

ACCOUNTANCY

Class XI

CBSE Syllabus

[Strictly according to the latest syllabus of the Central Board of Secondary Education, New Delhi.]

Including :

- Accounting for **Goods and Services Tax (GST)**
- Questions Based on **MISSING INFORMATION**
- Sufficient number of 1 mark questions with their answers at the end of each chapter as per the latest design of the Question Paper.
- High Order Thinking Skills (HOTS) Questions
- Project Work

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Meaning and Objectives of Accounting

LEARNING OBJECTIVES

After studying this Chapter, you should be able to understand :

- Need for Accounting
- Meaning of Accounting
- Characteristics of Accounting
- Objectives of Accounting
- Functions of Accounting
- Distinction between Book-keeping, Accounting and Accountancy
- Types or Branches of Accounting
- Accounting as Source of Information
- Users of Accounting Information
- Advantages of Accounting
- Limitations of Accounting
- Qualitative Characteristics of Accounting Information
- Role of Accounting

Need for Accounting

At the end of each year, all the businessmen want to know how much they have gained or lost during the year; how much capital is invested in the business at the end of the year; how much amount they are liable to pay and to whom they owe it; how much is owed to them and by whom etc. In order to attain such informations, it is essential to keep a complete and systematic record of each and every business transaction entered into during the year.

By keeping a complete and systematic record of every business dealing, the businessman can know how much is the amount of purchases; how much is the amount of sales; what are his total expenses and what is the amount of profit earned or loss incurred during the year. Furthermore, he can ascertain the financial position of his business, such as, how much capital it has at the end of the year and how that capital stands invested in various assets; how much amount he has to take and from whom and how much amount he is liable to pay and to whom. Besides, the properly maintained accounts are helpful in the assessment of Income-tax and Goods and Service Tax (GST) and are accepted as a proof in the court of law whenever needed.

Importance of accounting records is increasing day-by-day. Now-a-days the properly maintained accounts give the answer of a number of questions, such as : What is the cost of production? Is such cost reasonable or not? Can it be reduced and if so, in what manner? What should be the selling price based on the cost of production? Thus business owners can take important decisions with the help of the informations provided by accounting data.

Meaning of Accounting

Definitions of Accounting :

1. "Nearly every business enterprise has accounting system. It is a means of collecting, summarising, analysing and reporting in monetary terms, informations about business." — **R.N. Anthony**
2. "Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events, which are, in part atleast, of a financial character, and interpreting the results thereof." — **American Institute of Certified Public Accountants**
3. "Accounting is the science of recording and classifying business transactions and events, primarily of a financial character, and the art of making significant summaries, analysis and interpretations of those transactions and events and communicating the results to persons who must make decisions or form judgement." — **Smith and Ashburne**

Characteristics of Accounting

An analysis of the above definitions brings out the following as **characteristics or features or attributes of accounting** :

(1) **Accounting is an Art as well as Science** :— Art is the technique of attaining some pre-determined objectives. Accounting is an art of recording, classifying and summarising business transactions with a view to ascertain the net profit and financial position of the business enterprise.

Any organised body of knowledge which is based on certain specified principles is called science. In this respect accountancy is also a science since it is also an organised body of knowledge based on certain specified principles and accounting standards.

(2) **Recording of Financial Transactions only** :— Only those transactions and events are recorded in accounting which are of a financial character. There are so many transactions in the business which are very important for business but which cannot be measured and expressed in terms of money and hence such transactions will not be recorded. For example, the quarrel between the Production Manager and the Sales Manager, resignation by an able and experienced manager, strike by employees and starting of a new business by the other competitor etc. Though these events affect the earnings of the business adversely but as no one can measure the effect of such events in terms of money, these will not be recorded in the books of the business.

(3) **Recording in terms of money** :— Each transaction is recorded in the books in terms of money only. For example, if a businessman purchases 200 Chairs and 10 Tables, their value in terms of money will be recorded in the books. Similarly, if a business possesses ₹50,000 in Cash; Land measuring 2,000 Metres; 5 Trucks; 5

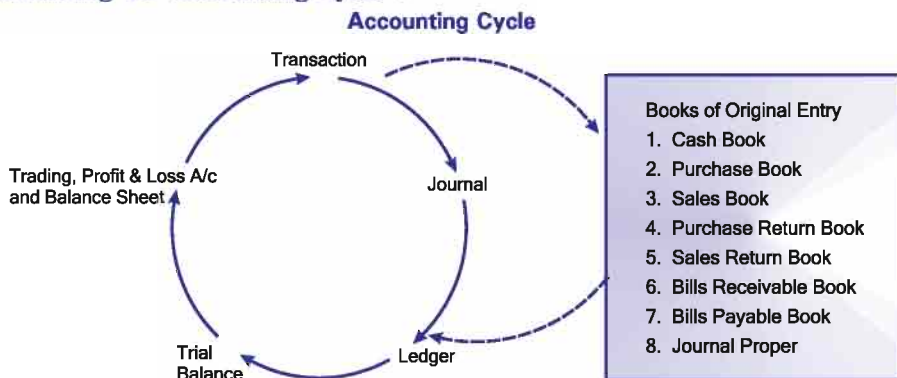
Machines; 10 ton of raw materials; 200 Chairs; 10 Tables, and so on, then in the absence of money measurement concept these different types of assets cannot be added up and hence cannot give any useful information. But if they are expressed in terms of money, they will immediately provide useful information such as, Cash ₹50,000; Land ₹2 Crore; Trucks ₹50,00,000; Machines ₹20,00,000; Goods ₹5,00,000; Chairs ₹50,000 and Tables ₹25,000.

In a small business where the number of transactions is quite small, all transactions are first of all recorded in a book called “Journal”. But in a big business where the number of transactions is quite large, the Journal is further sub-divided into various subsidiary books such as (I) ‘Cash Book’ for recording cash transactions; (II) ‘Purchases Book’ for recording credit purchases of goods; (III) ‘Sales Book’ for recording credit sales of goods; (IV) ‘Purchases Return Book’ for recording the return of credit purchases; (V) ‘Sales Return Book’ for recording the return of credit sales, (VI) Bills Receivable Book, (VII) Bills Payable Book, (VIII) Journal Proper etc. The number of subsidiary books to be maintained depends on the size and nature of the business.

(4) **Classifying** :— After recording the transactions in journal or subsidiary books, the transactions are classified. Classification is the process of grouping the transactions of one nature at one place, in a separate account. The book in which various accounts are opened is called “Ledger”. Separate accounts are opened in the Ledger in the name of each person, whether customer or supplier. Likewise, separate accounts are opened for purchases, sales, assets etc. Similarly, all expenses and incomes, which are already recorded in Journal are again classified under separate heads in the Ledger, such as Wages Account, Salary Account, Advertisement Account, Commission Account etc.

(5) **Summarising** :— Summarising is the art of presenting the classified data in a manner which is understandable and useful to management and other users of such data. This involves the balancing of ledger accounts and the preparation of Trial Balance with the help of such balances. Final Accounts are prepared with the help of Trial Balance which include Trading and Profit & Loss Account and a Balance Sheet. Trading account is prepared for calculating gross profit or gross loss during the year. Profit and Loss Account is prepared to ascertain the net profit or net loss during the year. Balance Sheet is prepared to present the financial position of the business.

Recording, Classifying and Summarising are also termed as ‘**Process of Accounting**’ or ‘**Accounting Cycle**’ :—



The above diagram shows the accounting cycle. This accounting cycle starts with the recording of business transactions in the Journal or Subsidiary Books and after passing through the Ledger and Trial Balance it results in the preparation of Final Accounts (*i.e.*, Trading and Profit & Loss Account and Balance Sheet). This accounting cycle is generally completed in an accounting year and is again repeated in each subsequent year.

(6) **Interpretation of the results** :— In Accounting, the results of the business are presented in such a manner (*i.e.*, by preparing Trading and Profit & Loss Account and Balance Sheet) that the parties interested in the business such as proprietors, managers, banks, creditors, employees etc. can have full information about the profitability and the financial position of the business.

(7) **Communicating** :— Accounting attributes also include the communication of financial data to the users who analyse them as per their individual requirements.

Objectives of Accounting

The following are the main objectives or utility of accounting :—

(1) **To keep systematic record of business transactions** :— The main objective of accounting is to keep complete record of business transactions according to specified rules. Complete record of business transactions helps to avoid the possibility of omission and fraud. For this purpose, all the business transactions are first of all recorded in Journal or Subsidiary Books and then posted into Ledger.

(2) **To calculate profit or loss** :— The second main objective of accounting is to ascertain the net profit earned or loss suffered on account of business transactions during a particular period. For this purpose Trading and Profit & Loss Account of the business is prepared at the end of each accounting period. All the items relating to purchases, sales, expenses and revenues (incomes) of the business are recorded in Trading and Profit & Loss Account. If the amount of revenue exceeds the expenditure incurred in earning that revenue, there is said to be a profit. In case the expenditure exceeds the revenue, there is said to be a loss. In addition, a businessman is able to get the following informations by preparing a Trading and Profit & Loss Account :—

- I. How much goods have been purchased during a particular period?
- II. How much goods have been sold during a particular period?
- III. How much goods have remained unsold and what is its value?
- IV. How much amount has been spent on various heads of expenditure and how much amount has been earned by various heads of revenues?

By attaining these informations a businessman can keep effective control on expenditure.

(3) **To know the exact reasons leading to net profit or net loss.**

(4) **To ascertain the financial position of the business** :— For a businessman, merely ascertaining profit or loss of the business is not sufficient. The businessman must also know the financial health of the business. For this purpose, after preparing the Profit & Loss Account a statement called 'Balance Sheet' is prepared which shows the assets and their values on the one hand and the liabilities and capital on the other hand. A Balance Sheet is actually a screen picture of the financial position of the business. At one glance, one would know the following by looking at the Balance Sheet :—

- I. How much the business has to recover from Debtors?
- II. How much the business has to pay to Creditors?
- III. How much the business has in the form of (a) Cash in hand, (b) Cash at Bank, (c) Closing Stock, and (d) Fixed Assets?

(5) **To ascertain the progress of the business from year to year.**

(6) **To prevent and detect errors and frauds.**

(7) **To provide informations to various parties :—** Another main objective of accounting is to communicate the accounting information to various interested parties like owners, investors, creditors, banks, employees and government authorities etc. The information helps them in taking sound and judicious decisions about the business entity.

Functions of Accounting :

Accounting performs the following major functions :

(1) **Maintaining Complete and Systematic Records :** Main function of accounting is to maintain complete and systematic records of business transactions, post them to ledger and to prepare the financial statements *i.e.*, Statement of Profit & Loss and the Balance Sheet.

(2) **Communicating the Financial Results to Various Parties :** Another main function of accounting is to communicate the information regarding net profit (or loss), assets, liabilities etc. to the interested parties.

(3) **Protecting the Assets of Business :** Another function of accounting is to maintain proper records of various assets such as Cash in hand, bank balance, inventory, debtors etc. It enables the management to keep proper control over them.

(4) **Providing Assistance to Management :** By providing timely information, accounting assists the management in the task of planning, controlling and decision-making.

(5) **Trusteeship :** In case of Companies, the management is entrusted with the task of controlling the resources of the enterprise. The management is expected to act as trustee of the Company's funds and the accounting assists them to control the resources properly.

(6) **Compliance of Legal Needs :** Under the provisions of various laws such as Companies Act, Income Tax Act, Goods and Service Tax (GST) Act etc. a business firm has to submit various statements such as annual accounts, Income Tax and GST Returns etc. Accounting performs this function by supplying the information to the government agencies.

Goods & Service Tax (GST) : All indirect taxes like Excise Duty, Sales Tax, VAT, Service Tax etc. have been merged into a single tax known as GST. GST is paid at the time of purchase and GST is collected at the time of sale.

(7) **Fixing Responsibility :** Another function of accounting is to determine the profitability of each department of an enterprise. It facilitates the fixing of responsibility of each departmental head.

Book-keeping, Accounting and Accountancy

These three are sometimes considered as synonymous, *i.e.*, having the same meaning. However, there is a fundamental difference amongst book-keeping, accounting and accountancy.

Book-keeping :— “Book Keeping is an art of recording business dealings in a set of books.” —**J.R. Batliboi**

“Book Keeping is the science and art of recording correctly in the books of account all those business transactions that result in the transfer of money or money’s worth.” —**R.N. Carter**

“Book keeping is an art of recording in books of accounts the monetary aspect of commercial or financial transactions.” —**Northcott**

It is mainly concerned with record keeping or maintenance of books of accounts. The maintenance of books of accounts includes the following four activities :

- (i) Identifying the transactions of financial nature from amongst the various transactions.
- (ii) Measuring the identified transactions in terms of money.
- (iii) Recording the identified transactions in the books of original entry.
- (iv) Classifying them into ledger.

The book-keeping function is routine and clerical in nature and can be performed by persons having limited knowledge of accounting. At present this function is increasingly done by computers.

Accounting :— Accounting starts where book-keeping ends. It includes the following activities :

- (i) Summarising the classified transactions in the form of Profit & Loss Account and Balance Sheet etc.
- (ii) Analysing and interpreting the summarised results. In other words, drawing the meaningful information from Profit & Loss Account and Balance Sheet etc.
- (iii) Communicating the information to the interested parties.

Thus an accountant’s work goes beyond that of a book-keeper. However, in actual practice the accounting process includes the book-keeping function also because on the basis of book-keeping records, an accountant draws up periodically such financial statements as Profit & Loss Account and Balance Sheet etc. In a small concern, the accountant performs the work of a book-keeper also.

Accountancy :— It refers to a systematic knowledge of accounting concerned with the principles and techniques which are applied in accounting. It tells us how to prepare the books of accounts, how to summarize the accounting information and how to communicate it to the interested parties. According to Kohler, ‘accountancy refers to the entire body of the theory and practice of accounting.’

Distinction between Book-keeping and Accounting

Book-keeping differs from accounting in the following respects :

Basis of Distinction	Book-keeping	Accounting
1. Scope	Book-keeping includes : (a) Identifying the transactions of financial nature; (b) Measuring the identified transactions in terms of money; (c) Recording the measured transactions; and (d) Classifying them into ledger.	Accounting in addition to Book-keeping includes : (a) Summarising the classified transactions; (b) Analysing and interpreting the summarised results; and (c) Communicating the results to parties interested in them.
2. Stage	Book-keeping is primary stage .	It is the secondary stage . Accounting starts where Book-keeping ends.
3. Objective	The main objective of Book-keeping is to maintain systematic records of transactions of financial nature.	Its main objective is to ascertain the net results and financial position of the business and to communicate them to interested parties.
4. Nature of Job	The Book-keeping function is routine and clerical in nature.	The Accounting function is analytical in nature.
5. Who Performs	The Book-keeping function is performed by junior staff .	The Accounting function is performed by senior staff .
6. Knowledge Level	It can be performed by persons having limited level of knowledge .	It is performed by persons having higher level of knowledge than that of Book-keeper.
7. Analytical Skill	The Book-keeper is not required to possess analytical skill.	The Accountant is required to possess analytical skill.

Distinction between Accounting and Accountancy

Basis of Distinction	Accounting	Accountancy
1. Meaning	It is concerned with recording, classifying and summarising of transactions.	It is a body of knowledge prescribing certain rules or principles to be observed while recording, classifying and summarising of transactions.
2. Scope	It is narrow in scope. Accounting starts where Book-keeping ends.	It is much wider in scope and includes Book-keeping as well as Accounting.
3. Relation	It depends on Book-keeping	It depends both on Book-keeping and Accounting.
4. Function	Its main function is to ascertain the net results and the financial position of the business and to communicate them to interested parties.	It includes the decision making function also on the basis of information provided by book-keeping and Accounting.

Types or Sub-fields of Accounting

Management now-a-days requires various types of informations to perform its functions more efficiently. To meet the increasing requirement of management, various specialised **branches of accounting** have come into existence such as Financial Accounting, Cost Accounting, Management Accounting, Tax Accounting, Social Responsibility Accounting etc. These branches are explained as under :

(1) **Financial Accounting** :— The main purpose of this branch of accounting is to record the business transactions in a systematic manner, to ascertain the profit or loss of the accounting period by preparing a Profit & Loss Account and to present the financial position of the business by preparing a Balance Sheet. This branch of accounting provides informations required by the management and various other interested parties.

(2) **Cost Accounting** :— The main purpose of cost accounting is to ascertain the total cost and per unit cost of goods produced and services rendered by a business. It also estimates the cost in advance and helps the management in exercising strict control over cost.

(3) **Management Accounting** :— The main purpose of management accounting is to present the accounting information in such a way as to assist the management in planning and controlling the operations of a business. The management accountant uses various techniques and concepts to make the accounting data more useful for managerial decision making. These techniques include ratio analysis, budgetary control, fund flow statement, cash flow statement etc.

(4) **Tax Accounting** :— The branch of accounting which is used for tax purposes is called Tax Accounting. Income tax and GST are computed on the basis of this accounting.

(5) **Social Responsibility Accounting** :— The society provides the infrastructure and the facilities without which business cannot operate at all. Hence the business also has a responsibility to the society. There is a growing demand for reports on activities which reflect the contribution of an enterprise to the society. Social responsibility accounting is the process of identifying, measuring and communicating the contribution of a business to the society. The contribution of a business to the society consist of providing employment to under-privileged, providing financial and manpower support for public programmes, environmental contribution, product safety, product durability, customer satisfaction etc. In social responsibility accounting techniques have been developed for measuring the cost of these contributions and the benefit to the society.

Accounting as a Source of Information

Accounting is often regarded as the language of business. Since the main aim of a language is to serve as a means of communication, accounting communicates the result of business activities to management, owners, investors, creditors, lenders, Government etc. Accounting as an information system is a process of identifying, measuring, recording, summarising and communicating the information about business to interested users of such information. Different groups of persons have

vested interests in a business organisation. Accounting provides useful information to all these interested parties.

Users of Accounting Information and Their Needs

Or

Parties Interested in Accounting Information

Accounting information is used by various groups of people who have contact with the business enterprise. They use accounting information in order to satisfy some of their varied needs for information.

These users may be classified into two groups :

(1) Internal Users, and (2) External Users

(1) **Internal Users** :— Internal users are the persons who have a direct interest in the business enterprise such as owners and management :

(i) **Owners** :— Owners (or present investors) contribute capital in the business and as such want to know about the profitability and financial soundness of the business. They also want to know whether the profits are increasing or decreasing? What are the reasons for the increase or decrease in profits? What is the value of fixed assets and floating assets of the business? All such information is provided by accounting.

(ii) **Management** :— Management need accounting information for the efficient and smooth running of the business enterprise. Their needs are met by the accounting information provided by published reports of the business enterprise such as Profit & Loss Account, Balance Sheet and Cash Flow Statement. However, most of the needs of management are met by unpublished internal reports which are prepared most frequently to meet the specific requirements of management. Such unpublished or internal reports provide the information relating to the cost of a product, speed of increase in the cost of production, profitability of each product, reasons for increase or decrease in sales and profits, estimates of future sales and profits etc. Management has direct access to these unpublished (or confidential) reports which contain valuable information not available to external users.

(2) **External Users** :— Individuals or organisations who have present or future interest in the business enterprise but are not part of the management are called external users of accounting information. They have no access to the internal or unpublished reports of the enterprise and hence make use of external or published reports such as Profit & Loss Account, Balance Sheet and Cash Flow Statement. The external users are, potential (new) investors, creditors, lenders, employees, Government etc.

Some of the external users and their needs for information are given below:

(i)	Potential Investors (for example, those who want to invest)	Potential investors need information to judge how safe and rewarding the proposed investment will be.
(ii)	Short-term creditors (For example, suppliers of goods and services on credit)	They want information about the creditworthiness of the business enterprise. They want to know whether the amount owing to them will be repaid when due and whether they should extend, maintain or restrict the credit to the enterprise.

(iii) Long-term creditors (Such as Financial Institutions)	They want to judge whether their principal and the interest thereof will be repaid when due and whether they should extend, maintain or restrict the long-term loans to the enterprise.
(iv) Employees	Employees need information about the profits of a business to assess the ability of the business to pay higher wages and bonuses. They may also use the financial statements (<i>i.e.</i> accounting information) to ascertain whether various amounts due to them such as provident fund is being deposited regularly.
(v) Tax Authorities	Tax authorities need information for the assessment of income tax, Goods and Service Tax (GST) etc.
(vi) Government and their Agencies	Government and their agencies need information to form policies relating to taxation, allocation of resources and for providing subsidies etc.
(vii) Social responsibility groups (such as environmental protection groups)	They need information on the impact on environment and the steps taken by the enterprise for the protection of environment.
(viii) Public	An enterprise affects the public in a variety of ways such as a provider of employment, provider of amenities in the locality and being the customer to local suppliers. Hence, public at large is interested in knowing the future plans of the enterprise.
(ix) Competitors	They want information on the relative strengths and weaknesses of the enterprise and for making comparisons.

As an information system, the accounting process provides information to all the users whether inside or outside the business-enterprise. Such information helps the users of the information in making various decisions. The information is communicated through various financial statements such as profit and loss account, balance sheet, fund flow statement, cash flow statement etc. The financial statements are normally prepared on yearly basis. However, the frequency of their preparation depends on the needs of their users. For example, the sales manager may require monthly or even weekly information of sales whereas the needs of investors, creditors etc. will be satisfied by annual financial statements. In order to make the information more understandable and meaningful, various items of financial statements are presented in the form of ratios, percentages, graphs, charts etc.

Advantages or Uses of Accounting

Accounting offers the following advantages :

(1) **Helpful in Management of Business** :— Management needs a lot of information for the efficient running of the business. All such information is provided by the accounting which helps the management in the following :—

(A) **Helpful in Planning** :— Management would like to know whether the sales are increasing or decreasing and also the speed of increase in the cost of production. All such information is provided by the accounting, which helps the

management in estimating the future sales and expenses. It also helps them to estimate the cash receipts and cash disbursements during the next accounting period.

(B) **Helpful in Decision Making** :— At times, the Management has to take a number of decisions. For example, What should be the selling price of the product? How much discount should be offered to the customers? Accounting provides all the informations required for making such decisions.

(C) **Helpful in Controlling** :— Management would like to see that the cost incurred is reasonable and that no department is overspending. Accounting provides information to the management in this regard.

(2) **Provides Complete and Systematic Record** :— Business transactions have grown in size and complexity and it is not possible to remember each and every transaction. Accounting keeps a prompt and systematic record of all the transactions and summarizes them in order to provide a true picture of the activities of the business entity.

(3) **Information Regarding Profit or Loss** :— Accounting reports the net result of business activities of an accounting period. The Profit & Loss Account prepared at the end of each accounting period discloses the net profit earned or loss suffered during that period. The information regarding profit is of great use to the owners and various other interested parties.

(4) **Information Regarding Financial Position** :— Accounting reports the financial position of the business by preparing a Balance Sheet at the end of each accounting period. Balance Sheet discloses the position of assets and their values on the one hand and liabilities and capital on the other hand.

(5) **Enables Comparative Study** :— By keeping a systematic record accounting helps the owners to compare one year's costs, expenses, sales and profit etc. with those of other years. Such a comparison provides the useful informations on the basis of which important decisions can be taken more judiciously.

(6) **Helpful in Assessment of Tax Liability** :— Properly maintained records will be of great help when the firm is assessed to Income Tax or GST. Such records when audited are trusted by the taxation authorities.

(7) **Evidence in Legal Matters** :— Properly maintained accounts, supported by authenticated documents are accepted by the courts as a firm evidence.

(8) **Facilitates Sale of Business** :— If a business entity is being sold, the accounting information can be utilised to determine the proper purchase price.

(9) **Helpful in Raising Loans** :— Accounting information is of great help while raising loans from banks or other financial institutions. Such institutions before sanctioning loan screen various financial statements of the firm such as final accounts, fund flow statement, cash flow statement etc.

(10) **Helpful in Partnership Accounts** :— Accounting records provide all the information needed at the time of admission of a partner, retirement or death of a partner and dissolution of the firm. Goodwill of the firm is also valued on the basis of accounting records.

(11) **Helpful in Prevention and Detection of Errors and Frauds.**

Limitations of Accounting

As discussed above, accounting provides information about the profitability and financial soundness of a concern to the owners and other interested parties. In addition, it provides various other valuable informations also. However, accounting has certain limitations which must be kept in mind while using such informations. These limitations are as follows :

(1) **Influenced by Personal Judgements** :— Accounting is as yet an exact science and accountant has to exercise his personal judgement in respect of various items. For example, it is extremely difficult to predict with any degree of accuracy the actual useful life of an asset which is needed for calculating depreciation. The same is true about method of valuation of stock and making provision for doubtful debts. Different persons are bound to have different opinions in respect of such things and hence it will result in ascertainment of different figure of profit or loss of a business by different persons. Hence the figure of profit cannot be taken as an exact figure.

(2) **Based on Accounting Concepts and Conventions** :— Accounts are prepared on the basis of a number of accounting concepts and conventions. Hence, the profitability and the financial position disclosed by it may not be realistic. For example, fixed assets are shown in the balance sheet according to the 'historical cost concept'. This means that the fixed assets are shown at their cost and not at their market value. The values realised on their sale may be more or less than the values stated in the balance sheet. Similarly, on account of convention of conservatism, the profit & loss account does not disclose the true profit of the business because future losses are provided whereas future incomes are ignored.

(3) **Incomplete Information** :— Accounting statements provide only the incomplete information because the actual profit or loss of a business can be known only when the business is closed down.

(4) **Omission of Qualitative Informations** :— Accounts contain only those informations which can be expressed in terms of money. Qualitative aspects of business units are completely omitted from the books as these cannot be expressed in monetary terms. Thus, changes in management, reputation of the business, cordial management-labour relations, firm's ability to develop new products, efficiency of management, satisfaction of firm's customers etc. which have a vital bearing on the profitability of the firm are all ignored and omitted from being recorded because all of these are qualitative in nature.

(5) **Based on Historical Costs** :— Accounts are prepared on the basis of historical costs (*i.e.*, the original costs) and as such the figures given in financial statements do not show the effect of changes in price level. The assets remain undervalued in many cases particularly land and building. The outcome of this practice is that balance sheet values of assets are not helpful in estimating the true financial position of the business.

(6) **Affected by Window Dressing** :— Window dressing refers to the practice of manipulating accounts, so that the financial statements may disclose a more favourable position than the actual position. For example, the purchases made at the end of the year may not be recorded or the closing stock may be over-valued. Hence, correct decisions cannot be taken on the basis of such financial statements.

(7) **Unsuitable for Forecasting** :— Financial Accounts are only a record of past events. Continuous changes take place in the demand of the product, policies adopted by the firm, the position of competition etc. As such, the financial analysis based on past events may not be of much use for forecasting.

Qualitative Characteristics (Attributes) of Accounting Information

Accounting information should be prepared and presented in such a way that it is able to depict a clear and orderly view of the business enterprise. Following characteristics of accounting information make it more useful for its users :

(1) **Reliability** :— Accounting information must be reliable. Reliability implies that the information must be factual and verifiable. The accounting information is said to have verifiability if such information can be verified from source documents such as cash memos, purchase invoices, sales invoices, correspondence, agreements, property deed and other similar documents. Verifiability ensures the truthfulness of the recorded transactions which can be independently checked by anyone interested to ascertain the true position. But if the source documents are not available, the accounting information disclosed by profit and loss account and balance sheet will not be capable of being verified and it would imply that it cannot be relied on.

Some accounting records are most reliable while others are not. For example, recording of fixed assets at actual cost is most reliable since the same can be independently verified from property deed. But it is not true for some other transactions because accounting is not an exact science. For example, depreciation charged on fixed asset cannot be independently verified since it is based on estimated useful life of the asset which requires personal judgement. Personal judgement is also required while valuing stock and making provision for doubtful debts. In order to ensure reliability in such transactions the personal judgements must be free from bias.

(2) **Relevance** :— Accounting informations depicted by financial statements must be relevant to the objectives of the enterprise. Unnecessary and irrelevant informations should not be included in financial statements. To be relevant, information must be capable of making difference in decision, that is, it must help the management investors, creditors and other users of the accounting information in making decisions. For example, the information regarding the rate of dividend paid by a company in previous years is a relevant information for the investors since it provides a basis for forecasting future dividends. Similarly, while reporting debtors in the balance sheet, it is the total amount of debtors which is relevant and not the number of debtors.

An accountant is usually faced with the problem of choosing the relevant data from the mass of data because the needs of different users may be different. For example, the information required by bankers will not necessarily be the same as required by investors. Hence the accountant will have to study the needs of various users and find out which information is common and relevant to all the users. In addition, a difficulty arises in deciding as to whose needs should be given priority. For example, certain information regarding the profitability may be relevant to creditors but its disclosure may be harmful to the interests of shareholders as it may give vital clues to the competitors. While taking a decision in this matter the accountant will be guided by the concepts of truth, justice and fairness.

(3) **Understandability** :— Accounting informations should be presented in such a simple and logical manner that they are understood easily by their users such as investors, lenders, employees etc. A person who does not have any knowledge of accounting terminology should also be able to understand them without much difficulty. This can be done by giving relevant explanatory notes to explain the information given in financial statements. General topics which should be included in explanatory notes are method of depreciation, method of valuation of inventory, description of contingent liabilities, explanation of reserves, comment on extraordinary gains and losses, disclosure of events occurring after the balance sheet date etc. These explanatory notes make the financial statements more useful and understandable.

(4) **Comparability** :— Comparability is a very useful quality of the accounting information. The financial statements should contain the figures of previous year alongwith the figures of current year so that the current performance can be compared with past performance. Similarly, the financial statements should be prepared in such a way that the profitability and financial position of the concern may be compared with other concerns of the similar type. Comparison reveals the strong and weak points of the business entity. Comparability is possible when different firms in the same industry adopt the same accounting principles from year to year. For example, if diminishing balance method of charging depreciation is selected, it should not be changed from year to year. Similarly the method of valuation of stock should also be consistently the same from year to year. However, the consistency principle does not mean that a particular method once adopted should never be changed. When change in method is desirable for the purpose of better preparing and reporting the accounting information, it should be changed. In such a case, the nature and effect of change and the justification for change must be stated clearly by way of footnotes to enable the users of accounting information to be aware of such change.

(5) **Faithful Presentation** :— Financial statements are required to show a True and fair view of the profitability, financial position and cash flows of an enterprise. Application of appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

In addition to the above, accounting information should also have the characteristics of timeliness, neutrality and completeness.

----- Role of Accounting

Role of accounting has been changing with the changes in business environment and increasing social demands. Over the centuries, the role of accounting remained confined to the record keeping of financial transactions only. But, today's rapidly changing business environment has changed the role of accounting and at present the accounting plays the following different roles :

(1) **Role of a Language** :— Accounting is viewed as a language of business because it prepares reports and statements which communicate information regarding the business enterprise.

(2) **Role of Historical Record** :— Accounting is viewed as chronological record of all financial transactions in the books of accounts according to specified rules.

(3) **Role of Determining the Net Profit** :— It is also regarded as a means of determining the true profit or loss of a business enterprise.

(4) **Role of Determining the Financial Position** :— It is also regarded as a means of showing the financial position of the business by the preparation of Balance Sheet.

(5) **Role of Information System** :— Accounting is now regarded as an information system because it is capable of providing the kind of information which managers and other interested parties require for taking appropriate decisions.

(6) **Role of Service Provider** :— Accounting is regarded as a service activity because it provides quantitative financial information which is helpful to the users in different ways.

SHORT ANSWER QUESTIONS

1. Define Accounting. (KVS 2013)
2. What are the attributes (features) of accounting?
3. What is Accounting Cycle? (Chandigarh 2019)
4. "Only financial transactions are recorded in Accountancy." Explain the statement.
5. What is the meaning of "recording in terms of money"?
6. Explain any three objectives of accounting. (Delhi 2018)
7. Give difference between Book-keeping and Accounting on the basis of stage, special skills and nature of job. (Delhi 2015)
8. What are types of Accounting?
9. Explain briefly any five advantages of accounting.
10. State any four limitations of accounting. (KVS 2019)
11. Explain any four qualitative characteristics of accounting information. (KVS 2019)
12. "Non-monetary transactions are not recorded in the books of accounts." Explain.
13. "Accounting information should be comparable." Do you agree with this statement? Give two reasons.

Ans. Yes, accounting information should be comparable, because

- (i) Comparability is needed to make inter-firm comparisons, *i.e.* to find out how a firm has performed as compared to the other firms, and
- (ii) Comparability is needed to make inter-period comparison, *i.e.* to find out how it has performed as compared to the previous years.

14. Explain 'Comparability' as qualitative characteristics of accounting information.

15. "The role of accounting has changed over the period of time." Explain.

Ans. The role of accounting has now shifted from that of a mere recording of business transactions to that of providing information to managers and other interested persons in order to help them to make appropriate decisions. It is now regarded as an information system.

16. What is the primary reason for business students and others to study accounting discipline?

Ans. Accounting information is presented and communicated in the form of financial statements, reports, graphs and charts to the internal and external users who require it for making important decisions. Primary reason to study accounting discipline is to acquire such knowledge which is helpful in understanding these statements, reports etc.

17. Briefly appreciate the exact nature of accounting.

Ans. In order to appreciate the exact nature of accounting, we must understand the following aspects of accounting :

(i) **Economic Events** : Accounting records only economic events. An economic event is a transaction which can be measured and expressed in terms of money.

(ii) **Identification, Measurement, Recording and Communication** :

Identification : It means determining what transactions are to be recorded. It involves observing activities and selecting those events that are of financial character and relate to the organisation.

Measurement : It means quantification of business transactions into financial terms by using monetary units.

Recording : Accounting is the art of recording business transactions according to some specified rules and in chronological order.

Communication : The recorded events are communicated to management and other internal and external users regularly through accounting reports.

(iii) **Organisation** : It refers to a business enterprise which can be a sole-proprietory concern, partnership firm, company or any other association of persons.

(iv) **Interested Users of Information** : They may be internal users and external users. Internal users include Chief Executive, Financial Officer, Vice President, Plant Managers, Stores Managers etc. External users include owners, potential investors, creditors, lenders, labour unions, Tax Authorities, Customers etc.

18. Identify the stakeholder group who would be most interested in the following :

- (i) The ethical or environmental activities of the firm.
- (ii) Whether the firm has a long-term future.
- (iii) The ability of the firm to carry on providing quality products.

(K.V.S. 2018)

Ans. (i) Social Responsibility Groups (such as environmental protection group).
 (ii) Potential Investors and Long term Creditors.
 (iii) Public or Customers.

VERY SHORT ANSWER QUESTIONS

(Questions Carrying 1 Mark)

1. What is meant by Accounting?

Ans. Accounting is the art of recording, classifying, summarising and communicating financial information to users for correct decision making.

2. Give any two objectives of accounting.

Ans. 1. To keep systematic record of business transactions.

2. To ascertain profit earned or loss suffered during a particular period.

3. How is profit or loss of a particular period is ascertained?

Ans. Profit or loss of a particular period is ascertained by preparing a Trading and Profit and Loss Account.

4. How do we ascertain the financial position of the business?

Ans. By preparing a Balance Sheet.

5. Name the branch of commerce, which keeps a record of monetary transactions in a set of books.

Ans. Book-keeping.

6. Give one point of distinction between Book-keeping and Accountancy.

(KVS 2014, 2017)

Ans. The main objective of book-keeping is to maintain systematic record of business transactions whereas the main objective of accounting is to ascertain profit or loss and the financial position of the business.

7. What is end product of financial accounting?

Ans. End product of accounting are the financial statements (*i.e.*, Profit & Loss Account and Balance Sheet) and reports which provide information that are useful to a variety of users who want to know the profitability and financial position of an enterprise.

8. Name any two users of accounting information.

(Delhi 2016, 2017)

Ans. (i) Owners, (ii) Creditors.

9. Who are the internal users of accounting information?

Ans. Internal users are the persons who are directly involved in managing and operating the business enterprise such as directors or the partners, managers and officers.

10. Name any two external users of accounting information?

(Delhi 2018) (Chandigarh 2018, 2019)

Ans. Any two of these : potential investors, creditors, lenders, employee unions, customers, Government etc.

11. State the nature of information required by Investors.

Ans. They want information regarding risks and returns on their investment in the business enterprise.

12. What type of information is required by long-term lenders?

Ans. They want information about the creditworthiness and the ability of the enterprise to pay interest and the repayment of their loans.

13. What are the informational needs of management?

Ans. Management needs timely information regarding sales, costs, profitability etc. for planning, controlling and decision making.

14. Mention two advantages of accounting.

- Ans.** (i) It provides complete and systematic record;
(ii) It provides information regarding Profit or Loss
- 15.** Write one limitation of accounting. (Delhi 2017)
- Ans. Based on Historical Costs :** Accounts are prepared on the basis of historical costs (*i.e.*, the original costs) and as such the figures given in the financial statements do not show the effect of changes in price level.
- 16.** Which qualitative characteristic of accounting information requires the use of common unit and common format of reporting? *(Chandigarh 2017)(KVS 2018)*
- Ans.** Comparability.
- 17.** 'Accounting information should be verifiable and free from personal Bias'. Name the qualitative characteristic of accounting information denoted by this statement.
- Ans.** Reliability.
- 18.** Meena is owner of a Restaurant. She paid son's fees from her personal bank account ₹20,000. Whether this constitute her Business Transaction? Give reason. (KVS 2018)
- Ans.** No. It is not a business transaction. It relates to personal dealings of the Proprietor which are not recorded in the books.

OBJECTIVE TYPE QUESTIONS

(A) Which of the following transactions are of financial character and will be recorded in the books?

- (i) Credit purchase of goods.
- (ii) Strike by employees.
- (iii) Goods worth ₹20,000 taken from the business and given by the proprietor to his friend as gift.
- (iv) Withdrawing of money by proprietor from business for personal use.
- (v) Interviewing the candidates for employment.
- (vi) Sale of household furniture for ₹10,000.
- (vii) Payment of school fees of proprietor's son from proprietor's personal bank account.
- (viii) Make promise to send the goods.
- (ix) Receiving an order to send the goods.
- (x) Loss of goods by fire.
- (xi) Value of human resources.

Ans. (i), (iii), (iv) (x)

(B) State whether the following statements are true or false :

- (i) Accounting is the language of business.
- (ii) Accounting is helpful in raising loans.
- (iii) Accounting is not accepted as evidence in legal matters.
- (iv) Management of an enterprise is internal user of its accounting information.
- (v) Accounting makes a record of qualitative aspects of business.

- (vi) Accounting is a service function.
- (vii) Accounting involves only the recording of business transactions.
- (viii) Accounts are prepared on the basis of historical costs.
- (ix) Only those transactions are recorded in accounting which can be expressed in terms of money.
- (x) Book-keeping starts where accounting ends.
- (xi) Creditors are external users of accounting information.
- (xii) A creditor would use an entity's financial report to determine whether or not credit may be granted to the firm.
- (xiii) Accounting may be affected by window dressing.

Ans. True (i), (ii), (iv), (vi), (vii), (viii), (ix), (xi), (xii), (xiii)

(C) Choose the best Alternate

1. Book-keeping means :
 - (A) Keeping books
 - (B) Recording in books
 - (C) Recording of business transactions in the books
 - (D) All of the above
2. Book-keeping means :
 - (A) Recording financial transactions in the books of accounts.
 - (B) Taking all steps from recording of transactions in the books of original entries to preparation of final accounts.
 - (C) Preparing Final Accounts
 - (D) Taking all steps after preparing final accounts.
3. Accounting Starts :
 - (A) Where book-keeping begins
 - (B) Where book-keeping ends
 - (C) Where books are not maintained at all
 - (D) After preparing final accounts
4. In accounts recording is made of :
 - (A) Only Financial Transactions
 - (B) Only Non-financial transactions
 - (C) Financial and non-financial transactions
 - (D) Personal transactions of the Proprietor
5. The characteristics of Accounting are :
 - (A) Recording
 - (B) Classifying
 - (C) Summarising
 - (D) All of the above
6. Which of the following is not a business transaction?
 - (A) Purchased furniture for ₹50,000 for business.
 - (B) Paid ₹25,000 as salaries to employees.
 - (C) Proprietor paid ₹10,000 for the school fees of his son from his own bank account.
 - (D) Proprietor paid ₹10,000 for the school fees of his son from business.

7. Ghanshyam is a furniture dealer. Which one of the following will not be recorded in his books?
- (A) Purchase of Timber for ₹50,000
 - (B) Sofa set worth ₹40,000 taken to his home
 - (C) Sale of household furniture for ₹5,000
 - (D) Dining table of ₹30,000 given to his friend as gift
8. The functions of Accounting are :
- (A) To ascertain Profit or Loss
 - (B) To ascertain the financial position of the Business
 - (C) To provide informations to various parties
 - (D) All of the above
9. The function of Accounting is not to :
- (A) Record the transactions of business
 - (B) Record the personal transactions of the Proprietor
 - (C) Ascertain the Profit or Loss of business
 - (D) Ascertain the Financial Position of the business
10. Which of the following transactions is not of financial character?
- (A) Purchase of asset on credit
 - (B) Purchase of asset for cash
 - (C) Withdrawing of money by proprietor from business
 - (D) Strike by Employees
11. Last step of accounting process is :
- (A) Provide information to various parties who are interested in business enterprise
 - (B) Record transactions in the books
 - (C) To make summary in the form of financial statements
 - (D) To classify the transactions under separate heads in the ledger
12. Internal users of accounting information are :
- (A) Potential Investors
 - (B) Creditors
 - (C) Management
 - (D) Employees
13. External users of accounting information are
- (A) Researchers
 - (C) Government
 - (B) Potential Investors
 - (D) All of the above
14. External users of accounting information are not
- (A) Lenders
 - (B) Officers
 - (C) Employees
 - (D) Public
15. Accounting Cycle starts with :
- (A) Recording of Transactions in Ledger
 - (B) Recording of Transactions in Journal
 - (C) Preparing Trial Balance
 - (D) Preparing Trading Account

16. Creditors of the business want to know :
- (A) Profitability of the Business
 - (B) Capability of the business to pay higher salaries
 - (C) Creditworthiness of the business
 - (D) Employment Opportunities
17. The advantages of accounting are
- (A) Information regarding Profit or Loss
 - (B) Information regarding Financial Position
 - (C) Helpful in Prevention of Errors
 - (D) All of these
18. Which of the following is not the advantage of accounting?
- (A) Systematic records
 - (B) Comparative Study
 - (C) Based on accounting concepts
 - (D) Helpful in decision making
19. Which of the following is an advantage of accounting?
- (A) Based on Historical Costs
 - (B) Omission of Qualitative Information
 - (C) Incomplete information
 - (D) Detection of Errors
20. The limitations of accounting are :
- (A) Influenced by Personal Judgements
 - (B) Based on Historical Costs
 - (C) Affected by window-dressing
 - (D) All of these
21. Which of the following is not the limitation of accounting?
- (A) Based on accounting conventions
 - (B) Evidence in Legal Matters
 - (C) Incomplete Information
 - (D) Omission of Qualitative Informations
22. Users of Accounting Informations are
- (A) Owners of Business
 - (B) Management of Business
 - (C) Creditors
 - (D) All of the above
23. Which one of the following is not an objective of accounting?
- (A) To provide information about the assets, liabilities and capital of the enterprise
 - (B) To provide information about the private assets and liabilities of the proprietor
 - (C) To maintain records of the business
 - (D) To provide information regarding the profit and loss of the enterprise
24. The information provided in the financial statements of an enterprise pertains to
- (A) The nation as a whole
 - (B) The industry as a whole
 - (C) Business enterprise
 - (D) Proprietor

25. The branches of accounting are :
- (A) Financial Accounting
 - (B) Cost Accounting
 - (C) Social Responsibility Accounting
 - (D) All of the above
26. Accounting is
- (A) Only an Art
 - (B) Only a Science
 - (C) Art and Science both
 - (D) Neither Art nor Science
27. If accounting information is based on facts and it is verifiable by documents it has the quality of
- (A) Relevance
 - (B) Reliability
 - (C) Understandability
 - (D) Comparability
28. Which of the following transactions is of a financial character and will be recorded in the business?
- (A) Goods taken from the business by the proprietor for her personal use
 - (B) Interviewing the candidates for employment
 - (C) Sale of Household furniture ₹5,000
 - (D) Received an order for sales of goods
29. Book-keeping is mainly concerned with :
- (A) Recording of financial data
 - (B) Designing the systems of summarising the recorded data
 - (C) Interpreting the data for internal and external users
 - (D) Preparation of financial statements of the business enterprise
30. Which of the following is not a sub-field of accounting?
- (A) Financial accounting
 - (B) Book Keeping
 - (C) Management accounting
 - (D) Cost Accounting
31. Which of the following is the most relevant accounting information for taxation authorities?
- (A) Cash Balance of the firm
 - (B) Book Value of the Fixed Assets
 - (C) Credit Sales of the year
 - (D) Profit generated during the year
32. Which of the following limitations of accounting states that accounts may be manipulated to conceal vital facts :
- (A) Accounting is not fully exact
 - (B) Accounting may lead to window dressing
 - (C) Accounting ignores price level changes
 - (D) Accounting ignores qualitative elements

- [Ans. 1. (C) 2. (A) 3. (B) 4. (A) 5. (D)
6. (C) 7. (C) 8. (D) 9. (B) 10. (D)
11. (A) 12. (C) 13. (D) 14. (B) 15. (B)
16. (C) 17. (D) 18. (C) 19. (D) 20. (D)
21. (B) 22. (D) 23. (B) 24. (C) 25. (D)

26. (C) 27. (B) 28. (A) 29. (A) 30. (B)
31. (D) 32. (B)]

(D) Fill in the Blanks

- Accounting records only the transactions of nature.
- Accounting is both art as well as
- Scope of Accounting is than that of Book-keeping.
- Accounting where book-keeping
- Process of accounting starts with transactions.
- Accounting records can be produced as in a court of law.
- Accounting measures the business transactions in terms of units.

Ans. 1. Financial; 2. Science; 3. Wider; 4. Starts; Ends; 5. Identifying; 6. Evidence; 7. Monetary.

HIGHER ORDER THINKING SKILLS (HOTS) QUESTIONS

- What is the traditional function of Accounting?
- Is the basic objective of Book-keeping to maintain systematic records or to ascertain net results of operations of financial transactions?
- Recording of financial transactions and preparing the financial statements are the only objectives of accounting. Do You agree?
- What is the first step of Accounting Process?
- What is the last step of Accounting Process?
- On 1st Jan., 2015, Mr. Vadera was appointed as Marketing Manager of the firm with a salary of ₹50,000 per month. State whether this event will be recorded in the books of accounts. (Delhi 2015)
- A firm follows a practice of giving the figures of previous year alongwith the figures of current year. Now the Accountant of the firm wants to discontinue this practice. Do you justify this decision?
- Give two examples of transactions which are not recorded in accounting.
- A firm has received a large order to supply the goods. Will it be recorded in the books?
- Mr. Ganpati, the proprietor of a business, sold his residential house for ₹50 Lac. Will it be recorded in the books of accounts?
- Miss Priti, an electronic goods dealer, gifted a washing machine valued ₹25,000 to her friend Suruchi. Will it be recorded in the books of accounts?
- How is accounting influenced by personal judgements?
- Mr. Vishwanath established a Travel Agency. Over the years the Travel Agency earned high reputation. Mr. Vishwanath considers the value of goodwill of his Travel Agency at ₹50 lac. He wants to record the value of the goodwill in the books of accounts. Can he do so?
- What is meant by qualitative information?

15. Huge loss occurred due to the strike by employees. Will it be recorded?
16. If the accounting information is not clearly presented, which of the qualitative characteristic of the accounting information is violated?
17. Confidence and trust that the reported information is a reasonable representation of the actual items and events, that have occurred, depicts which qualitative characteristic of accounting information.
18. Which value is most important for a good accountant?
19. The accountant of the firm found an error in the books of accounts but neither he rectified the error nor disclosed it to the management fearing that it will risk his job. Which value has been violated by the accountant?
20. Accounting records business transactions and events which are of financial nature. Do you consider it a limitation of accounting?

**ANSWERS TO HIGHER ORDER THINKING
SKILLS (HOTS) QUESTIONS**

Ans.

1. Recording of financial transactions.
2. The basic objective of book-keeping is to maintain systematic records of financial transactions.
3. No. Besides these two, accounting has the objective of providing useful information to the management and communication of financial information to the users.
4. Recording of transactions in the books of accounts.
5. Communicating the final results to the users who analyse them as per their individual requirements.
6. No. The appointment will not be recorded because it has not resulted in any change in the financial position of the firm. (It will be recorded only when the salary is paid.)
7. No. Comparability of current year figures with that of previous year is a qualitative characteristic of financial information. Discontinuation of this practice will result in discontinuation of a good practice being followed by the firm.
8. (i) Resignation by General Manager.
(ii) Value of human resources.
9. No. Only the receipt of order has not resulted in any change in the financial position of the firm.
10. No. Personal dealings of the proprietor are not recorded in the books of the firm. However, if he invests this amount in the business it will be treated as additional capital introduced by the proprietor and then it will be recorded in books of the firm.
11. Yes. It will be treated as drawings of Miss Priti and will be recorded in the books.

- 12.** Accountant has to exercise his personal judgement in respect of various items. For example, it is extremely difficult to predict with any degree of accuracy the actual useful life of an asset which is needed for calculating depreciation. The same is true about method of valuation of stock and making provision for doubtful debts.
- 13.** No. Only the purchased goodwill can be recorded in the books of accounts. As per Accounting Standard 26 (Intangible Assets), self generated goodwill is not recorded in the books of accounts because consideration in money or money's worth has not been paid for it.
- 14.** Qualitative aspects of business units are those aspects which cannot be expressed in monetary terms, such as changes in management, reputation of the business, cordial management-labour relations, firm's ability to develop new products, efficiency of management, satisfaction of firm's customers etc.
- 15.** No. Because only those transactions and events are recorded in accounting which are of a financial character and the effect of which can be measured in terms of money.
- 16.** Understandability.
- 17.** Reliability.
- 18.** A good accountant is the one who is honest and shrewd. He must ensure that all transactions are recorded in the books of accounts and there should be no hiding of facts. Sometimes, pressure may be put on him to hide certain facts in accounts to evade tax or any other purpose. But he should behave in a honest and shrewd manner.
- 19.** Accountant has violated the value of honesty and trust.
- 20.** Yes, it is a limitation of accounting because there are events which have a vital bearing on the profitability of the firm and such events are ignored.