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Chapter – 1

Introduction of Accounting

MEANING OF ACCOUNTING

It is a means of collecting, summarizing, analysing and reporting in monetary term, information about business.

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Accounting is an art of recording, classifying and summarising in a significant manner and in terms of money, transaction and event which are, in part at least of a financial character and interpreting the result thereof .

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CHARACTERISTICS OF ACCOUNTING

- **ACCOUNTING IS AN ART AS WELL AS SCIENCE**
As an art, it is an art of recording, classifying, and summarising business transaction with a view to ascertain the net profit and financial position of the business enterprise. As a science it is an organised body, of knowledge based on certain specified principles and accounting standard.
- **RECORDING OF FINANCIAL TRANSACTION ONLY**
Only those transactions are recorded in accounting which are of financial character.
- **RECORDING IN TERMS OF MONEY**
Each transaction is recorded in the books in terms of money.

FUNCTION OF ACCOUNTING

1. IDENTIFYING: - The first function is to identify the transaction of financial character and measure them in money terms.

2. RECORDING - In a small business where number of transaction is quite small, all transaction are first recorded in a book called Journal. But in a big business where the number of transaction are large, the Journal are further divided into various subsidiary books.

3. CLASSIFYING: - After recording, next the transactions are classified. Classification is the process of grouping the transaction of one nature at one place in a separate account. The books in which various accounts are opened is called ledger.

4. SUMMARISING: - Summarising is the art of presenting the classified data which is understandable and useful to management and other users of such data. This involves balancing of ledger and the preparation of trail balance with the help of such balances. Final accounts are prepared with the help of trial balance

5. INTERPRETATION: - In Accounting, the result of the business are presented in such a manner that parties interested can have full information about the profitability and financial position the business.

6. COMMUNICATING: - Accounting function also includes the communication of financial data to the users who analysis them as per their requirement.

OBJECTIVES OF ACCOUNTING

- ✚ To keep systematic record of business transactions
- ✚ To calculate profit and loss.
- ✚ To know exact reasons leading to net profit or net loss.
- ✚ To ascertain the financial position of the business.
- ✚ To ascertain the progress of the business from year to year.
- ✚ To prevent and detect errors and frauds.
- ✚ To provide information to various parties.

USERS OF ACCOUNTING INFORMATION

(A) INTERNAL USERS

Internal users are the person who are directly involve in managing the business enterprise such as director or the partners, managers, officers. These people need accounting information for the efficient and smooth functioning of the business enterprise.

(B) EXTERNAL USERS

Individual or organisations who have present or future interest in the business enterprise but are not a part of the management are called external users of accounting information

EXTERNAL USERS OF ACCOUNTING INFORMATION

- ✚ Owners
- ✚ Potential Investor
- ✚ Creditors
- ✚ Lenders
- ✚ Employees

-  Government
-  Public

BRANCHES OF ACCOUNTING

FINANCIAL ACCOUNTING assists keeping a systematic record of financial transactions the preparation and presentation of financial reports in order to arrive at a measure of organisational success and financial soundness.

COST ACCOUNTING assists in analysing the expenditure for ascertaining the cost of various products manufactured or services rendered by the firm and fixation of prices thereof. It also helps in controlling the costs and providing necessary costing information to management for decision-making.

MANAGEMENT ACCOUNTING deals with the provision of necessary accounting information to people within the organisation to enable them in decision-making, planning and controlling business operations.

As a result, the scope of accounting has become so vast, that new areas like human resource accounting, social accounting, responsibility accounting have also gained prominence.

QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION

Qualitative characteristics are the attributes of accounting information which tend to enhance its understandability and usefulness. In order to assess whether accounting information is decision useful, it must possess the characteristics of reliability, relevance, understandability and comparability.

1. Reliability

Reliability means the users must be able to depend on the information. A reliable information should be free from error and bias and faithfully represents what it is meant to represent.

2. Relevance

To be relevant, information must be available in time, must help in prediction and feedback, and must influence the decisions of users.

3. Understandability

Understandability means decision-makers must interpret accounting information in the same sense as it is prepared and conveyed to them.

4. Comparability

To be comparable, accounting reports must belong to a common period and use common unit of measurement and format of reporting.

ADVANTAGES OR USES OF ACCOUNTING

- ✓ **HELPFUL IN MANAGEMENT OF BUSINESS:** - Management needs a lot of information for the efficient running of the business. These accounting information is helpful in planning, decision making and controlling.

- ✓ **PROVIDE COMPLETE AND SYSTEMATIC RECORD:** - Accounting keeps a prompt and systematic record of all the transactions and summarizes them to provide a true picture of the activities of the business.

- ✓ **REGARDING PROFIT OR LOSS:-** Accounting report give information about net profit or loss of the business by preparing profit and loss a / c at the end of each accounting period :
- ✓ **INFORMATION REGARDING FINANCIAL POSITION: -** Accounting report the financial position of the enterprises by preparing Balance Sheet at the end of each accounting year.
- ✓ **ENABLES COMPARATIVE STUDY: -** By keeping systematic record of accounting helps the owner to compare current year records with that of past years. Such comparison provide useful information for decision making.
- ✓ **A HELPFUL IN ASSESMENT OF TAX LIABILITY A EVIDENCE IN LEGAL MATTERS**

LIMITATION OF ACCOUNTING

- ✓ **INFLUENCED BY THE PERSONAL JUDGEMENTS:** Accounting is affected by the personal judgment of accountant in respect of various items.
- ✓ **BASED ON ACCOUNTING CONCEPTS AND CONVENTIONS: -** Accounting 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.

- ✓ **INCOMPLETE INFORMATION:** - Accounting statement provide only the incomplete information because actual profit or loss of a business can be known only when the business is closed down
- ✓ **OMISSION OF QUALITATIVE INFORMATIONS:** - Accounts contain only those information which are expressed in monetary terms. Qualitative aspects of business units are completely omitted from the book as these cannot be expressed in monetary term.
- ✓ **BASED ON HISTORICAL COSTS:** - Accounts are prepared on the basis of historical costs (or the original costs) and as such the figures given in financial statements do not show the effect of changes in price level.
- ✓ **AFFECTED BY WINDOW DRESSING:** - Window dressing refers to the practice of manipulating accounts, to show financial statement more favourable than actual position.