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Accounting Equation, Double Entry System & Accounting Concepts

AAT Level I

FAC - Financial Accounting

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UNIT 02 – ACCOUNTING EQUATION, DOUBLE ENTRY SYSTEM & ACCOUNTING CONCEPTS

	Accounting Equation, Double Entry System and Accounting Concepts, (25%)	
02	2.1	Entity concept
	2.2	Elements of Accounting (including; Assets, Liabilities, Income, Expenses and Equity)
	2.3	Recording Business Transactions in line with Accounting Equation
	2.4	Dual aspect of a transaction
	2.5	Double Entry System
	2.6	Other Accounting Concepts (Going concern, Periodic, Historical Cost, Money Measurement, Matching, Accrual, Prudence, Consistency, Realization, Materiality, Substance over-form)

1. ENTITY CONCEPT

- The business is treated separate from the owners.
- Hence transactions are recorded from the point of view of the firm and not the owner.
- Hence capital is a liability and drawings is an asset.

2. ELEMENTS OF ACCOUNTING

Assets
Liabilities
Equity
Income
Expenses

3. ACCOUNTING EQUATION

- Accounting equation is a simple way to illustrate two facts about a business, which is what a business owns and what it owes.
- Entire double entry accounting concept is based on the basic accounting equation.
- **DERIVING THE BASIC ACCOUNTING EQUATION**
  - Assets = Capital
  - Assets = Capital + Liabilities
  - Assets = Capital + Profit + Liabilities
  - Assets = Capital + (Income – Expenses) + Liabilities
  - Assets + Expenses = Capital + Income + Liabilities
  - NCA + CA + Expenses = Capital + Income + NCL + CL
  - Stock + Debtors + Cash + Expenses = Capital + Income + Bank Loan + Creditors

4. Calculation of Profit/Loss

- Profit/Loss = Income – Expenses
- Profit/Loss = (Closing Capital – Opening Capital) + Drawings – Additional Capital

01. Exercise

The below information given for an organization.

	Rs.		
1. Motor vehicle	300,000	9. Bank balance	50,000
2. Machinery	200,000	10. Land & building	400,000
3. Inventory	50,000	11. Cash in hand	60,000
4. Debtors / Trade receivables	80,000	12. Prepaid telephone	3,000
5. Creditors / Trade payables	50,000	13. Office equipment	12,000
6. Accrued electricity	10,000	14. Mortgage loan	15,000
7. Advance rent received	5,000	15. Interest income receivable	7,000
8. Bank loan	100,000	16. Tax payable	11,000

- Distinguish the above information using,
  a) Non-current assets
  b) Current assets
  c) Non-current liabilities
  d) Current liabilities

- Calculate the capital balance

02. Exercise

Below transactions are given for Mahinda's business for the month of January 2016.

Show the impact on the accounting equation.

Date	Transaction	Amount
2/1	Mahinda invested cash	100,000
3/1	Purchased a motor vehicle	45,000
4/1	Cash purchases	30,000
5/1	Cash sales	48,000
6/1	Obtained a bank loan	60,000
7/1	Repayment of bank loan	32,000
8/1	Mahinda's drawings	50,000
9/1	Interest income received	48,000
10/1	Electricity expenses paid	16,000

03. **EXERCISE**

BELOW TRANSACTIONS ARE GIVEN FOR CHAMARI'S BUSINESS FOR THE MONTH OF MARCH 2016.

Show the impact on the accounting equation.

Date	Transaction	Amount
2/3	Invested Capital	500,000
3/3	Cash purchases	300,000
4/3	Credit purchases	700,000
5/3	Cash sales	500,000
6/3	Credit sales	400,000
7/3	Return inwards	50,000
8/3	Return outwards	40,000

9/3	Discounts allowed	20,000
10/3	Discounts received	30,000
11/3	Obtained a bank loan	400,000
12/3	Owners drawings	80,000
13/3	Paid Bank loan	200,000
14/3	Received from debtors	150,000
15/3	Paid to creditors	130,000
16/3	Electricity paid	32,000

04. **EXERCISE**

The below transaction happened during the month of January 2016.

No	Capital +	Creditors =	Cash +	Stock +	Debtors +	Equipment
1	+50,000		+50,000			
2	+60,000		+60,000			
3	+20,000				+20,000	
4		+30,000	-20,000	+50,000		
5			-60,000			+60,000
6	-3,000		-1,000	-2,000		

- Except #1 & #6 all the other transactions affect to the net income,
  1. Describe the transactions
  2. Make the income statement

05. **EXERCISE**

The below equations of a business,

Capital +	Creditor =	Cash+	Stock+	Debtors+	Equipment
+300,000		+100,000			+200,000
-10,000		-10,000			
	+50,000		+50,000		
-5,000		-5,000			
+1,000	-1,000				
-2,000	+2,000				
+50,000		+50,000			
-1,000					-1,000
+80,000				+80,000	
-1,000				-1,000	

- Except #1,2 & 5 all the other transaction s affect to the net income,
  1. Describe the transactions
  2. Make the income statement

PAST PAPERS: ACCOUNTING EQUATION AND PROFIT EQUATION

2019 July – Question 01

1.12 The following information was extracted from the books of **Super Traders** for the year ended 31st March 2019:

	Rs.
Total assets as at 31st March 2019	950,000
Capital as at 01st April 2018	400,000
Profit for the year	150,000
Additional capital introduced during the year	100,000
Drawings made during the year	75,000

Based on the above information, calculate the total liabilities as at 31st March 2019. (03 marks)

2019 July – Question 05 (A)

(A) The following transactions were extracted from the books of accounts of **Saman Traders**, a sole proprietorship for the month of January 2019:

Date	Transaction
02.01.2019	Purchased Rs.723,000/- worth of goods on credit for re-sale.
05.01.2019	**Saman,** the owner has taken goods costing of Rs.50,000/- for his personal use.
10.01.2019	Sold goods costing of Rs.575,000/- for Rs.600,000/- on credit basis.
15.01.2019	Cash received from Debtors Rs.550,000/-.
28.01.2019	Telephone Bill for the month of January 2019 was Rs.18,000/- and paid only Rs.12,000/-.
30.01.2019	Purchased a motor bicycle of Rs.500,000/- for cash for office use.

You are required to:

Record the effect of each of the above transactions to the following Accounting Equation.

[Non-Current Assets (Fixed Assets) + Inventory + Debtors + Cash = Equity + Liabilities]

(06 marks)

2019 January – Question 01

1.6 The following information was extracted from the books of **Moon Lanka Traders** for the year ended 31st March 2018:

Description	Rs.
Capital as at 01st April 2017	750,000
Additional capital introduced during the year	50,000
Liabilities as at 31st March 2018	75,000
Total assets as at 31st March 2018	987,000

Based on the above information, profit for the year ended 31st March 2018 would be:

(1) Rs.112,000/-. (2) Rs.237,000/-. (3) Rs.187,000/-. (4) Rs.162,000/-.

2019 January – Question 05 (B)

(B) **Wijesooriya** started a sole proprietorship on 01st September 2018. The following transactions have been extracted from his books of accounts for the month of September 2018:

Date	Transaction
01.09.2018	**Wijesooriya** commenced the business investing Rs.800,000/- in cash. Further he invested his personal van valued at Rs.1,500,000/- to the business for delivering the goods.
05.09.2018	Purchased goods worth Rs.625,000/- on credit for resale.
18.09.2018	Sold goods costing Rs.375,000/- for Rs.485,000/- on cash basis.
26.09.2018	Staff salary of Rs.125,000/- was paid.
28.09.2018	**Wijesooriya** withdrew Rs.35,000/- in cash from the business for his personal use.
30.09.2018	Paid Rs.125,000/- to creditors for goods purchased on credit.

You are required to:

Record the effects of each of the above transactions to the following accounting equation.

[Non-current assets (fixed assets) + Inventory + Cash = Equity + Liabilities] (06 marks)

2018 July – Question 01

1.11 The following information was extracted from the books of **Rose Traders** for the year ended 31st March 2018:

Description	Rs.
Capital as at 01st April 2017	500,000
Profit for the year ended 31st March 2018	175,000
Liabilities as at 31st March 2018	425,000
Drawings during the year	25,000

Based on the above information,

Calculate the value of total assets as at 31st March 2018 of **Rose Traders**. (03 marks)

2018 July – Question 05

(A) The following transactions were extracted from the books of **Multi Traders,** a sole proprietorship for the month of January 2018:

Date	Transaction
05.01.2018	Stocks costing of Rs.150,000/- were sold to **Rathna Traders** for Rs.170,000/- on credit basis.
20.01.2018	Received cash from **Rathna Traders** amounting to Rs.100,000/-.
22.01.2018	Purchased goods worth Rs.200,000/- in cash for resale.
27.01.2018	The owner invested additional capital of Rs.1,000,000/- in cash to the business.
31.01.2018	Staff salary of Rs.125,000/- was paid for the month of January.

You are required to:

Record the effect of each of the above transactions to the following accounting equation.

(Inventory + Debtors + Cash = Equity + Liability) (05 marks)

2018 January – Question 01

1.5 The following information was extracted from the books of **Saman Traders** for the year ended 31st March 2017:

Description	Rs.
Capital as at 01st April 2016	550,000
Profit for the year ended 31st March 2017	155,000
Drawings during the year	350,000
Additional capital introduced during the year	200,000
Liabilities as at 31st March 2017	300,000

Based on the above information, the value of total assets as at 31st March 2017 of **Saman Traders** is:

(1) Rs.1,155,000/-. (2) Rs.705,000/-. (3) Rs.1,555,000/-. (4) Rs.855,000/-.

(02 marks)

1.13 The following information was extracted from the books of **Piyal Opticals** for the year ended 31st December 2017:

	Rs.
Net assets as at 01st January 2017	525,000
Net assets as at 31st December 2017	850,000
Drawings by the owner during the year	150,000
Additional capital introduced during the year	250,000

Calculate the Net Profit of **Piyal Opticals** for the year ended 31st December 2017, using the "Profit Equation".

(03 marks)

2018 January – Question 05

(A) The following transactions were extracted for the month of November 2017 from the books of **Tikiri Traders**, a sole proprietorship:

Date	Transaction
01.11.2017	Purchased goods worth Rs.650,000/- on credit for resale.
05.11.2017	Obtained a short-term loan of Rs.750,000/- from **ABC Bank**.
20.11.2017	The owner of **Tikiri Traders** has taken goods costing of Rs.30,000/- for his personal use.
25.11.2017	Telephone bill for the month of November 2017 was Rs.5,000/-, however only Rs.4,000/- was paid during the month.
28.11.2017	Sold goods costing of Rs.200,000/- for Rs.220,000/- on credit basis.
30.11.2017	Paid Rs.300,000/- to a creditor for goods purchased on credit.

You are required to:

Record the effect of each of the above transactions to the following accounting equation:

(Inventories + Debtors + Cash = Equity + Liabilities) (06 marks)

(B) **Asanka Traders** is a sole proprietorship which manufactures and sells concrete blocks. Credit sales of **Asanka Traders** for the month of December 2017 are as follows:

2017 July – Question 01

1.2 The following information were extracted from the books of **Kapila Motors** for the year ended 31st March 2017:

Description	Rs.
Net assets as at 01.04.2016	325,000
Net assets as at 31.03.2017	385,000
Drawings during the year	35,000
Additional capital introduced during the year	10,000

Based on the above information, the net profit / (loss) for the year ended 31st March 2017 would be:

(1) (Rs.105,000) (2) (Rs.35,000) (3) Rs.85,000/- (4) Rs.15,000/-

(02 marks)

2017 July – Question 02

(b) The following transactions were extracted for the month of March 2017 from the books of the business of **Rose**, a sole proprietor:

Date	Transaction
01.03.2017	**Rose** commenced the business by investing Rs.500,000/- in cash.
05.03.2017	Purchased goods for resale for Rs.750,000/- on credit.
15.03.2017	Stocks costing of Rs.300,000/- were sold for cash with a profit margin of 10% on cost.
20.03.2017	Rs.200,000/- was paid to a supplier.
25.03.2017	Paid electricity bill of Rs.10,000/- for the month of March 2017.
31.03.2017	Purchased a computer for Rs.100,000/- on credit basis for office use.

You are required to:

Record the effect of each of the above transactions to the following accounting equation:

[Non-Current Assets (Fixed Assets) + Inventories + Debtors + Cash = Equity + Liabilities]

(06 marks)

(Total 10 marks)

2017 January – Question 01

1.5 The following information were extracted from the books of **ABC Enterprise** which is a sole proprietorship:

Description	Rs.
Capital as at 01st April 2015	200,000
Drawings during the year	120,000
Profit for the year ended 31st March 2016	145,000
Liabilities as at 31st March 2016	80,000

Based on the above information, total assets as at 31st March 2016 would be:

(1) Rs.305,000/-. (2) Rs.545,000/-. (3) Rs.345,000/-. (4) Rs. 225,000/-.

(02 marks)

1.8 The following information was extracted from the books of **XYZ Traders**:

	Rs.
Net assets as at 01st April 2015	150,000
Additional Capital	25,000
Net Assets as at 31st March 2016	135,000
Drawings by the owner during the year	12,000

The Net Profit / (Loss) of **XYZ Traders** for the year ended 31st March 2016 by using the profit equation is:

(1) (Rs.22,000/-). (2) Rs.28,000/-. (3) Rs.52,000/-. (4) (Rs. 28,000/-).

(02 marks)

2017 January – Question 02

(a) The following transactions were extracted from the books of **Mathews Traders** for the month of June 2016.

Date	**Transaction**
01.06.2016	Sold goods costing Rs.40,000/- for Rs.60,000/- on credit basis.
07.06.2016	Purchased goods for resale worth of Rs.50,000/- on credit.
08.06.2016	Paid Rs.10,000/- to a creditor for goods purchased on credit.
24.06.2016	Staff salary of Rs.45,000/- was paid for the month of June.
30.06.2016	**Mathew** invested additional capital of Rs.90,000/- in cash to the business.
30.06.2016	Purchased an office equipment for Rs.10,000/- from **Cooray Ltd.** on credit for office use.

You are required to:

Record the effect of each of the above transactions to the following accounting equation:

[Fixed assets + Inventories + Debtors + Cash = Capital + Liabilities] (06 marks)

2016 July – Question 05

Harshana, started his own business on 01st April 2016 with the help of his father. The following transactions have been extracted from the books of his business for the month of April 2016:

Date	Transaction
01.04.2016	He introduced Rs.750,000/- in cash and Rs.325,000/- worth of goods for resale, to commence the business.
03.04.2016	Sold goods costing Rs.75,000/- for Rs.100,000/- on cash basis .
15.04.2016	Sold goods costing Rs.200,000/- for Rs.250,000/- on credit basis.
19.04.2016	Purchased goods for Rs.525,000/-, on credit basis.
25.04.2016	Collected Rs.10,000/- from a customer.
30.04.2016	Purchased a motor bicycle for Rs.250,000/- for office use by paying Rs.100,000/- in cash and the balance is to be settled within 2 months.

You are required to:

(a) **Record** the effects of each of the above transactions to the accounting equation.

(Fixed Assets + Inventories + Debtors + Cash = Capital + Liabilities) (07 marks)

(b) **Prepare** the Statement of Financial Position as at 30th April 2016. (03 marks)

(Total 10 marks)

2015 July

Sanath started a proprietorship on 01st January 2015 and the transactions that occurred during the first two weeks of his business are given below:

Date	Description
01.01.2015	**Sanath** commenced his business by depositing Rs.950,000/- in a bank current account and purchased goods worth Rs.250,000/- for cash.
02.01.2015	Business startup expenses of Rs.12,000/- were paid by cash.
03.01.2015	Purchased goods for resale on credit for Rs.350,000/- and incurred transportation cost of Rs.10,000/-.
07.01.2015	Cash sales of Rs.40,000/- including a profit margin of 25%.
10.01.2015	Staff salary of Rs.75,000/- was paid. Sold goods on credit for Rs.100,000/- including a profit of Rs.10,000/-.
12.01.2015	**Sanath** paid his personal rent expense of Rs.50,000/- from the business.

You are required to:

Record the effects of the above transactions to the following accounting equation.

[Inventory + Debtors + Cash = Capital + Liabilities + (Income - Expenses)] (08 marks)

2015 January

06. (A) The following transactions during the month of March 2014 were extracted from the books of the business of **Namal,** a sole proprietor.

Date	Description
01.03.2014	**Namal** commenced a business by investing Rs.2,500,000/- in cash.
02.03.2014	Purchased goods for resale for Rs.1,000,000/- on credit.
10.03.2014	Stocks costing of Rs.250,000/- was sold on credit with a margin of 30% on cost.
18.03.2014	Collected Rs.200,000/- from customer.
25.03.2014	Staff salary of Rs.300,000/- was paid.
28.03.2014	Goods costing of Rs.125,000/- were drawn by **Namal** for his personal use.
30.03.2014	Purchased a delivery van for Rs.850,000/- in cash for office use.

You are required to, show the effects of the above transactions to the accounting equation: (Fixed Assets + Inventories + Debtors + Cash = Capital + Liabilities)

(07½ marks)

2014 July

(B) **Amal** opened a shop on 01st October 2013. The following transactions took place during the first month of his business.

Date	Transaction
01.10.2013	**Amal** commenced the business introducing Rs.85,000/- in cash.
07.10.2013	Credit purchases were Rs.35,000/-, payable in 30 days.
12.10.2013	Paid first month's shop rent of Rs.8,000/-.
17.10.2013	Sold goods for Rs.11,000/-, and collected Rs.4,000/- in cash. The cost of goods sold was Rs.9,000/-.
18.10.2013	Goods costing Rs.2,500/- were drawn for **Amal's** personal use.
25.10.2013	Collected Rs.6,000/- from a debtor.
28.10.2013	Paid Rs.5,000/- to a creditor for goods purchased on credit.
31.10.2013	Credit purchases were Rs.10,000/- and cash purchases were Rs.20,000/-.

You are required to,

(a) Show the effects of the above transactions to the accounting equation.
(Inventories + Debtors + Cash = Capital + Liabilities)

(b) Prepare the Statement of Financial Position (Balance sheet) as at 31st October 2013.

(13 marks)
(Total 25 marks)

2013 July

06. (A) You are given the following transactions of **Reka Tex,** a sole proprietorship, during the month of January 2013:

Date	Description
02nd January	Sold Rs.25,000/- cost of goods for Rs.30,000/- on cash.
04th January	Sold Rs.12,000/- cost of goods for Rs.20,000/- on credit.
06th January	Cash purchases were Rs.25,000/- and credit purchases were Rs.30,000/-.
10th January	Received Rs.19,000/- from a debtor.
18th January	Rs.6,000/- paid for a telephone bill.
23rd January	Paid Rs.23,000/- for a full settlement of a creditor's invoice of Rs.25,000/-.
28th January	Rent income received was Rs.3,000/-.

You are required to illustrate the effects of each transaction to the accounting equation (Inventories + Debtors + Cash = Capital + Liabilities).

Example:- Settlement of bank loan - Rs.30,000/-.

Inventories	+	Debtors	+	Cash	=	Capital	+	Liabilities
				-30,000	=			-30,000

(07½ marks)

2012 January

04. (A) You are given the following transactions of the business of **Roshan**, a sole trader, during the month of January 2011:

	Date	
(1)	01.01.2011	Invested Rs.200,000/- cash by **Roshan** to the business.
(2)	03.01.2011	Purchased goods costing Rs.350,000/- on credit basis.
(3)	05.01.2011	Sale of goods for cash Rs.80,000/- and cost of goods sold is Rs.67,500/-.
(4)	09.01.2011	**Roshan** has taken goods costing Rs.15,000/- from the business for his personal use.
(5)	13.01.2011	Paid for electricity Rs.5,000/-.
(6)	15.01.2011	Received interest income of Rs.5,000/- to the bank account.

You are required to, illustrate the effects of these transactions to the accounting equation. (Cash + Bank + Inventories = Capital + Liabilities)

<u>Example</u>: Accrued rent for the month is Rs.6,000/-.

Cash + Bank + Inventories = Capital + Liability

= - 6,000 + 6,000

(07 marks)

2010 January

06. (a) **Rex Traders** had fixed assets of Rs.400,000/-, total assets of Rs.820,000/- and total liabilities of Rs.280,000/- as at 01st April 2010. **Rex Traders** maintains a gross profit margin of 20% on sales. **Rex Traders** has no credit sales.

Rex Traders has recorded the following transactions for the month of April 2010:

		Rs.
1.	Paid for a new computer	20,000
2.	Sales	100,000
3.	Purchases on credit	60,000
4.	Cash purchases	20,000
5.	Paid to creditors	89,000
6.	Rent paid	11,000
7.	Goods lost	2,000
8.	Sale proceeds of old computer	6,000
9.	Repayment of loan	5,000
10.	Drawings	3,000

The old computer was purchased at Rs.15,000/- five years ago. All the fixed assets are depreciated at 25% per annum on the straight-line basis.

You are required to:

(i) Present the impact of each of the above transactions in the following format of the accounting equation.

Revenue	- Expense	+ Capital	+ Liabilities	= Assets

(ii) Calculate the owner's equity at the end of April 2010. (07½ marks)

2010 December

(c) Impact of some of the transactions in the accounts of **Silva Bake House** are given below:

Item	Cash	Inventories	Receivables	Capital	Fixed Assets	Revenue	Expenses
1	**+ 5,000**	**- 3,000**	**-**	**-**	**-**	**+ 5,000**	**+ 3,000**
2	+ 3,000	-	-	+ 6,000	+ 3,000	-	-
3	-	- 500	-	-	+ 500	-	-
4	-	- 4,000	-	- 4,000	-	-	-
5	-	-	-	+ 300	-	-	+ 300
6	-	-	-	-	- 700	-	+ 700
7	+ 1,000	- 3,000	+ 3,000	-	-	+ 4,000	+ 3,000
8	+ 2,000	-	- 2,100	-	-	-	+ 100

You are required to, identify possible transactions that causes impact of item 2 to 8 above.

Example relating to Item 1 is given below:
Transaction: Cash sales of Rs.5,000/- of goods costing for Rs.3,000/-.

(08 marks)

CIMA / ACCA - MCQ's

1. Select from the following, the correct impact on the accounting equation due to settling a creditor in cash:

    (1) Decrease in assets and decrease in liabilities
    (2) Decrease in assets and increase in liabilities
    (3) Decrease in liabilities and decrease in equity
    (4) Decrease in liabilities and increase in equity

2. The following information was extracted from the books of Moon Lanka Traders for the year ended 31st March 2018:

Capital as at 01st April 2017	750,000
Additional capital introduced during the year	50,000
Liabilities as at 31st March 2018	75,000
Total assets as at 31st March 2018	987,000

Based on the above information, profit for the year ended 31st March 2018 would be:

(1) Rs.112,000/-. (2) Rs.237,000/-. (3) Rs.187,000/-. (4) Rs.162,000/-.

a. On 01st April 2018, Sahan purchased an office cupboard worth Rs.45,000/- for office use from Danapala Furniture on credit.

The effect of the above transaction to the Accounting Equation is:

(1) Increase in assets and decrease in liabilities
(2) Decrease in equity and decrease in liabilities
(3) Increase in assets and increase in liabilities
(4) Decrease in equity and increase in liabilities

3. Which one of the following transactions affects increase in equity?

    (1) Obtaining a short-term loan amounting to Rs.300,000/- from a bank.
    (2) A receipt of Rs.150,000/- from a trade debtor.
    (3) A receipt of an advance of Rs.560,000/- for next year's building rent.
    (4) Introducing Rs.150,000/- in cash to the business by the owner.

4. Which one of the following transactions affects decrease in liabilities?

    (1) Purchase of raw material of Rs.150,000/- from ABC textiles on credit.
    (2) Sale of garments for Rs.850,000/ on three-months credit to MKK Fashions.
    (3) Settlement of a short-term loan of Rs.755,000/- to UE Bank.
    (4) Payment of Rs.500,000/- in advance for next year's building rent.

5. The following information was extracted from the books of Saman Traders for the year ended 31st March 2017:

Capital as at 01st April 2016	550,000
Profit for the year ended 31st March 2017	155,000
Drawings during the year	350,000
Additional capital introduced during the year	200,000
Liabilities as at 31st March 2017	300,000

Based on the above information, the value of total assets as at 31st March 2017 of Saman Traders is:
(1) Rs.1,155,000/-. (2) Rs.705,000/-. (3) Rs.1,555,000/-. (4) Rs.855,000/-.

6. The following information were extracted from the books of Kapila Motors for the year ended 31st March 2017: Description Rs. Net assets as at 01.04.2016 325,000 Net assets as at 31.03.2017 385,000 Drawings during the year 35,000 Additional capital introduced during the year 10,000

Based on the above information, the net profit / (loss) for the year ended 31st March 2017 would be:
(1) (Rs.105,000) (2) (Rs.35,000) (3) Rs.85,000/- (4) Rs.15,000/-

7. Which one of the following statements indicates the correct effect to the business of settling a short-term loan obtained from the bank?

(1) Increase in assets and increase in capital.
(2) Decrease in assets and increase in liabilities.
(3) Increase in assets and increase in liabilities.
(4) Decrease in assets and decrease in liabilities.

8. Select from the following the correct impact on accounting elements due to cash receipt from a trade debtor:

(1) Increase in assets and increase in liabilities.
(2) Decrease in assets and decrease in liabilities.
(3) Decrease in assets and decrease in capital.
(4) There is no change in assets.

9. The following information were extracted from the books of ABC Enterprise which is a sole proprietorship:

Capital as at 01st April 2015	200,000
Drawings during the year	120,000
Profit for the year ended 31st March 2016	145,000
Liabilities as at 31st March 2016	80,000

Based on the above information, total assets as at 31st March 2016 would be:
(1) Rs.305,000/-. (2) Rs.545,000/-. (3) Rs.345,000/-. (4) Rs. 225,000/-.

10. The following information was extracted from the books of XYZ Traders: Rs. Net assets as at 01st April 2015 150,000 Additional Capital 25,000 Net Assets as at 31st March 2016 135,000 Drawings by the owner during the year 12,000

The Net Profit / (Loss) of XYZ Traders for the year ended 31st March 2016 by using the profit equation is:
(1) (Rs.22,000/-). (2) Rs.28,000/-. (3) Rs.52,000/-. (4) (Rs. 28,000/-).

CA Past Papers

2014 September

Question No. 14

What is the equity of the entity as at 31 March 2014 based on the following information?

	Rs.
Total assets as at 31 March 2013	500,000
Total liabilities as at 31 March 2013	100,000
Short term loan given by the owner to the business on 1 April 2014	150,000
Drawings of inventory by the owner on 31 March 2014	40,000
Profit for the year ended 31 March 2014 (before accounting for the drawings of inventory)	160,000

(1) Rs. 500,000 (2) Rs. 560,000 (3) Rs. 520,000 (4) Rs. 600,000

(2 marks)

2015 March

1.7. Yellow (Pvt.) Limited purchased goods for Rs. 100,000 on credit during the year ended 31 December 2014. 80% of such goods were sold for Rs. 125,000 on cash during the year.

Which of the following statements shows the correct impacts on the accounting equation if these transactions are recorded as per the double entry system?

A. Assets increase by Rs. 20,000; Capital increases by Rs. 45,000; Liabilities increase by Rs. 100,000

B. Assets increase by Rs. 125,000; Capital increases by Rs. 25,000; Liabilities increase by Rs. 100,000

C. Assets increase by Rs. 145,000; Capital increases by Rs. 45,000; Liabilities increase by Rs. 100,000

D. Assets increase by Rs. 245,000; Capital increases by Rs. 25,000; Liabilities increase by Rs. 100,000

(2 marks)

2015 September

1.8. A company sold a computer which had a carrying value of Rs. 67,000 to a supplier to settle an amount of Rs. 80,000 payable to that supplier. The effect of this transaction on the accounting equation will be;

	Non-current Assets	+	Current Assets	=	Equity	+	Liabilities
A.	- 67,000		+ 80, 000	=	+ 13,000		-
B.	- 67,000		-	=	+ 13,000		- 80,000
C.	+ 67,000		-	=	- 13,000		+ 80,000
D.	– 67,000		+ 13,000	=	+ 26,000		- 80,000

2017 March

1.7 Zigma Traders sold goods costing Rs. 1,000 and earned revenue of Rs. 1,250. The business enters into transactions only on a cash basis.

Which of the following explains the impact to the accounting equation of the above transaction?

A. Assets and capital increase by Rs. 250
B. Assets increase by Rs. 1,250, capital increases by Rs. 250 and liabilities increase by Rs. 1,000
C. Assets and liabilities increase by Rs. 250
D. Both assets and capital increase by Rs. 1,250

CMA – Pilot Paper

Saman, just after leaving school, decided to start a business of buying and selling of garments. The following transactions took place during the first month.

Date	*Transactions*
01/01	Saman invested Rs.400,000/- as capital of the business.
02/01	Obtained a loan of Rs.200,000 from Kapila, a friend of Saman.
05/01	Opened a bank current account by depositing Rs.250,000/-.
08/01	Purchased goods for Rs.175,000/-for cash and Rs.75,000 on credit.
11/01	Purchased furniture and office equipment for Rs.80,000/- and paid by a cheque.
15/01	Sold goods costing Rs.40,000/- for Rs.65,000/-.
20/01	Saman paid his personal telephone bill of Rs.2,500 out of the business's cash.
25/01	Rs.20,000 paid to Kapila as a loan repayment.
30/01	Paid Rs.45,000 to creditors subject to Rs.5,000 discount.
31/01	Paid Rs.25,000 for the rent of the business building.

You are required to show the impact of above transactions to the business using the accounting equation. (Use the following format for this purpose.)

Date	*Assets =*	*Equity +*	*Liabilities*

A/L Papers

Question - 01

Which of the following would be the impact to the accounting equation if the owner settled a business creditor of Rs.50 000 subject to a 10% discount by issuing a cheque of his personal bank account.

	Equity	+	Liability	=	Assets
(1)	50 000		- 50 000		0
(2)	45 000		- 45 000		0
(3)	5 000		- 50 000		- 45 000
(4)	50 000		- 5 000		45 000
(5)	- 5 000		- 45 000		- 50 000

Question - 02

Total assets as at 01/04/2014	Rs.560 000
Total Liabilities as at 01/04/2014	Rs.160 000

Transactions took place during the year are as follows:

- Sales Rs.240 000 (Included a profit of 331/3% on cost)
- Invoice price of return inwards Rs.60 000 (Included a profit of 20% on selling price)
- Goods drawings of the owner Rs.18 000
- Additional capital invested Rs.40 000

What was the balance in the capital account as at 31/03/2015?

(1) Rs.470 000
(2) Rs.510 000
(3) Rs.333 000
(4) Rs.426 000
(5) Rs.422 000

Question - 03

Decrease in the assets during the year 2014 in Naveen's business was Rs.56 000 and decrease in liabilities was Rs.24 000. Drawings and additional capital during the year were Rs.6 000 and Rs.19 000 respectively. What would be the profit or loss for the year?

(1) Profit of Rs. 19 000
(2) Profit of Rs. 45 000
(3) Loss of Rs. 19 000
(4) Loss of Rs. 93 000

Question - 04

Ganesh started a furniture shop on 01/01/2017 investing Rs.2 000 000 and purchased a lorry worth of Rs.1 000 000 from Tharaka Traders. Purchased furniture worth Rs.200 000 from Moratu Plc subjected to 10% trade discount. Furniture of which the invoice price is Rs.20 000 was sent back to the supplier.

Which of the following basic accounting equation shows the correct effect after the above transactions.

Assets = Equity + Liabilities (Rs.000')

(1) 1 980 1 980 -

(2) 2 160 2 000 160

(3) 2 162 2 000 162

(4) 3 162 2 000 1 162

(5) 3 180 2 000 1 160

Unit 02 - Accounting Equation, Double Entry System & Accounting Concepts

	Accounting Equation, Double Entry System and Accounting Concepts, (25%)	
02	2.1	Entity concept
	2.2	Elements of Accounting (including; Assets, Liabilities, Income, Expenses and Equity)
	2.3	Recording Business Transactions in line with Accounting Equation
	2.4	Dual aspect of a transaction
	2.5	Double Entry System
	2.6	Other Accounting Concepts (Going concern, Periodic, Historical Cost, Money Measurement, Matching, Accrual, Prudence, Consistency, Realization, Materiality, Substance over-form)

2.4. DUAL ASPECT OF TRANSACTION

The dual aspect concept indicates that each transaction made by a business needs to be recorded in two separate accounts. These accounts form a basis of double-entry accounting and other financial accounting which is used to generate reliable financial statements.

2.5. DOUBLE ENTRY SYSTEM

- This is a systematic method of book keeping where every entry to an account requires a corresponding and opposite entry to a different account.
- Every transaction involves the simultaneous receiving and giving of value, and is therefore recorded twice.
- All the transaction and events have double way impact on accounting entity's assets liabilities and equity therefore the results of any transaction should be recorded in two places simultaneously.
  E.g. When purchasing goods for resale on credit, business inventory increases as well as creditors.
- Above double way impact is recreated in accounts two places by recording a "debit” entry in one place and “credit" in another place simultaneously
- **ADVANTAGES OF DOUBLE ENTRY SYSTEM**
  - Availability of complete records
  - Facilitates the control of operations
  - Provides arithmetical accuracy
  - Preparation of financial statements

2.5.1. Ledger

- The central place of keeping all ledger accounts is called as "Ledger"
- Although small businesses keep all accounts in one ledger, some large businesses more than one ledger due to higher number of accounts. Therefore, ledger can be classified as follows.

  1. General Ledger
  2. Sub Ledger

- **GENERAL LEDGER**
  - The complete record of financial transactions and events
  - The principal book of accounts and contains all the accounts of business
  - Holds account information that is needed to prepare financial statements.
  - Includes accounts for assets, liabilities, capital, income and expenses.

2.5.2. Ledger Account

- The types of document used to record the impact of transaction; accounting to double entry system is defined as ledger accounts. In other words this document is used record all the financial charges in assets, liabilities, expenses, income and equity during a period.

.... Account

DEBIT				CREDIT			
Date	Description	Ledger Folio	Amount	Date	Description	Ledger Folio	Amount

- **CLASSIFICATION OF ACCOUNTS**

  1. Real Accounts :Property accounts (Land, Building, Vehicles, Plant, Equipment)
  2. Personal Accounts: Accounts belongs to persons. (Debtors, Creditors)
  3. Nominal Accounts : Income and Expenses accounts

2.5.3. Basic Accounting Principles

DESCRIPTION	Increase	Decrease	Balance
(1) Assets	Debit	Credit	Debit
(2) Expenses & losses	Debit	Credit	Debit
(3) Liabilities	Credit	Debit	Credit
(4) Income & profits	Credit	Debit	Credit
(5) Equity	Credit	Debit	Credit

2.5.4. Types of Accounts

1. Assets accounts
2. Liabilities accounts
3. Expenses and losses accounts
4. Income and profits accounts
5. Equity account

2.5.5. Double entries for common transactions

(1) <u>Cash purchases</u>
Purchases account Dr
Cash book Cr

(2) <u>Cash sales.</u>
Cash book Dr
Sales accounts Cr

(3) <u>Credit Purchases</u>
Purchases account Dr
Creditors account Cr

(4) <u>Credit Sales</u>
Debtors account Dr
Sales account Cr

(5) <u>Return outwards (Purchase returns)</u>
Creditors account Dr
Return outwards accounts Cr

(6) <u>Return inwards (Sales Returns)</u>
Return inwards accounts Dr
Debtors accounts Cr

(7) <u>Purchase of fixed assets</u>
Fixed assets account Dr
Cash book Cr

(8) <u>Purchase of fixed assets on credit</u>
Fixed assets account Dr
Fixed asset creditor account Cr

(9) <u>Additional capital by cash</u>
Cash book Dr
Capital account Cr

(10) <u>Additional capital by an asset</u>
Respective asset account Dr
Capital account Cr

(11) <u>Cash drawings</u>
Drawings accounts. Dr
Cash book Cr

(12) <u>Stocks drawings</u>
Drawings account Dr
Purchases account Cr

(13) <u>Payment to Creditors</u>
Creditors accounts Dr
Cash book Cr

(14) <u>Receipt from debtors</u>
Cash book Dr
Debtors account Cr

(15) <u>Payment of expenses by cash</u>
Respective expense account Dr
Cash book Cr

(16) <u>Receipt of income by cash</u>
Cash book Dr
Respective income account Cr

(17) <u>Depositing of cash in the bank</u>
Cash book – bank column Dr
Cash book – cash column Cr

(18) <u>Withdrawing cash from bank</u>
Cash book – cash column Dr
Cash book – bank column Cr

(19) <u>Giving cash discounts to debtors</u>
Discounts allowed account Dr
Debtors account Cr

(20) <u>Receipt of discounts from creditors</u>
Creditors account Dr
Discounts received account Cr

01. EXERCISE

Prepare the ledger accounts for following transactions.

1. Investment of capital 100,000
2. Cash Purchases 40,000
3. Cash sales 60,000
4. Electricity paid 5,000
5. Rent income received 9,000
6. Obtained a bank loan 75,000
7. Purchased a machinery 55,000
8. Owners drawings 14,000
9. Owners drawings – stock 16,000
10. Bank loan repayment 45,000

02. EXERCISE

Prepare the ledger accounts for following transactions.

1. Credit purchases 50,000
2. Credit sales 70,000
3. Return inwards 3,000
4. Return outwards 2,000
5. Discount received 8,000
6. Discount allowed 12,000
7. Payments to creditors 17,000
8. Received from debtors 19,000

03. EXERCISE

The below transactions given of an organization

1. Owner invests Rs 200,000 for the business.
2. Bought a Motor vehicle Rs 5,000
3. Bought goods for sale on credit Rs 90,000
4. Bought a bank loan Rs 20,000
5. Selling goods worth Rs 40,000 for Rs 55,000 on credit.
6. Drawing Rs 2,000.
7. Owner settled for a business creditor Rs 75,000.
8. Owner collected money from a business debtor R s 10,000.
9. Bought goods for Rs 200,000 on credit. Sold it to Rs 300,000.
10. Sales return from the debtors Rs 60,000 (cost is 40,000)
11. Received from the debtors Rs 100,000. Discount given Rs 10,000
12. Bad debts Rs 10,000
13. Provision for doubtful debts Rs 5,000
14. Payment for the creditors Rs 70,000. Discount received Rs 10,000
15. Purchase return to creditors Rs 20,000
16. Bought stationary Rs 50,000
17. Used stationary Rs 30,000
18. Received an electricity bill of Rs 8,000
19. Paid insurance 25,000 and prepaid insurance includes Rs 10,000
20. Received investment income Rs 70,000 & Received in advance includes Rs 20,000
21. Motor vehicle deprecation Rs 10,000
22. Bank loan repayment Rs 15,000
23. Paid bank interest Rs 10,000
24. Stock damaged Rs. 4,000

You are required to show the double entries for the above transactions.

2.6. ACCOUNTING CONCEPTS

2.6.1. Entity Concept

- Business is treated as a separate entity from its owners
- Owners investment is a Liability for the business
- Ex : Owners investment of Money / Assets , Owners drawings
- Significance
  - Separating the business from the owners
  - Tax purposes

2.6.2. Dual Aspect Concept / Accounting Equivalence Concept

- Every transaction has an equal impact on assets and liabilities in a such a way that total assets are always equal to total liabilities.
- Ex : Capital invested by owner will increase the cash and increase the capital
- Significance
  - Help to detect errors
  - Encourage to post each entry in opposite side of two affected accounts

2.6.3. Going Concern Concept

- It is assumed that business will continue for a foreseeable future, (For a long time) until it has entered in to a state of liquidation.
- Significance
  - Depreciation is charged
  - Prepayments are carried forwarded
  - Assure the investors to get income for their investments
  - Fixed Assets treated as Non-Current Assets

2.6.4. Money measurement Concept

- Accounting is done only for those transactions that could be measured in monetary terms.
- An event of machinery breakdown is not recorded but payment for repairing the machine will be recorded.
- Significance
  - Guide what to record and what not to record
  - Uniformity of recording transactions
  - Easy to understand the accounts
  - Easy to compare with two periods or two firms

2.6.5. Cost Concept (Historical Cost Concept)

- An asset is ordinarily recorded at the price paid to acquire it (the Cost).
- Significance

    - Assets shown at the price it has been acquired, which can be verified from the supporting documents.
    - Helps to calculate depreciation
    - The fixed assets need to revised each time the financial statements are prepared

2.6.6. Accounting Period Concept

- Accounting information is prepared for a specific time period. Usually for a 12 month period.
- Significance
    - Helps in taking timely corrective action and develop appropriate strategies
    - Calculating taxes
    - to assess and analize the performance of the business
    - To distribute their income at regular intervals

2.6.7. Accrual Concept

- Income and expenditure shall be recognized as they are earned and incurred - not as money is received and paid.
- Significance
    - To know the actual income and actual expense during a particular time period.
    - To calculate the net profit of the business.

2.6.8. Realization Concept

- Revenue should be accounted for only when it is actually realized or it has become certain that revenue will be realized (Only when services rendered or goods delivered). Actual receipt of cash is not necessary.
- Significance
    - Helps in making accounting information more objective.

2.6.9. Matching Concept (Periodic Matching of Cost & Revenue Concept)

- Income should be matched with the expenditure incurred to generate that income, when calculating the profit.
- When calculating the profit for an accounting period first Income relevant for the year has to be identified (According to the Accruals concept) then that income has to be matched with all expenditure incurred (Cash or non-cash) to earn the firstly identified income.
- Ex : Depreciation, Cost of Sales
- Significance
    - Helps to determine the exact profit for a particular period.

2.6.10. Materiality Concept

- The financial statement should give importance for the material items (which Influence the decision of stakeholders) and unimportant items are not disclosed separately and are merged with other items.

2.6.11. Consistency Concept

- The accounting policies followed by an entity should be consistently applied by it over the years.
- But accounting principles change is allowed, if it will be resulted in better reflection of financial performance and financial position. The changes should be disclosed.
- Ex : Depreciation method, Method of valuation of Stock

2.6.12. Conservatism Concept / Prudence Concept

- All prospective losses should be taken in to consideration but no doubtful income should be taken in to consideration in recording of transactions.
- Ex : Provisions made for Doubtful Debts, but no provisions are made for discounts receivables, Inventory will be measured at lower of cost and net realizable value

2.6.13. Disclosure Concept

- The accounts and financial statements of an entity should disclose full and fair information to the beneficiaries in order to enable them to form a correct opinion on the performance of such entity, which in turn would allow them to take correct decisions.

04. EXERCISE

A Sole Trade running a small business has raised the following questions on his financial statements:-

(1) The cost of inventories as at 31/03/2006 was Rs. 150,000/=, and the net realizable value of same was Rs. 140,000/= when finalizing the yearend accounts, which value should be taken as Closing Inventories?

(2) I (the sole trader) have taken Rs. 10,000/= worth of inventory for my personal use. How should it be brought to account?

(3) Rent paid during the year ended 31/03/2006 was Rs. 70,000/=. Monthly rent al payable is Rs. 5,000. The final accounts reflected a rent expenditure of Rs. 60,000/=. What is the reasons difference?

(4) The business has received cash as Rent in advance for the year 2007 in the year 2006. Should it be taken as revenue in the year 2006?

(5) A loss of Inventory by fire amounting to Rs. 50,000/= was written off in the Profit & Loss Account, but not in the Trading Account. Is it correct?

You are required to write the answers to these question stating the relevant Accounting Principle / Concept.

05. EXERCISE

A sole trader operating a small business of buying and selling raised the following questions on his financial statements.

(1) Telephone bills paid during the year were Rs. 10,000 why was an amount of Rs. 12,000 included in the Profit and Loss account for telephone bills

(2) Why the value of his house not included in his business accounts?

(3) He has purchased a lorry several years ago. Now in his accounts it is shown at a value of Rs.10. Why?

(4) Closing stock is valued at lower of its cost or market value? Why?

(5) A customer has placed an order, during the year. Why is it not treated as a sale of that year?

You are required to answer these questions, stating the relevant Accounting principle / Concept.

06. A/L QUESTIONS

1. Among the items in the financial statements, what effects on profitability?

(1) Assets and Liabilities

(2) Liabilities and Capital

(3) Income and Assets

(4) Income and Expenditure

(5) Expenses and Assets

2. Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. Which of the elements are directly related to the measurement of financial position

(1) Assets, liabilities and equity

(2) Income and expenses

(3) Income, expenses, assets, liabilities

(4) Assets, expenses, drawings

(5) None of the above

3. A company acquired equipment on 01/04/2009 for Rs. 800,000 on credit. This equipment was depreciated at 10% per annum on cost for the year ended 31/03/2010. Which of the following equations shows the effects of the above transactions?

	Assets	=	Liabilities	+	Equity
(1)	800,000	=	880,000	-	80,000
(2)	800,000	=	720,000	+	80,000
(3)	720,000	=	800,000	-	80,000
(4)	720,000	=	720,000		
(5)	720,000	=			720,000

4. Which of the following accounting equations are correct?

A - Net Assets = Equity

B - Assets + Revenue = Equity + Liabilities + Expenses
C - Assets + Expenses = Equity + Liabilities + Revenue
D - Net Assets = Total Assets – Non-Current Liabilities – Current Liabilities

(1) B and C only
(2) B, C and D only
(3) A, C and D only
(4) A, B and C only
(5) All A, B, C and D

5. Which of the following pair of account type balances are closed and carried forward respectively at the end of an accounting year?

	Closed	**Carried Forward**
(1)	Asset	Expense
(2)	Expense	Asset
(3)	Liability	Income
(4)	Income	Expense

6. State whether each of the following account balances is classified as an **asset**, a **liability**, equity, an **income** or an **expense**.

Account name	Classification
(a) Purchases	____________________
(b) Cash at bank	____________________
(c) Commission received in advance	____________________
(d) Sales returns	____________________

7. State **two** characteristics of a liability

(1) ____

(2) ____

8. Which of the following statements is incorrect in relation to the double entry system?

(1) The double entry system provides basis for the accounting equation
(2) It is the method of posting transactions to ledger
(3) Its fundament rule is that for every debit entry there should be a corresponding credit entry
(4) It helps to assure the arithmetic accuracy of the transactions posted to the ledger
(5) It ensures that all transactions have been correctly recorded in the ledger

9. In which A/C's brought forward balance can be seen to the next accounting period at the end of the financial year?

(1) Assets, Liabilities and Equity
(2) Assets, Liabilities and Expenses
(3) Income, Expenses and Equity
(4) Income, Liabilities and Expenses
(5) Income, Assets and Expenses

10. An example for a transaction which results in an enhancing of assets and liabilities is

(1) Settle a loan by owner's money
(2) Cash withdrawal by the owner
(3) Purchase of goods on credit
(4) Cash received from debtor
(5) Borrow money by mortgaging an asset

11. Which of the following is correct?

	Accounts	To record	Entry in the account
(1)	Assets	An increase	Debit
		A decrease	Credit
(2)	Capital	An increase	Debit
		A decrease	Credit
(3)	Liabilities	An increase	Debit
		A decrease	Credit
(4)	Expenses	An increase	Debit
		A decrease	Credit
(5)	Income	An increase	Debit
		A decrease	Credit

12. Which of the following is correct?

		Debit Account	Credit Account
(1)	Received commission by cheque	Bank	Commission income
(2)	Paid rates by cash	Rates	Cash
(3)	Paid motor expenses by cheque	Bank	Motor expenses
(4)	Received refund of insurance by cheque	Bank	Insurance
(5)	Took cash out of business for private use	Cash	Bank

13. 2006 August part 1: Q 6

A company that maintains control accounts only in the general ledger and subsidiary ledgers for debtors and creditors keeps accounts according to the

(1) Double entry system in both types of ledgers

(2) Single entry system in both types of ledgers

(3) Double entry system only in the subsidiary ledgers

(4) Double entry system in the general ledger and Single-entry system in subsidiary ledgers

(5) Double entry system in the subsidiary ledger and Single-entry system in the general ledger

14. 2007 August part 1: Q 26

Provide **two** examples of **Real** Accounts and Nominal Accounts.

a) **Real** Accounts : (1)……………………………… (2)………………………………..

b) **Nominal** Accounts : (1)……………………………… (2)………………………………..

15. 2009 August part 1: Q 9

Which of the following statements is **incorrect** in relation to the double entry system.

(1) The double entry system provides basis for the accounting equation.

(2) It is the method of posting transactions to the ledger

(3) Its fundamental rule is that for every debit entry there should be a corresponding credit entry.

(4) It helps to assure the arithmetic accuracy of the transactions posted to the ledger.

(5) It ensures that all transactions have been correctly recorded in the ledger.

16. 2009 August part 1: Q 33

State whether each of the following account balances is classified as an asset, a Liability, an Equity, an Income or an Expense.

	Account Name	Classification
(1)	Purchases	……………………………
(2)	Cash at bank	……………………………
(3)	Commission received in advance	……………………………
(4)	Sales returns	……………………………

17. 2011 August part 1: Q 1

The changes in financial position of an entity for a given period shows the changes in

(1) Profit Earned

(2) Total assets

(3) Equity and Liabilities

(4) Borrowings

(5) Cash flows