

CHAPTER-4 – Process and Basis of Accounting

Question 1

The accounting process begins with the identification of the firm's financial transaction and then recording, classifying, and summarizing of a economic transaction, which helps in preparation of financial statement.

Question 2

In cash basis of accounting, incomes are recorded only when the company receives the cash. Likewise, expenses are recorded in the books only when the cash is paid.

Question 3

Accrual basis of accounting facilitates recording of incomes when it is earned, irrespective if the cash is collected or not. Similarly, expenses are recorded when it is due irrespective of when the cash is paid for them.

Question 4

Outstanding expenses are not recorded in cash basis of accounting.

Question 5

Two advantages of accrual basis of accounting are as follows:

- (i) It aids in ascertaining true profit or loss for a specific period.
- (ii) It is in accordance with the matching principle of accounting.

Question 6

The Companies Act, 2013 recognizes the accrual basis of accounting.

Question 7

Yes, the cash basis of accounting is in violation of GAAP as it does not follow the matching principle of accounting as well as the accrual concept.

Question 8

The steps involved in the accounting process is as follows:

- **Identification** - Accounting only records transactions that have an economic value. Any transaction that cannot be calculated in terms of money or money's worth cannot be considered for accounting. For all the economic transaction it is important to have a voucher/ invoice/ bill as material evidence and such a document is known as the source document.
- **Voucher**- As per the source document's details, the transaction is initially recorded in a voucher and is then transferred to the journal book.
- **Recording**- The book of original entry is the book in which the transaction is recorded with reference to the source document. Journal is an example of an original book of entry.
- **Posting of Ledger**- Transactions after being recorded in the journal are then classified into different accounts based on its nature in the ledger.
- **Trial Balance and Financial Statement**- Preparation of trial balance and financial statement is the final step in the accounting process. The closing balance of the ledger account

aids in the preparation of the trial balance and financial statement. Trial balance takes into consideration the debit and credit balance of ledger account to cross check the correctness of the posting and balancing of the ledger account. The balances recorded in the trial balance serve as the basis for preparing the financial statement of a company.

