

LESSON-1 ACCOUNTING – AN INTRODUCTION

SUMMARY

Accounting is the art of recording, classifying and summarizing in terms of money transactions and events of a financial nature and interpreting the results thereof. It is the process of collecting, recording, summarizing and communicating financial information. It is an information system which generates information for decision making by the interested parties.

Important accounting terms are: Business entity, transactions, purchases, sales, debtors, creditors, etc.

Main points to remember:

- meaning of Book-Keeping
- meaning and nature of accounting
- distinguish between book keeping and accounting
- advantages & limitations of accounting
- branches of accounting

BOOK KEEPING AND ACCOUNTING

- Recording of business transactions in a systematic manner in the books of account is called book-keeping. Book-Keeping is concerned with recording of financial data

“The art of keeping a permanent record of business transactions is book-keeping”.

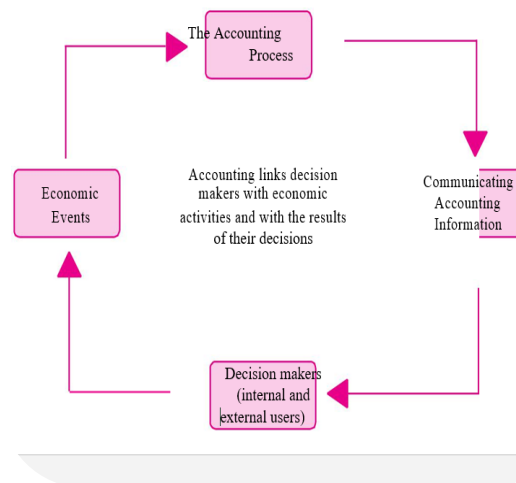
- From books of accounts important details such as total sales, total purchases, total cash receipts, total payments, etc. may be ascertained. In 1941, the American Institute of Certified Public Accountants (AICPA) defined accounting as

“The art of recording, classifying, summarising, analysing and interpreting the business transactions systematically and communicating business results to interested users in accounting”

The American Accounting Association defined accounting as :

“It is the process of identifying, measuring, recording and communicating the required information relating to the economic events of an organization to the interested users of such information.

Accounting process can be summarized as:



Difference between book keeping and accounting: Book keeping and accounting can be differentiated on the basis of nature,

objective, function, basis, level of knowledge, etc.

[4]

Basis of Difference	Book-keeping	Accounting
Nature	It is concerned with identifying financial transactions; measuring them in monetary terms; recording and classifying them.	It is concerned with summarizing the recorded transactions, interpreting them and communicating the results.
Objective	It is to maintain systematic records of financial transactions.	It aims at ascertaining business income and financial position by maintaining records of business transactions.
Function	It is to record business transactions. So its scope is limited.	It is the recording, classifying, summarizing, interpreting business transactions and communicating the results. Thus its scope is quite wide.
Basis	Vouchers and other supporting documents are necessary as evidence to record the business transactions.	Book-keeping works as the basis for accounting information.
Level of Knowledge	It is enough to have elementary knowledge of accounting to do book-keeping.	For accounting, advanced and in-depth knowledge and understanding is required.
Relation	Book-keeping is the first step to accounting.	Accounting begins where book-keeping ends.

Branches of Accounting

The changing requirements of the business over the centuries have given rise to specialized branches of accounting and these are :

- Financial Accounting
- Cost Accounting
- Management Accounting
- Tax Accounting
- Social Accounting

Objectives and Functions of Financial Accounting

- Finding out Various Balances
- Providing Knowledge of Transactions
- Ascertaining Net Profit or Loss
- Depicting Financial Position
- Information to All Interested Users
- Fulfilling Legal Obligations
- Functions of Accounting

Major functions of accounting:

- Maintaining Systematic Records
- Communicating the financial results
- Meeting Legal Requirements
- Fixing responsibility
- Decision making

Advantages of Accounting:

- Financial Information about Business
- Assistance of Management
- Replace Memory
- Facilitates Comparative Study
- Facilitates Settlement of Tax Liabilities
- Facilitates Loans
- Evidence in Court
- Facilitates Sale of Business
- Assistance in the Event of Insolvency
- Helpful in Partnership Accounts

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

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

Internal Users

- Owners
- Management
- Employees and Workers

External Users

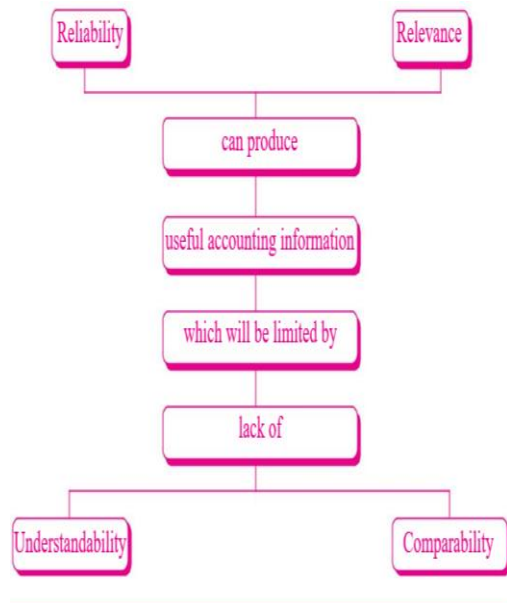
- Banks and Financial Institutions
- Investors and Potential Investors
- Creditors
- Government and Its Authorities
- Researchers

- Consumers
- Public

Qualitative Characteristics of Accounting Information

Reliability;
 Relevance;
 Understandability and
 Comparability.

The accounting information produced in the light of Reliability and Relevance Qualitative Characteristics can be useful but its usefulness shall be limited if it lacks understandability and comparability. We may explain this with the help of a diagram:



ACCOUNTING TERMS

Transaction, Purchases, Sundry Creditors, Sales, Sundry Debtors, Revenue (Sales), Expenses, Income, Gain, Loss, Profit, Expenditure, Drawings, Capital, Assets, Current assets, Non-current assets, Liability, Stock or Inventory, Goods, Receivables, Payables, Bill Receivable, Bill Payable, Event, Cost, Voucher, Discount, Trade Discount, Cash Discount

Role of an Accountant in Society

- To maintain the proper books of accounts which portray the true and fair view of the results of the business.
- To provide information and reports to management to enable them to discharge their duties more effectively.
- To act as auditor for attestation of accounts as per the requirement of law.
- To act as an internal auditor to assist and strengthen the hands of the management.
- To act as tax consultant to handle the tax matters of the business.
- To act as management consultant to provide services regarding financial planning of the business to their clients.