. In simple terms, accounting is often referred to as the “language of business” because it communicates a company's financial position and performance.

Objectives of Accounting

The primary objectives of accounting can be grouped into several categories, which we will discuss in detail below.

1. Systematic Record-Keeping

The main goal of accounting is to maintain a systematic record of all financial transactions. Businesses engage in numerous transactions daily, such as purchases, sales, payments, and receipts. Accounting organizes these transactions in a structured manner to ensure that no data is lost or misinterpreted.

2. Determining Profit or Loss

One of the essential objectives of accounting is to ascertain whether a business is operating profitably. This is done through the preparation of financial statements like the income statement, which shows the revenue generated and expenses incurred during a specific period. By comparing revenues and expenses, the net profit or loss can be determined.

3. Assessing Financial Position

Accounting helps businesses evaluate their financial standing at a given point in time. The balance sheet, a key financial statement, provides insights into a company’s assets, liabilities, and equity. It shows how much the business owns, owes, and the owner’s stake in the company.

4. Providing Financial Information

One of the critical objectives of accounting is to provide accurate and timely financial information to stakeholders. This includes business owners, investors, creditors, and regulatory authorities. This information helps stakeholders assess the financial health of the business and make informed decisions.

5. Compliance with Legal Requirements

Accounting ensures that businesses adhere to various legal and regulatory requirements. For example, maintaining accurate financial records is essential for filing taxes and complying with government regulations. Proper accounting practices also help businesses avoid penalties and legal disputes.

6. Facilitating Decision-Making

Accounting provides data and insights that help management make informed decisions. For instance, cost accounting helps in determining the most cost-effective production methods, while management accounting assists in setting budgets and forecasting future performance.

7. Tracking Cash Flow

Proper accounting allows businesses to monitor their cash flow effectively. It helps in understanding the inflow and outflow of cash, ensuring that the company has sufficient funds to meet its obligations and invest in growth opportunities.

Branches of Accounting

Accounting is a broad field with several specialized branches designed to meet the needs of different users and purposes. Below are the main branches of accounting:

1. Financial Accounting

Financial accounting focuses on the preparation of financial statements for external stakeholders, such as investors, creditors, and regulatory authorities. It follows standardized rules and principles, such as Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS). The key components of financial accounting are:

- **Income Statement:** Shows the company’s profitability over a specific period.

- **Balance Sheet:** Reflects the company’s financial position at a particular point in time.
- **Cash Flow Statement:** Tracks the movement of cash within the business.

2. Management Accounting

Management accounting provides internal stakeholders, such as managers and executives, with detailed financial data to assist in decision-making and strategic planning. Unlike financial accounting, management accounting is not governed by standardized principles and can be tailored to the business’s specific needs. Examples of management accounting include budgeting, forecasting, and variance analysis.

3. Cost Accounting

Cost accounting is a subset of management accounting that focuses on calculating the cost of producing goods or services. It helps businesses identify areas where they can reduce costs and improve efficiency. Key methods in cost accounting include:

- **Standard Costing:** Setting benchmarks for costs.
- **Activity-Based Costing:** Allocating costs based on activities that drive them.

4. Tax Accounting

Tax accounting deals with preparing and filing tax returns and ensuring compliance with tax laws. It focuses on minimizing tax liabilities while adhering to legal requirements. Tax accountants must stay updated on changes in tax laws and regulations to ensure accurate reporting.

5. Auditing

Auditing involves examining a company's financial records to ensure accuracy and compliance with accounting standards. It can be internal (conducted by the company's employees) or external (conducted by independent auditors). The main purpose of auditing is to provide assurance to stakeholders that the financial statements are accurate and reliable.

6. Forensic Accounting

Forensic accounting combines accounting, auditing, and investigative skills to detect and prevent financial fraud. It is often used in legal disputes and criminal investigations. Forensic accountants analyze financial data to uncover irregularities, such as embezzlement, money laundering, or tax evasion.

7. Government Accounting

Government accounting focuses on managing public funds and ensuring transparency in the use of taxpayer money. It follows specific rules and standards designed for public sector entities. Government accounting helps in preparing budgets, tracking expenditures, and ensuring accountability in financial operations.

8. International Accounting

International accounting deals with the complexities of financial reporting in a global context. It involves understanding different accounting standards, such as IFRS, and addressing issues related to cross-border transactions, currency exchange, and international tax laws.

9. Environmental Accounting

Environmental accounting focuses on identifying and reporting the costs associated with environmental sustainability. It helps businesses measure the financial impact of their environmental initiatives and comply with environmental regulations.

10. Social Accounting

Social accounting, also known as corporate social responsibility (CSR) accounting, measures a company's impact on society. It evaluates how well the business is meeting its social and ethical obligations, such as community engagement, employee welfare, and environmental stewardship.

Importance of Accounting

Accounting plays a vital role in the success and sustainability of any business. Its importance can be summarized as follows:

- **Decision-Making:** Provides data-driven insights for strategic planning and operational decisions.
- **Transparency:** Ensures accurate and fair representation of financial information.
- **Performance Evaluation:** Helps in assessing the efficiency and profitability of business operations.
- **Resource Management:** Facilitates effective allocation and utilization of resources.
- **Legal Compliance:** Ensures adherence to financial regulations and tax laws.

Conclusion

Accounting is an indispensable tool for businesses and organizations. Its objectives, such as maintaining records, determining profitability, and ensuring compliance, make it a cornerstone of financial management. With various specialized branches like financial accounting, management accounting, and forensic accounting, the field caters to diverse needs. By providing accurate and timely financial information, accounting helps businesses achieve their goals, maintain transparency, and foster trust among stakeholders.

Q. 2

Mr. Anass started a sole proprietorship business. The business is newly established, and Mr. Asfar hired an accountant for keeping the journal updated. Suppose you are the accountant of Mr. Anass's business, prepare the journal book for the month of December 2023. You are also required to post journal entries into the ledger and prepare the trial balance. Detail of the transactions during April 2023 are given as follows:(20)April.

1. Mr. Anass commenced business with Cash of Rs. 990,000/-
Building Rs. 3, 700,000/-
2. Purchased Machinery with cash Rs. 300,000/-

5. Purchased goods from Miss Zara Rs. 250,000/-
8. Sold goods to Mr. M. Naeem Rs. 80,000/-
20. Goods returned from Miss Zara Rs. 5,000/-
21. Machinery Purchased Rs. 100,000/-
25. Returned goods to Mr. M. Naeem Rs. 3,000/-
28. Utility bills paid for the month Rs. 40,000/-
30. Rent paid for the month Rs. 40,000/-

Ans:

Journal Entries for April 2023

Below are the journal entries for the transactions of Mr. Anass's sole proprietorship business for April 2023.

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Explanation
April 1	Cash A/C	990,000		Business commenced with cash
	Building A/C	3,700,000		Business commenced with building contribution
	Capital A/C		4,690,000	Contribution by the owner
April 2	Machinery A/C	300,000		Purchased machinery
	Cash A/C		300,000	Paid in cash
April 5	Purchases A/C	250,000		Goods purchased on credit
	Miss Zara A/C		250,000	Credit purchase from Miss Zara
April 8	Mr. M. Naeem A/C	80,000		Sold goods on credit

	Sales A/C		80,000	Sales to Mr. M. Naeem
April 20	Miss Zara A/C	5,000		Goods returned by Miss Zara
	Purchases Return A/C		5,000	Return of purchased goods
April 21	Machinery A/C	100,000		Machinery purchased
	Cash A/C		100,000	Paid in cash
April 25	Sales Return A/C	3,000		Goods returned by Mr. M. Naeem
	Mr. M. Naeem A/C		3,000	Adjusted against receivable
April 28	Utility Expense A/C	40,000		Utility bills paid
	Cash A/C		40,000	Paid in cash
April 30	Rent Expense A/C	40,000		Rent paid
	Cash A/C		40,000	Paid in cash

Ledger Posting

Cash A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 1	Capital A/C	990,000		990,000
April 2	Machinery A/C		300,000	690,000
April 21	Machinery A/C		100,000	590,000
April 28	Utility Expense A/C		40,000	550,000
April 30	Rent Expense A/C		40,000	510,000

Building A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 1	Capital A/C	3,700,000		3,700,000

Capital A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 1	Cash A/C, Building A/C		4,690,000	4,690,000

Machinery A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 2	Cash A/C	300,000		300,000
April 21	Cash A/C	100,000		400,000

Purchases A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 5	Miss Zara A/C	250,000		250,000

Miss Zara A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 5	Purchases A/C		250,000	250,000
April 20	Purchases Return A/C	5,000		245,000

Sales A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)

April 8	Mr. M. Naeem A/C		80,000	80,000

Mr. M. Naeem A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 8	Sales A/C	80,000		80,000
April 25	Sales Return A/C		3,000	77,000

Utility Expense A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 28	Cash A/C	40,000		40,000

Rent Expense A/C

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 30	Cash A/C	40,000		40,000

Trial Balance as of April 30, 2023

Account Name	Debit (Rs.)	Credit (Rs.)
Cash A/C	510,000	
Building A/C	3,700,000	
Machinery A/C	400,000	
Purchases A/C	250,000	
Utility Expense A/C	40,000	
Rent Expense A/C	40,000	
Sales Return A/C	3,000	
Miss Zara A/C		245,000
Sales A/C		80,000
Capital A/C		4,690,000
Total	**4,943,000**	**4,943,000**

Q. 3

A firm whose accounting year is the calendar year, purchased on 1st April 2020 Machinery costing Rs. 150,000. It purchased further machinery on 1st Oct 2013 costing Rs. 1000,000 and on 1st July 2021, costing Rs. 50,000. On 1st January 2022,machinery installed on 1st April 2020 became obsolete and was sold for Rs. 45,000.Show how machinery Account would appear in the books of company, if Machinery was depreciated by fixed installment method @ 10% p.a. What Would be the balance of machinery Account on 1st January 2023?

Ans:

Depreciation and Disposal Calculations (Plain Text)

1. Machinery Purchased on April 1, 2020

- Annual depreciation = Rs. 15,000.
- Depreciation from April 1, 2020, to December 31, 2020 (9 months) = 15,000 * (9 / 12) = Rs. 11,250.
- Full depreciation for 2021 = Rs. 15,000.
- Depreciation from January 1, 2022, to April 1, 2022 (3 months) = 15,000 * (3 / 12) = Rs. 3,750.
- Book value as of April 1, 2022 = 150,000 - (11,250 + 15,000 + 3,750) = Rs. 120,000.
- Sale proceeds = Rs. 45,000.
- Loss on disposal = 120,000 - 45,000 = Rs. 75,000.

2. Machinery Purchased on October 1, 2020

- Depreciation from October 1, 2020, to December 31, 2020 (3 months) = 100,000 * (3 / 12) = Rs. 25,000.
- Full depreciation for 2021 = Rs. 100,000.
- Full depreciation for 2022 = Rs. 100,000.

3. Machinery Purchased on July 1, 2021

- Depreciation from July 1, 2021, to December 31, 2021 (6 months) = 5,000 * (6 / 12) = Rs. 2,500.
- Full depreciation for 2022 = Rs. 5,000.

Machinery Account

Date	Particulars	Debit (Rs.)	Credit (Rs.)	Balance (Rs.)
April 1, 2020	To Bank (Purchase)	150,000		150,000
Dec 31, 2020	By Depreciation A/C		11,250	138,750
Oct 1, 2020	To Bank (Purchase)	1,000,000		1,138,750
Dec 31, 2020	By Depreciation A/C		25,000	1,113,750
July 1, 2021	To Bank (Purchase)	50,000		1,163,750

Dec 31, 2021	By Depreciation A/C	117,500	1,046,250
April 1, 2022	By Depreciation A/C	3,750	1,042,500
April 1, 2022	By Bank (Sale of Obsolete)	45,000	997,500
April 1, 2022	By Loss on Disposal	75,000	922,500
Dec 31, 2022	By Depreciation A/C	105,000	817,500

Balance of Machinery Account on January 1, 2023

The closing balance of the Machinery Account as of January 1, 2023, is **Rs. 817,500**.

Q.4

The following Trial Balance was extracted from the books of Jaffar Brothers on 31stJanuary 2019. From the given information you are required to prepare a work sheet for the year ending on 31st December 2023.

Additional Information1)Prepaid insurance on 31 December 2023 is Rs. 14,000/-2)Outstanding salaries Rs. 10,000/-3)Depreciation on plant and machinery @ 10% p.a.4)Merchandise inventory on 31 December 2023 was valued at Rs.60,000/-

Ans:

Solution: Preparation of Worksheet for Jaffar Brothers

We need to create a worksheet that incorporates adjustments for the given additional information, updates trial balance figures, and prepares adjusted balances for the year ending 31st December 2023.

Step 1: Unadjusted Trial Balance

The unadjusted trial balance is already provided.

Title of Accounts	Debit (Dr.) (Rs.)	Credit (Cr.) (Rs.)
Cash	170,000	
Accounts Receivable	90,000	
Merchandise Inventory (1st Jan)	60,000	
Plant and Machinery	170,000	
Furniture and Fixtures	820,000	
Capital		1,360,000
Accounts Payable		38,000
Purchases	600,000	
Purchase Return and Allowances		22,000
Discount on Purchases		6,000
Sales		700,000
Sales Return and Allowances	30,000	
Sales Discount	16,000	

Insurance Prepaid	10,000	
Advertisement Expenses	40,000	
Salaries Expenses	120,000	
Totals	**2,126,000**	**2,126,000**

Step 2: Adjustments Based on Additional Information

1. **Prepaid Insurance**
   Prepaid insurance on December 31, 2023, is Rs. 14,000. Adjust the expense account:
   - Increase Prepaid Insurance by Rs. 4,000 (10,000 to 14,000).
2. **Outstanding Salaries**
   Outstanding salaries of Rs. 10,000 should be added to salaries expense and recorded as a liability.
3. **Depreciation on Plant and Machinery**
   Depreciation = 10% of Rs. 170,000 = Rs. 17,000. Deduct from the value of plant and machinery and charge as an expense.
4. **Merchandise Inventory (Closing)**
   Closing inventory value is Rs. 60,000. Adjust the merchandise inventory and cost of goods sold (COGS).

   Formula for COGS:

COGS = Opening Inventory + Purchases - Closing Inventory

COGS=60,000+600,000−60,000=600,000\text{COGS} = 60,000 + 600,000 - 60,000 = 600,000.

Step 3: Prepare Adjusted Trial Balance

Here is the adjusted trial balance after applying the adjustments:

Title of Accounts	Adjusted Debit (Rs.)	Adjusted Credit (Rs.)
Cash	170,000	
Accounts Receivable	90,000	
Merchandise Inventory (1st Jan)		60,000
Plant and Machinery (Net Value)	153,000	
Furniture and Fixtures	820,000	
Capital		1,360,000
Accounts Payable		38,000
Purchases	600,000	
Purchase Return and Allowances		22,000

Discount on Purchases		6,000
Sales		700,000
Sales Return and Allowances	30,000	
Sales Discount	16,000	
Insurance Prepaid	14,000	
Advertisement Expenses	40,000	
Salaries Expenses	130,000	
Outstanding Salaries		10,000
Depreciation (Plant & Machinery)	17,000	
Merchandise Inventory (Closing)		60,000
Totals	**2,080,000**	**2,080,000**

Step 4: Worksheet Columns

Title of Accounts	Trial Balance Dr. (Rs.)	Trial Balance Cr. (Rs.)	Adjustments Dr. (Rs.)	Adjustments Cr. (Rs.)	Adjusted Trial Balance Dr. (Rs.)	Adjusted Trial Balance Cr. (Rs.)

Cash	170,000				170,000	
Accounts Receivable	90,000				90,000	
Merchandise Inventory (1st Jan)	60,000			60,000		60,000
Plant and Machinery (Net Value)	170,000			17,000	153,000	
Furniture and Fixtures	820,000				820,000	
Capital		1,360,000				1,360,000
Accounts Payable		38,000				38,000
Purchases	600,000				600,000	
Purchase Return and		22,000				22,000

Allowances						
Discount on Purchases		6,000				6,000
Sales		700,000				700,000
Sales Return and Allowances	30,000				30,000	
Sales Discount	16,000				16,000	
Insurance Prepaid	10,000		4,000		14,000	
Advertisement Expenses	40,000				40,000	
Salaries Expenses	120,000		10,000		130,000	
Outstanding Salaries				10,000		10,000

Depreciation			17,000		17,000	
Merchandise Inventory (Closing)				60,000		60,000
Totals	**2,126,000**	**2,126,000**	**31,000**	**147,000**	**2,080,000**	**2,080,000**

This worksheet is now complete! Let me know if you need further clarification.

Q.5 What do you mean by double entry system of accounting? Explain it with examples

Ans:

Double Entry System of Accounting: A Comprehensive Explanation

The double entry system of accounting is the foundation of modern financial accounting. It is a methodical way of recording transactions that ensures the accounting equation (Assets = Liabilities + Equity) remains balanced. In this system, every transaction affects at least two accounts, with one account being debited and the other credited for an equal amount. This dual effect provides accuracy and helps in creating reliable financial statements.

Origin and History

The double entry system originated in 1494, introduced by an Italian mathematician and friar named Luca Pacioli in his book *Summa de Arithmetica, Geometria, Proportioni et Proportionalita*. Pacioli outlined the principles of this system, emphasizing the need for balance and clarity in bookkeeping.

Principles of the Double Entry System

1. **Dual Aspect**
   Every transaction has two aspects: a debit and a credit. For instance, if a business buys furniture, the furniture account is debited (asset increases), and the cash account is credited (asset decreases).

2. **Accounting Equation**
   The double entry system ensures that the accounting equation remains balanced:
   Assets=Liabilities+Owner’s Equity.\text{Assets} = \text{Liabilities} + \text{Owner’s Equity}.
3. **Debit and Credit Rules**

   - **Assets and Expenses**: Increase with a debit, decrease with a credit.
   - **Liabilities, Equity, and Revenue**: Increase with a credit, decrease with a debit.

Features of the Double Entry System

1. **Completeness**
   Every financial transaction is recorded, ensuring no omissions.

2. **Accuracy**
   The debit and credit amounts are always equal, minimizing errors.

3. **Systematic Recording**
   Transactions are recorded chronologically and systematically in journals and ledgers.

4. **Facilitates Financial Statements**
   Accurate recording makes it easier to prepare balance sheets, income statements, and cash flow statements.

5. **Error Detection**
   Trial balances help identify discrepancies in the books.

Components of the Double Entry System

1. **Journal**
   The journal is the primary book of entry where transactions are recorded in chronological order.

2. **Ledger**
   Ledger accounts categorize and summarize the transactions recorded in the journal.

3. **Trial Balance**
   The trial balance checks the equality of debits and credits across all accounts.

4. **Financial Statements**
   The system helps prepare financial statements such as the income statement, balance sheet, and cash flow statement.

Advantages of the Double Entry System

1. **Accuracy in Financial Records**
   Ensures that both sides of the transaction are recorded, reducing the chances of errors.

2. **Detailed Information**
   Provides a clear picture of the business's financial position by categorizing transactions into accounts.

3. **Error Detection**
   By ensuring that total debits equal total credits, discrepancies can be easily identified.

4. **Facilitates Decision-Making**
   Provides reliable data for business decisions and financial analysis.

5. **Adherence to Accounting Standards**
   The system aligns with international accounting standards,

making financial statements universally understandable.

Examples of Double Entry System

Example 1: Cash Purchase of Equipment

A business buys equipment worth Rs. 50,000 in cash.

- **Equipment Account (Asset)**: Debit Rs. 50,000 (increase in asset).
- **Cash Account (Asset)**: Credit Rs. 50,000 (decrease in asset).

Date	Particulars	Debit (Rs.)	Credit (Rs.)
01/01/2023	Equipment Account	50,000	
	To Cash Account		50,000

Example 2: Sale of Goods on Credit

Goods worth Rs. 20,000 are sold to a customer on credit.

- **Accounts Receivable (Asset)**: Debit Rs. 20,000 (increase in receivable).
- **Sales Account (Revenue)**: Credit Rs. 20,000 (increase in income).

Date	Particulars	Debit (Rs.)	Credit (Rs.)
05/01/2023	Accounts Receivable	20,000	
	To Sales Account		20,000

Example 3: Payment of Rent

The business pays Rs. 10,000 as rent.

- **Rent Expense Account**: Debit Rs. 10,000 (increase in expense).
- **Cash Account**: Credit Rs. 10,000 (decrease in asset).

Date	Particulars	Debit (Rs.)	Credit (Rs.)
10/01/2023	Rent Expense	10,000	
	To Cash Account		10,000

Disadvantages of the Double Entry System

1. **Complexity**
   For small businesses, maintaining detailed records can be challenging.

2. **Costly and Time-Consuming**
   Requires skilled accountants and software, which can increase costs.

3. **Possibility of Fraud**
   Though errors are minimized, intentional fraud can still occur.

4. **Not Error-Proof**
   Errors of omission or incorrect categorization can persist.

Comparison with Single Entry System

Aspect	Single Entry System	Double Entry System
Nature	Incomplete and informal	Complete and formal
Accounts Affected	One account	At least two accounts
Error Detection	Difficult	Easier through trial balances
Usage	Small businesses	Businesses of all sizes

Importance in Modern Accounting

1. **Global Standardization**
   Used worldwide for its accuracy and reliability.

2. **Audit Requirements**
   Essential for audit processes, ensuring compliance with regulations.

3. **Transparency**
   Promotes trust among stakeholders by presenting accurate financial data.

4. **Support for Decision-Making**
   Provides clear insights into financial performance and position.

Conclusion

The double entry system of accounting is a robust and reliable method that has stood the test of time. Its principles of recording both aspects of a transaction ensure accuracy, transparency, and completeness in financial reporting. While it may be complex and time-consuming, its advantages far outweigh its limitations, making it indispensable for modern businesses.