CHAPTER 1

Introduction to Accounting

(Meaning and Objectives of Accounting and Accounting Information)

LEARNING OBJECTIVES

This Chapter would enable you to understand:

- ❑ Meaning and Definitions of Accounting
- ❑ Attributes (Characteristics) of Accounting
- ❑ Objectives of Accounting
- ❑ Functions of Accounting
- ❑ Advantages of Accounting
- ❑ Limitations of Accounting
- ❑ Role of Accounting in Business
- ❑ Accounting Process
- ❑ Branches of Accounting
- ❑ Book Keeping, Accounting and Accountancy
- ❑ Accounting Information and its Types
- ❑ Qualitative Characteristics of Accounting Information
- ❑ Users of Accounting Information
- ❑ Systems of Accounting

MEANING AND DEFINITIONS OF ACCOUNTING

Accounting is a systematic process of identifying, measuring, recording, classifying, summarising, interpreting and communicating financial information to the users. It gives information on:

(*i*) the resources available;

(*ii*) how the available resources have been employed; and

(*iii*) the results achieved by their use.

It shows the profit earned or loss incurred during the accounting period, value and nature of assets, liabilities and owners' equity, *i.e.*, capital.

Since accounting is a medium of communication, it is called the **language of business.**

"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 at least, of a financial character, and interpreting the results thereof."

—American Institute of Certified Public Accountants

"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 judgment."

—Smith and Ashburne

"Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information."

—American Accounting Association

ATTRIBUTES (CHARACTERISTICS) OF ACCOUNTING

The definitions of accounting bring to light the following characteristics of accounting:

1. Identification of Financial Transactions and Events: Accounting records only those transactions and events which can be measured in terms of money. This involves identifying transactions and events that are part of economic activity, for example, purchase of raw material or sale of finished goods by a firm. Such transactions are identified with the help of bills and receipts as evidence of the transactions.

2. Measuring the Identified Transactions: Accounting measures the transactions and events in terms of a common measurement unit (that is the currency of a country). In other words, *financial transactions and events are measured in terms of money.*

Note: *An event which cannot be measured in terms of money is not recorded in the books of account. For example, event like the calibre or quality of management team or appointment of a manager are not recorded in the books of account.*

3. Recording: Accounting is an art of recording business transactions in the books of account. Recording is the process of recording business transactions of financial character in the book of original entry, *i.e.*, Journal. This book is further sub-divided into subsidiary books such as Cash Journal or Cash Book (for recording cash transactions), Purchases Journal or Purchases Book (for recording credit purchases of goods), Sales Journal or Sales Book (for recording credit sales), etc.

4. Classifying: Classification is the process of grouping transactions or entries of one nature at one place. The transactions recorded in the 'Journal' or the subsidiary books are classified or posted to the main book of account known as the **Ledger**. This book contains individual account heads under which all financial transactions of a similar nature are collected. For example, in Rahul's Account in the Ledger, all business transactions related to Rahul are posted so that what is ultimately due to Rahul or due from Rahul can be ascertained.

5. Summarising: This involves presenting the classified data in a manner which is understandable and useful for internal as well as external users of accounting statements. This process leads to the preparation of the following statements:

(*i*) Trial Balance,
(*ii*) Trading and Profit and Loss Account or Statement of Profit and Loss (in case of Companies) and
(*iii*) Balance Sheet.

The above statements are collectively known as **Final Accounts** or **Financial Statements.**

6. Analysis and Interpretation: Analysis and interpretation of the financial data are carried out so that the users of financial data can make a meaningful judgement of the profitability and financial position of the business. This helps in planning for the future in a better way.

7. Communicating: Finally, the accounting function involves communicating the financial data, *i.e.*, financial statements, to its users. The accounting information must be provided in time and presented to the users so that appropriate decisions may be taken at the right time.

OBJECTIVES OF ACCOUNTING

The objectives of accounting are:

1. Maintaining Accounting Records: The objective of accounting is to record financial transactions and events of the organisation in the books of account in a systematic manner following the principles of accountancy.

2. Determining Profit or Loss: Another objective of accounting is to determine the net result of transactions for a period. In other words, to determine whether during the accounting period, the firm has earned a profit or incurred a loss. For this purpose, a statement called an **Income Statement** or the **Trading and Profit and Loss Account** is prepared. Revenues resulting from the transactions of the period are recorded in the credit and expenses in the debit. The difference between the two sides is either profit or loss.

3. Determining Financial Position: Another objective of accounting is to determine financial position. It is known from the Balance Sheet. Financial position of the business is as relevant for the users of financial statements as is the Income Statement, *i.e.*, Profit and Loss Account (Statement of Profit and Loss, in the case of Companies).

4. Facilitating Management: The management often requires financial information for decision-making, effective control, budgeting and forecasting. Accounting provides financial information to assist the management in discharging this function.

5. Providing Accounting Information to Users: Yet another objective of accounting is to provide accounting information to users, both internal and external, who analyse them as per their needs.

6. Protecting Business Assets: Another objective of accounting is to have records of assets owned by the business. Accounting maintains record of assets owned by the business which enables the management to protect them and exercise control.

FUNCTIONS OF ACCOUNTING

1. Maintaining Systematic Accounting Records: The primary function of accounting is to maintain systematic accounting records of financial transactions and events. It means that the accounting records should be maintained following the accounting rules, principles and concepts. It is so because reliable financial statements can be drawn if proper accounting records are maintained.

2. Preparation of Financial Statements: Financial statements means final accounts prepared at the end of the accounting period. It includes Income Statement (Profit and Loss Account) and Position Statement (Balance Sheet). It is an important function of accounting because the financial statements show the financial performance, *i.e.*, profit earned or loss incurred during the accounting year and the financial position, *i.e.*, Balance Sheet as at the end of the accounting year. Both the statements are important for all the users for taking decisions.

3. Meeting Legal Requirements: Accounting records are accepted as evidence by the court of law if they are maintained systematically following the accounting rules, principles and concepts. Besides, the law such as the Companies Act, Income Tax Act, GST Act, etc., require submissions of returns in the form and period as is prescribed in the law. The returns can be submitted if the accounting records are maintained systematically and timely. A systematic accounting record maintained following the accounting principles and concepts is accepted by the authorities to be correct. Thus, it is a function of accounting to meet the legal requirements.

4. Communicating the Financial Information: It is yet another function of accounting to communicate the financial information to the users, which may be internal users or external users, such as management, banks, employees, government authorities, etc.

5. Assistance to Management: Management often requires financial information which is given by the accounting records which in turn helps the management in decision-making. Accounting record should be maintained in such a manner that the assets owned are known. It will assist the management in protecting the assets and also exercising control.

ADVANTAGES OF ACCOUNTING

1. Financial Information about Business: Financial performance during the accounting period, *i.e.*, profit earned or loss incurred and also the financial position at the end of the accounting period is known through accounting.

2. Assistance to Management: The management makes business plans, takes decisions and exercises control over the affairs on the basis of accounting information.

3. Replaces Memory: A systematic and timely recording of transactions obviates the necessity to remember transactions. The accounting record provides the necessary information.

4. Facilitates Comparative Study: A systematic record enables a businessman to compare one year's results with those of other years and locate significant factors leading to change, if any.

5. Facilitates Settlement of Tax Liabilities: A systematic accounting record immensely helps in settlement of income tax and Goods and Services Tax (GST) liabilities, since it is a good evidence of the correctness of transactions.

6. Facilitates Loans: Loan is granted by the banks and financial institutions on the basis of growth potential which is supported by the performance. Accounting makes available the information with respect to performance.

7. Evidence in Court: Systematic record of transactions is often accepted by the Courts as good evidence.

8. Facilitates Sale of Business: If someone desires to sell his business, the accounts maintained by him will enable the ascertainment of the proper purchase price.

9. Assistance in the Event of Insolvency: Insolvency proceedings involve explaining many transactions that have taken place in the past. Systematic accounting records assist a great deal in such situation.

10. Helpful in Partnership Accounts: At the time of admission or retirement or death of a partner or in case of dissolution of the firm, the accounting record is of vital importance and use because it provides the basis to reach a settlement.

11. Helpful in Decision-making: Accounting helps in taking a large number of decisions like the amount to be withdrawn by proprietor, the price at which goods should be sold, etc.

LIMITATIONS OF ACCOUNTING

1. Accounting is not Fully Exact: Accounting is not fully exact in spite of the fact that most transactions are recorded on the basis of evidence, yet some estimates are also made for ascertaining profit or loss, for examples, estimating the useful life of an asset, providing for doubtful debts, net realisable value of closing stock, etc.

2. Unrealistic Information: Accounting information may not be realistic since accounting statements are prepared following the accounting concepts and conventions. For example, under the Going Concern Concept, it is taken that business will continue for a foreseeable future. Accordingly, assets are recorded at cost and depreciated over their useful life. The assets may not be actually realisable at book value.

3. Accounting Ignores the Qualitative Elements: Accounting is confined to monetary matters only, therefore, qualitative elements like quality or skills of management and staff, industrial relations and public relations are ignored.

4. Accounting Ignores the Effect of Price Level Changes: Accounting statements are prepared at historical cost. Money, as a measurement unit, changes in value frequently, *i.e.*, it does not remain stable. Accounting, however, presumes that value of money remains stable. Unless price level changes are considered, accounting information will not show correct financial results.

5. Accounting May Lead to Window Dressing: The term window dressing means manipulation of accounts in a way so as to conceal vital facts and present the financial statements to show a better position than what it actually is. In this situation, income statement (*i.e.*, Profit and Loss Account) fails to provide a true and fair view of the result of operations and the Balance Sheet fails to provide a true and fair view of the financial position of the enterprise.

ROLE OF ACCOUNTING IN BUSINESS

Accounting is a process of identifying, measuring, recording, classifying, summarising, analysing, interpreting and communicating the financial transaction of a business in a useful manner.

Following points highlight the role of accounting in the field of business:

1. Maintenance of Systematic Records: The primary role of accounting is to maintain systematic records of financial transactions in order to ascertain the net profit or loss for the accounting period and financial position of the business as on a particular date.

2. Assistance to Management: Accounting provides assistance to management by providing financial information for its effective functioning and taking rational decisions.

3. Facilitates Comparative Study: A systematic record of financial transactions enables a businessman to compare one year's results with those of other years and locate significant reasons leading to change, if any.

4. Evidence in Court: Accounting records are often accepted by courts as good evidence.

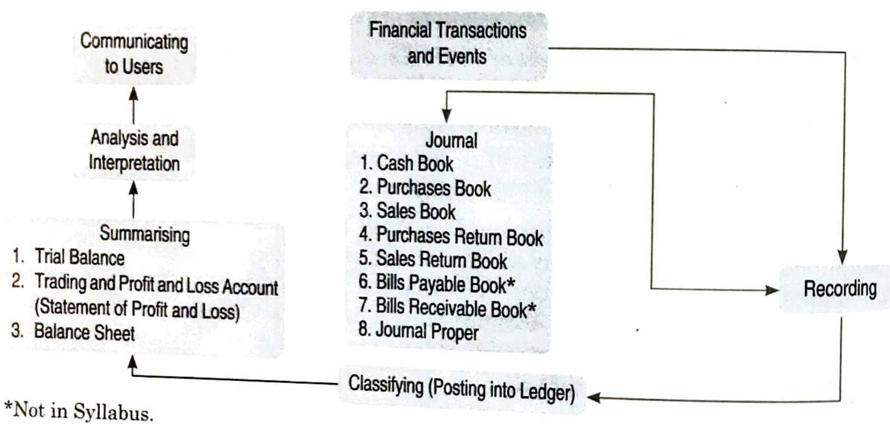
5. Others:

(*i*) Proper accounting records obviates the necessity to remember business transactions.
(*ii*) Facilitates Raising Loans.
(*iii*) Facilitates sale of Business by ascertaining the proper purchase price.
(*iv*) Facilitates settlement of tax liabilities.

ACCOUNTING PROCESS

Based on the attributes of accounting, the steps of accounting process are as follows: (*i*) Identifying Financial Transactions and Events, (*ii*) Recording, (*iii*) Classifying, (*iv*) Summarising, (*v*) Analysing and Interpreting and (*vi*) Communicating. The accounting process may be explained with the help of a diagram:

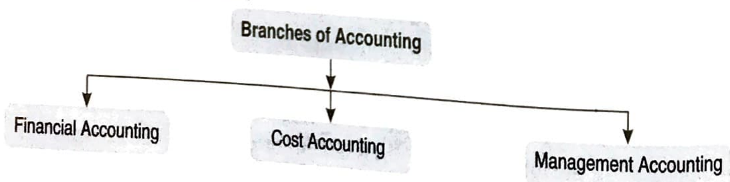
Accounting Process



*Not in Syllabus.

BRANCHES OF ACCOUNTING

With the changing times, following specialised branches of accounting have emerged to meet the changed requirements:



Financial Accounting

Financial Accounting is that branch of accounting which records financial transactions and events, summarises and interprets them before communicating the results to the users. It determines profit earned or loss incurred during an accounting period (usually a year) and the financial position on the date when the accounting period ends. The end-product of financial accounting is the Profit and Loss Account for the period ended (which shows the profit earned or loss incurred) and the Balance Sheet as on the last day of the accounting period (which shows the financial position).

In short, financial accounting is confined to the preparation of financial statements, *i.e.,* the Profit and Loss Account and the Balance Sheet, for the users of accounting information.

Cost Accounting

This branch of accounting is concerned with ascertaining cost of products, operations, processes or activities. It is that branch of accounting which deals with recording costs with the objective of ascertaining, reducing and controlling costs.

Management Accounting

Management Accounting is the most recently developed branch of accounting. It is concerned with generating accounting information relating to funds, costs, profits, etc., as it enables the management in decision-making. We may say that Management Accounting addresses the needs of a single user group, *i.e.,* the management.

BOOK KEEPING, ACCOUNTING AND ACCOUNTANCY

The terms 'Book Keeping' and 'Accounting', often considered as same is not correct. The two terms are different from each other. Accounting is a wider concept and includes Book Keeping.

Meaning of Book Keeping

Book Keeping is a part of accounting being a process of recording financial transactions and events in the books of account. Thus, Book Keeping involves:

1. Identifying financial transactions and events,
2. Measuring them in terms of money,
3. Recording the identified financial transactions and events in the books of account, and
4. Classifying recorded transactions and events, *i.e.,* posting them into Ledger accounts.

Definitions of Book Keeping

"*Book Keeping is an art of recording in the books of account the monetary aspect of commercial and financial transactions.*" **—Northcott**

"*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 the art of recording business transactions in a systematic manner."
—**A.N. Rosen Kampff**

Accounting

Accounting is a wider concept than Book Keeping. It starts where Book Keeping ends. In other words, Book Keeping is a part of accounting.

Difference between Book Keeping and Accounting

Basis	*Book Keeping*	*Accounting*
1. **Scope**	Book Keeping is concerned with identifying financial transactions and events; measuring them in money terms; recording them in the books of account and classifying them.	Accounting is concerned with summarising the recorded transactions and events, interpreting them and communicating the results thereof.
2. **Stage**	It is a primary stage. It is the basis for accounting.	It is a secondary stage. It begins where Book Keeping ends.
3. **Objective**	The objective of Book Keeping is to maintain systematic records of financial transactions.	The objective of Accounting is to ascertain net results of operations and financial position and to communicate information to the interested parties.
4. **Nature of Job**	This job is routine in nature.	This job is analytical and dynamic in nature.
5. **Performance**	It being a routine work is performed by junior staff.	It being a specialised function is performed by senior staff.
6. **Special Skills**	Book Keeping is mechanical in nature and, thus, does not require special skills.	Accounting requires special skills and ability to analyse and interpret.

Accountancy

Accountancy is a systematic knowledge of accounting. It explains how to deal with various aspects of accounting. It educates us how to maintain the books of account and how to summarise the accounting information and communicate it to the users. In the words of **Kohler**, *accountancy refers to the entire body of the theory and practice of accounting.*

Accounting and Accountancy

Accountancy is knowledge whereas accounting is the action or process. Accounting process is carried out on the basis of the rules and principles framed by accountancy. Thus, it may be said that accountancy is knowledge of accounting and accounting is the application of accountancy.

ACCOUNTING INFORMATION

"Accounting is a service activity. Its function is to provide qualitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions."
—**Accounting Principles Board**

As an information system, accounting collects financial data, records it in the books of account, classifies and summarises it to produce financial information that is communicated to its users. Accounting begins with the identification of transactions of financial nature and ends with the preparation of financial statements (*i.e.*, Income Statement and Balance Sheet). Each step in the process of accounting generates information. Generation of information is not an end in itself, it is a way to facilitate the communication of information to users of accounting information.

Types of Accounting Information

Accounting information refers to the financial statements generated through the process of Book Keeping, use of which helps the users to arrive at decisions. The financial statements so generated are the Income Statement, *i.e.*, Profit and Loss Account and the Position Statement, *i.e.*, Balance Sheet. The information made available by these statements can be categorised into the following:

1. Information Relating to Profit or Surplus;
2. Information Relating to Financial Position; and
3. Information about Cash Flow.

Let us now discuss these in detail.

1. Information Relating to Profit or Surplus: The Income Statement makes available the accounting information about the profit earned or loss incurred as a result of business operations or otherwise during an accounting period.

A firm prepares Trading Account, a part of the Profit and Loss Account, which provides information about Gross Profit or Gross Loss and Profit and Loss Account provides information about the Net Profit or Net Loss.

2. Information Relating to Financial Position: The Position Statement, *i.e.*, the Balance Sheet makes available the information about the financial position of the entity. The Position Statement provides information about the assets owned by the entity, amounts receivable and the cash and bank balances held by it. These are represented in the liabilities by the amounts owed by the entity towards loans, creditors and amounts payable, and capital.

3. Information about Cash Flow: Cash Flow Statement is a statement that shows flow, both inflow and outflow, of cash during a specific period. It is of immense use as many decisions such as payment of liabilities, payment of dividend and expansion of business, etc., are based on availability of cash.

QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION

Qualitative characteristics are attributes that make the accounting information useful to users. The qualitative characteristics are:

1. Reliability: Accounting information must be reliable. Reliability of information means it is verifiable, free from bias and material error.

2. Relevance: Accounting information must be relevant to the user. Information is relevant if it meets the needs of the users in decision-making.

3. Understandability: Understandability means that the information provided through the financial statements must be presented in a manner that the users are able to understand it.

4. *Comparability:* Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods, known as **intra-firm comparison** or with the accounting information of other enterprises, known as **inter-firm comparison**.

USERS OF ACCOUNTING INFORMATION

Users of Accounting Information may be categorised into Internal Users and External Users.

Internal Users

(i) ***Owners:*** Owners contribute capital in the business and thus are exposed to maximum risk. Naturally, they are interested in knowing the profit earned or loss incurred by the business besides the safety of their capital. The financial statements give the information about profit or loss and financial position of the business.

(ii) ***Management:*** The management makes extensive use of accounting information to arrive at informed decisions such as determination of selling price, cost controls and reduction, investment into new projects, etc.

(iii) ***Employees and Workers:*** Employees and workers are entitled to bonus at the year-end, which is linked to the profit earned by an enterprise. Therefore, the employees and workers are interested in financial statements. Besides, the financial statements also reflect whether the enterprise has deposited its dues towards Employees' Provident Fund and Employees' State Insurance, etc., or not with the appropriate authorities.

External Users

(i) ***Banks and Financial Institutions:*** Banks and financial institutions are an essential part of any business as they provide loans to businesses. Naturally, they watch the performance of the business to know whether it is making progress as projected to ensure the safety and recovery of the loan advanced and payment of interest. They assess it by analysing the accounting information.

(ii) ***Investors and Potential Investors:*** Investment involves risk and also the investors do not have direct control over the business affairs. Therefore, they rely on the accounting information available to them and seek answers to questions such as—what is the earning capacity of the enterprise and how safe is their investment?

(iii) ***Creditors:*** Creditors are those parties who supply goods and/or services on credit. It is a common business practice that a large number of suppliers remain invested in credit sales. Before granting credit, creditors satisfy themselves about the credit-worthiness of the business. The financial statements help them immensely in making such an assessment.

(iv) ***Government and its Authorities:*** The government makes use of financial statements to compile national income accounts and other information. The information available to it enables it to take policy decisions.

Government levies varied taxes such as custom duty, GST and income tax. These government authorities assess correct tax dues after an analysis of the financial statements.

(v) ***Researchers:*** Researchers use accounting information in their research work.

(vi) ***Consumers:*** Consumers require accounting information for establishing good accounting control so that cost of production may be reduced with the resultant reduction in the prices of products they buy. Sometimes, prices of some products are fixed by the government, so it needs accounting information to fix fair prices so that consumers and producers are not exploited.

(vii) ***Public:*** They want to see the business running since it makes substantial contribution to the economy in many ways, *e.g.*, employment of people, patronage to suppliers, etc. Thus, financial accounting provides useful financial information to various user groups for decision-making.

IS ACCOUNTING AN ART OR A SCIENCE?

Accounting is an Art as well as a Science. Art is the technique which helps us to achieve our desired objectives. Accounting is an art of recording, classifying and summarising financial transactions. It helps us in knowing the profitability and financial position of the business.

Any organised knowledge based on certain basic principles is a 'science'. Accounting is also a science as it is an organised knowledge based on certain basic principles.

SYSTEMS OF ACCOUNTING

The systems of recording transactions in the books of account are two namely:

1. Double Entry System, and
2. Single Entry System.

1. Double Entry System

Double Entry System of accounting is a system of accounting under which both, debit and credit, aspects of accounting are recorded. A transaction has two aspects—Debit and Credit—and at the time of recording a transaction, one aspect is recorded on the debit side and other aspect is recorded on the credit side. For example, at the time of cash purchases, goods are received and in return cash is paid. In the transaction, two aspects are involved, *i.e.*, receiving goods and paying cash and under the Double Entry System, both these aspects are recorded. One part, *i.e.*, the receipt of goods, is debited and the second part, *i.e.*, payment of cash, is credited. In other words, if only two accounts are affected (as in the purchase of building for cash), one account, Building, is debited and the other account, Cash, is credited for the same amount. If more than two accounts are affected by a transaction, the sum of the debit entries must be equal to the sum of the credit entries. Thus, on any day, total amount debited is equal to the total amount credited.

Thus, we can define Double Entry System as: "*The system which recognises and records both aspects of a transaction. The Double Entry System has proved to be a scientific and complete system of accounting.*"

Features of the Double Entry System

1. It maintains a complete record of each transaction.
2. It recognises two-fold aspect of every transaction, *viz.*, the aspect of receiving (value in) and the aspect of giving (value out).
3. In this system, one aspect is debited and the other aspect is credited following the rules of debit and credit.
4. Since one aspect of a transaction is debited and the other is credited, the total of all debits is always equal to total of all credits. It helps in establishing arithmetical accuracy by preparing the Trial Balance.

Stages of Double Entry System

A complete system of double entry book keeping has following three stages:

1. Recording the transactions in the Journal.
2. Classifying transactions in the Journal by posting them to the appropriate ledger accounts and then preparing the Trial Balance.
3. Closing the books and preparing the final accounts.

All these stages shall be discussed one by one in succeeding chapters.

Advantages of the Double Entry System

The advantages of Double Entry System are:

(i) ***Scientific System:*** Double Entry System is a scientific system of recording business transactions as compared to other systems of Book Keeping. It helps attain the objectives of accounting.

(ii) ***Complete Record of Transactions:*** Under the system, both sides of a transaction are recorded. It is a complete record as it results in showing correct income or loss, assets and liabilities.

(iii) ***Arithmetical Accuracy of Accounts is Ensured:*** By the use of this system, arithmetical accuracy of the accounting work can be established through the Trial Balance.

(iv) ***Determining Profit or Loss:*** Profit earned or loss incurred during a period can be determined by preparing Profit and Loss Account.

(v) ***Knowledge of Financial Position:*** Financial position of the firm or the institution can be ascertained at the end of each period by preparing the Balance Sheet.

(vi) ***Full Details for Purposes of Control:*** The system permits accounts to be maintained in as much detail as necessary and, therefore, provides significant information for purposes of control, etc.

(vii) ***Comparative Study is Possible:*** Results of one year may be compared with those of previous years and reasons for the change may be ascertained.

(viii) ***Helps Management in Decision-making:*** Management may be able to obtain good information for its work, especially in making decisions.

(ix) ***Detection of Frauds and Misappropriations:*** Frauds and misappropriations are minimised since complete information about all assets and liabilities is available.

It is because of these advantages that the Double Entry System is used extensively in all countries.

2. Accounts from Incomplete Records or Single Entry System

Account from Incomplete Records or Single Entry System of recording transactions in the books of account may be defined as an incomplete Double Entry System. In this system, all transactions are not recorded on double entry basis. In some transactions, both aspects of the transactions are recorded, while in others, either one aspect is recorded or not recorded at all. Instead of maintaining all the accounts, only Personal Accounts and Cash Book are maintained under this system. The accounts maintained under this system are incomplete and unsystematic and, therefore, not reliable.

Since all transactions are not recorded under this system on double entry basis, it is not possible to prepare a Trial Balance. As a result, the Profit and Loss Account and the Balance Sheet cannot be prepared.

QUESTIONS

Higher Order Thinking Skills (HOTS) Questions

Q. 1. Accounting records transactions and events that can be measured in money terms. Is this, in your opinion, a limitation of accounting or an advantage? Give reasons.

Ans. Yes. Accounting records only financial transactions and events. It is an advantage as transactions of diverse nature are recorded using a common yardstick, *i.e.*, money. But there are other important transactions and events which may have far-reaching effect on business. They are not recorded because they cannot be measured in money terms. For example, production loss due to labour strike. Thus, it is a limitation to that extent.

Q. 2. Resignation by a Marketing Manager is not recorded in the books of account. Why?

Ans. It is not recorded because it cannot be measured in money terms.

Q. 3. Book Keeping is not a part of accounting. Do you agree with the statement?

Ans. No. Book Keeping is a part of accounting. Two processes of accounting, *i.e.*, collecting and recording of financial transactions and events are the processes of Book Keeping.

Q. 4. Is the basic objective of Book Keeping to maintain systematic records or to ascertain net results of operations of financial transactions? (*MSE Chandigarh 2011*)

Ans. The basic objective of Book Keeping is to maintain systematic records of financial transactions.

Q. 5. Recording the transactions and events correctly and preparing financial statements are the only objectives of accounting. Do you agree?

Ans. No. Besides recording them correctly and preparing financial statements, accounting has the objectives of facilitating management control and communicating financial information to the users.

Q. 6. Which type of accounting information shows profit earned or loss incurred?

Ans. Profit and Loss Account (in case of firms) and Statement of Profit and Loss (in case of Companies) shows profit earned or loss incurred during the accounting period.

Q. 7. State whether the following statements are **True** or **False** with reason:

(*i*) Accounting may be influenced by the personal judgment.

(*ii*) Financial Statements are not comparable.

(*iii*) Accounting Information must be presented in such a way that only accounting people understand it.

(*iv*) Accounting Information must be reliable.

Ans. (*i*) *True:* Accountant has to exercise his personal judgment in respect of various items such as estimating useful life of an asset to charge depreciation.

(*ii*) *False:* Financial Statements of two or more years are comparable or of different firms in the same industry if they adopt the same accounting policies year to year.

(*iii*) *False:* Accounting Information must be presented in a simple and logical manner that they are understood easily by the users.

(*iv*) *True:* Accounting Information must be reliable, *i.e.*, the information must be factual and verifiable.

Multiple Choice Questions (MCQs)

Select the correct alternative:

(*i*) Book Keeping and Accounting
- (*a*) means same and are used interchangeably.
- (*b*) does not mean same and are not used interchangeably.
- (*c*) means both (*a*) and (*b*).
- (*d*) None of the above.

(*ii*) Accounting
- (*a*) includes Book Keeping.
- (*b*) does not include Book Keeping.
- (*c*) may or may not include Book Keeping.
- (*d*) None of these.

(*iii*) Which of the following will not be recorded in the books of account?
- (*a*) Sales of goods
- (*b*) Payment of salary
- (*c*) Quality of staff
- (*d*) Purchase of Goods

(*iv*) Book Keeping is concerned with
- (*a*) recording financial data relating to business operations.
- (*b*) designing for systems recording, classifying and summarising recorded data.
- (*c*) interpreting data for internal and external users.
- (*d*) All of the above.

(*v*) Which is the last step of accounting as a process of information?
- (*a*) Recording the transaction
- (*b*) Preparation of financial statements
- (*c*) Communication of information
- (*d*) Analysis and interpretation of information

(*vi*) Basic function of financial accounting is to
- (*a*) record all business transactions.
- (*b*) interpret financial data.
- (*c*) assist the management.
- (*d*) None of these.

(*vii*) Transactions are posted into Ledger Account from
- (*a*) Vouchers.
- (*b*) Journal book.
- (*c*) Bank Statement.
- (*d*) None of these.

(*viii*) Which of the following is not a business transaction?
- (*a*) Purchase of goods for resale amounted to ₹ 50,000
- (*b*) Paid salaries and wages amounted to ₹ 10,000
- (*c*) Paid rent for office premises ₹ 5,000
- (*d*) Purchased a LCD for personal use

(*ix*) Which of the following transactions will not be recorded in the books of account?
- (*a*) Purchased a LCD for personal use, paying the amount from personal bank account.
- (*b*) Purchased machinery for manufacture.
- (*c*) Purchased machinery for resale.
- (*d*) Paid salaries and wages.

(*x*) Accounting does not show the realisable value of business. It is a/an
- (*a*) limitation of Accounting.
- (*b*) advantage of Accounting.
- (*c*) Both (*a*) and (*b*).
- (*d*) None of these.

(*xi*) Which of the following is not an internal user of financial statements?
- (*a*) Board of Directors
- (*b*) Managers
- (*c*) Employees
- (*d*) Lenders

(*xii*) Which of the following is not a characteristic of accounting?
- (*a*) Recording non-monetary transactions
- (*b*) Classifying
- (*c*) Analysis
- (*d*) Summarising

(*xiii*) Which of the following is a limitation of accounting?
- (*a*) Assistance to Management
- (*b*) Replaces Memory
- (*c*) Unrealistic Information
- (*d*) Evidence in Court

(*xiv*) Cost of Goods Manufactured is determined by
- (*a*) Financial Accounting.
- (*b*) Cost Accounting.
- (*c*) Management Accounting.
- (*d*) Human Resource Accounting.

(*xv*) Qualitative characteristic of Accounting includes
- (*a*) Reliability and Relevance.
- (*b*) Understandability and Comparability.
- (*c*) Both (*a*) and (*b*).
- (*d*) None of the above.

(*xvi*) Which of the following is not a qualitative characteristic of accounting information?
- (*a*) Reliability
- (*b*) Understandability
- (*c*) Comparability
- (*d*) Materiality

(*xvii*) Which qualitative characteristic of accounting information is reflected when accounting information is clearly presented?

(*a*) Reliability (*b*) Relevance
(*c*) Comparability (*d*) Understandability

(*xviii*) Which external user of accounting information is most interested in knowing the long-term solvency position of the firm?

(*a*) Employees (*b*) Management
(*c*) Bank and Financial Institutions (*d*) Researchers

[(*i*) (*b*); (*ii*) (*a*); (*iii*) (*c*); (*iv*) (*a*); (*v*) (*c*); (*vi*) (*a*); (*vii*) (*b*); (*viii*) (*d*); (*ix*) (*a*); (*x*) (*a*); (*xi*) (*d*); (*xii*) (*a*); (*xiii*) (*c*); (*xiv*) (*b*); (*xv*) (*c*); (*xvi*) (*d*); (*xvii*) (*d*); (*xviii*) (*c*).]

Very Short Answer Type Questions

Q. 1. Give the meaning of 'Accounting'. (*Delhi 2011*)

Ans. Accounting is a process of identifying financial transactions, measuring them in money terms, recording them in primary books, classifying, summarising, analysing, interpreting them and communicating the results to the users.

Q. 2. List **any two** functions of Accounting.

Ans. Two functions of accounting are:

(*i*) Identifying financial transactions; and (*ii*) Recording them in the books of account.

Q. 3. What are the steps involved in the process of accounting?

Ans. The steps involved in the process of accounting are:

(*i*) Identifying financial transactions and events;
(*ii*) Recording in the books of account;
(*iii*) Classifying the recorded entries;
(*iv*) Preparation of Trial Balance;
(*v*) Preparation of Final Accounts;
(*vi*) Analysis and Interpretation of Financial Statements; and
(*vii*) Communicating to the users.

Q. 4. Name the branch of commerce, which keeps a record of monetary transactions in a set of books. (*MSE Chandigarh 2009*)

Ans. Book Keeping.

Q. 5. Define Book Keeping.

Ans. Book Keeping is an art of recording in the books of account the monetary aspect of commercial and financial transactions.

Q. 6. What is the function of Book Keeping?

Ans. The function of Book Keeping is to identify financial transactions and events, measuring them in money terms, recording them in the books of account and classifying the recorded transactions.

Q. 7. Name **any two** objectives of Accounting. (*KVS 2010*)

Ans. The two objectives of Accounting are:

(*i*) Ascertaining profit or loss; and (*ii*) Ascertaining financial position.

Q. 8. What are the advantages of Accounting? **(Any Two)**

Ans. Two advantages of Accounting are:

(*i*) Financial performance and position is known; and
(*ii*) Assist management in making business plans, take decisions and exercise control.

Q. 9. What are the limitations of Accounting? **(Any Two)** (*Delhi 2008, KVS 2010*)

Ans. The limitations of Accounting are:

(*i*) Non-financial informations are not recorded; and
(*ii*) It ignores price level changes.

Q. 10. Name **any one** external user of Accounting information. (*Delhi 2009*)

Ans. Creditors.

Q. 11. What are the **two** accounting systems to record financial transactions in the books of account?

Ans. The two accounting systems are:

(*i*) Double Entry System; and
(*ii*) Accounts from Incomplete Records or Single Entry System.

Q. 12. Name the external user of accounting information from whom the firm purchases goods on credit. (*KVS 2012*)

Ans. Supplier of goods.

Q. 13. Is the basic objective of Book Keeping to maintain systematic records or to ascertain net results of operations of financial transactions? (*MSE Chandigarh 2012*)

Ans. The basic objective of Book Keeping is to maintain systematic records of financial transactions.

Q. 14. Name the external users directly concerned with accounting information. (*MSE Chandigarh 2015*)

Ans. (*i*) Creditors, (*ii*) Bankers or Financial Institutions, and (*iii*) Government and its Authorities.

Short Answer Type Questions

1. Explain the meaning of Accounting. (*Delhi 2011*)
2. What is the process of Accounting?
3. Define Book Keeping. What is the function of Book Keeping?
4. What is the difference between Book Keeping and Accounting? (*KVS 2003, 2006*)
5. Discuss briefly the types of Accounting Information.
6. Why the following parties are interested in Accounting Information:
   (*a*) Investors; (*b*) Government? (*MSE Chandigarh 2011*)

7. State what is the end-product of Financial Accounting. *(MSE Chandigarh 2008)*
   [**Hint:** Financial Statements, *i.e.*, (*i*) Income Statement, (*ii*) Balance Sheet.]
8. What are the attributes (features) of Accounting? *(MSE Chandigarh 2006)*
9. What do you mean by Accounting? What are its main objectives? *(KVS 2007)*
10. What are the advantages of Accounting? *(MSE Chandigarh 2003; Delhi 2004)*
11. Explain the primary objectives of Accounting. *(MSE Chandigarh 2009)*
12. Explain **any four** objectives of Accounting. *(KVS 2012)*
13. Define Accounting. Explain **any two** limitations of Accounting. *(MSE Chandigarh 2007; KVS 2008)*
14. What is Accounting? Explain **four** of its functions. *(Delhi 2001, 2002)*
15. What do you mean by Accounting? Explain in brief **any four** advantages of Accounting. *(Delhi 2010)*
16. What do you mean by Financial Accounting? Explain the **four** main limitations of Financial Accounting. *(Delhi 2004)*
17. Accounting provides information about the profitability and financial soundness of a concern. In addition, it provides various other valuable information also. However, accounting has certain limitations. Explain **any three** of such limitations. *(KVS 2015; KVS 2016)*
18. What do you mean by Financial Accounting? Explain its **one** main function. *(Delhi 2008)*
19. Write a short note on Double Entry System of Accounting.

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