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**SUBJECT: PRINCIPLES OF ACCOUNTING**

**DEPARTMENT: BBA (2ND SEMESTER)**

**SECTION: A**

**SUBMITTED TO: SIR QUAID IQBAL**

**QUESTION NO: 1**

Differentiate between current assets and fixed assets, in your own words with examples?

**ANSWER:**

**CURRENT ASSETS:**

**Current assets** are those which are used within a year. They are also called **short term assets.**

**EXAMPLES:**

1. Cash
2. Office supplies
3. Accounts receivable
4. Short-term investments etc.

**FIXED ASSETS:**

Fixed assets are those which are used more than a year. They are also called long term assets.

**Examples:**

1. Land
2. Building
3. Vehicles
4. Equipments etc.

**QUESTION NO: 2**

Suppose you are a bank manager and a company is requesting for loan, so on what grounds, will you take your final decision to approve or deny its request?

**ANSWER**

Being a bank manager, before providing loan to a company, I will ask them for their financial statements especially the Income statement and cash flow statement.

Secondly I will take it in consideration whether this business will grow in future or not.

Lastly I will ask them for collateral.

**QUESTION NO: 3**

You are an owner of business name “butter milk” the balance sheet items are as follows, at the close of business on February 30, 2020

|  |  |
| --- | --- |
| ACCOUNTS PAYABLE | **?** |
| ACCOUNT RECEIVABLE | **$ 1250** |
| LAND | **$ 55000** |
| NOTES PAYABLE | **$ 70000** |
| CASH | **$ 7400** |
| FURNITURE AND FIXTURE | **$ 20000** |
| SUPPLIES | **$ 3440** |
| BUILDING | **$ 45000** |
| YOUR CAPITAL | **$54090** |

**ANSWER:**

**BUTTER MILK**

**BALANCE SHEET**

**FEBRUARY 30, 2020**

|  |  |  |  |
| --- | --- | --- | --- |
| **ASSETS** |  | **LIABILITIES AND OWNER’ EQUITY** |  |
| Accounts receivableLandCashFurniture and fixtureSuppliesBuilding  | **$ 1250****$ 55000****$ 7400****$ 20000****$ 3440****$ 45000** | **LIABILITIES:**Notes payableAccounts payable**TOTAL LIABILITIES****OWNER’S EQUITY**Capital | **$ 70000****$ 8000****$ 78000****$ 54090** |
| **TOTAL** | **$ 132090** | **TOTAL LIABILITIES AND OWNER’S EQUITY** | **$ 132090** |

**QUESTION: 4**

What is the difference between cash flow statement and income statement? Explain in your own words with examples.

**ANSWER**

**CASH FLOW STATEMENT:**

In many cases, while a transaction occurs it is not recorded on the income statement. In such cases it is put in the statement of cash flow.

**For Example:**

A loan that is taken and kept aside for a later use. This statement records this cash as transaction.

**INCOME STATEMENT:**

Income statement is also called profit and loss statement. This statement have accounts of revenues and expenses. Expenses are subtracted from the total revenues and result in Profit/loss.

This report shows the total amount of sales, all costs incurred in achieving them and other operating costs.

**QUESTION NO: 5**

What are debit and credit rules? Explain in your own words.

**ANSWER:**

The word Debit had been derived from the Latin word “Debere” which means “To owe” which was shortened to “Dr.” Similarly, Credit had been derived from the Latin word “Credere” meaning “On which one believes” and it finally turned into “Cr”. We can also say that these (**Debit & Credit**) are the operators of accounting which operate the subject of accounting.

**Rules of Debit and Credit:**

The financial transactions result in increasing or decreasing the values of various individual accounts in the ledger. The following **rules of debit and credit** are applied to record these increases or decreases in individual ledger accounts.

**Rules for Asset Accounts:**

[Assets](https://www.playaccounting.com/explanation/exp-oa/assets/) are recorded on the debit side of the account. Any increase to an asset is recorded on the debit side and any decrease is recorded on the credit side of its account. For example, the amount of cash in hand at the first day of the [accounting period](https://www.playaccounting.com/accounting-terms/ctd-a/accounting-period/) is recorded on the debit side of cash in hand account. Whenever an amount of cash is received, an entry is made on the debit side of cash in hand account. Whenever an amount of cash is paid out, an entry is made on the credit side of cash in hand account.

**Rules for Liability Accounts:**

[Liabilities](https://www.playaccounting.com/explanation/lc-exp/liabilities/) are recorded on the credit side of the liability accounts. Any increase in liability is recorded on the credit side and any decrease is recorded on the debit side of a liability account. For example, the amount payable to United Traders on the first day of the accounting period is recorded on the credit side of the United Traders Account.

If more goods are bought from United Traders (thereby incurring an additional liability to United Traders), an entry would be made on the credit side of United Traders Account. If an amount is paid to United Traders (thereby reducing the liability to United Traders), an entry is made on the debit side of United Traders Account.

**Rules for Capital Accounts:**

[Capital](https://www.playaccounting.com/accounting-terms/c/capital/) is recorded on the credit side of an account. Any increase is also recorded on the credit side. Any decrease is recorded on the debit side of the respective capital account. For example, the amount of capital of Mr. Tom on the first day of the accounting period will be shown on the credit side of Tom’s Capital Account.

If he introduces any additional capital, an entry will be made on the credit side of his capital account. If he takes any money or goods from the [business](https://www.playaccounting.com/accounting-terms/b/business/) for his personal use that will reduce his capital and therefore an entry will be made on the debit side of his account.

Notice that the rules of debit and credit for asset accounts are exactly opposite to the rules of debit and credit for liability and capital accounts.

**Rules for Expense Accounts:**

An expense is a loss and therefore results in a decrease in capital. Since a decrease in capital is recorded on the debit side of an account, all expenses are also recorded on the debit side of the relevant account. Hence, when salaries is paid to workers, we make an entry on the debit side of salaries account. Usually, but not always, there will be no entries made on the credit side of the accounts kept for expenses.

**Rules for Income or Revenue Accounts:**

An income or [revenue](https://www.playaccounting.com/explanation/exp-fs/revenue/) results in an increase of capital. Since increases in capital are recorded on the credit side of capital account, all incomes are also recorded on the credit side of the relevant account. Hence, when we receive any rent from a tenant, we make an entry on the credit side on the rent income account. Usually, but not always, there will be no entries made on the debit side of the accounts kept for incomes and revenue.

**QUESTION: 6**

How many types of people use financial data and for what purposes? Explain their types with examples.

**ANSWER:**

The final product of the Accounting information is decision making, whether that decision is made by owners, management, creditors, governmental regulatory bodies, labor unions or by many other people those have an interest in the financial performance of the company.

**Financial Statements** represent a formal record of the financial activities of an entity. These are written reports that quantify the financial strength, performance and liquidity of a company. Financial Statements reflect the financial effects of business transactions and events on the entity.

## Four Types of Financial Statements

The four main types of financial statements are:

**1. Statement of Financial Position**

Statement of Financial Position, also known as the Balance Sheet, presents the financial position of an entity at a given date. It is comprised of the following three elements:

* [Assets:](https://accounting-simplified.com/elements-of-financial-statements.html) Something a business owns or controls (e.g. cash, inventory, plant and machinery, etc.)
* [Liabilities:](https://accounting-simplified.com/liabilities.html) Something a business owes to someone (e.g. creditors, bank loans, etc.)
* [Equity:](https://accounting-simplified.com/equity.html) What the business owes to its owners. This represents the amount of capital that remains in the business after its assets are used to pay off its outstanding liabilities. Equity therefore represents the difference between the assets and liabilities.

**2. Income Statement:**

Income Statement, also known as the *Profit and Loss Statement*, reports the company's financial performance in terms of net profit or loss over a specified period. Income Statement is composed of the following two elements:

* [Income:](https://accounting-simplified.com/income.html) What the business has earned over a period (e.g. sales revenue, dividend income, etc.)
* [Expense:](https://accounting-simplified.com/expense.html) The cost incurred by the business over a period (e.g. salaries and wages, [depreciation](https://accounting-simplified.com/financial/fixed-assets/depreciation-methods/), rental charges, etc.)

Net profit or loss is arrived by deducting expenses from income.

**3. Cash Flow Statement:**

Cash Flow Statement, presents the movement in cash and bank balances over a period. The movement in cash flows is classified into the following segments:

* Operating Activities: Represents the cash flow from primary activities of a business.
* Investing Activities: Represents cash flow from the purchase and sale of assets other than inventories (e.g. purchase of a factory plant)
* Financing Activities: Represents cash flow generated or spent on raising and repaying share capital and debt together with the payments of interest and dividends.

**4. Statement of Changes in Equity:**

Statement of Changes in Equity, also known as the *Statement of Retained Earnings*, details the movement in owners' equity over a period. The movement in owners' equity is derived from the following components:

* Net Profit or loss during the period as reported in the [income statement](https://accounting-simplified.com/financial/statements/income-statement-profit-and-loss.html)
* Share capital issued or repaid during the period
* Dividend payments
* Gains or losses recognized directly in equity (e.g. revaluation surpluses)
* Effects of a [change in accounting policy](https://accounting-simplified.com/standard/ias-8/changes-in-accounting-policies.html) or [correction of accounting error](https://accounting-simplified.com/standard/ias-8/correction-of-accounting-errors.html)