INTRODUCTION TO ACCOUNTING

DEFINITIONS:

American Institute of certified public accounts:

"Accountancy has been defined as the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are of financial character and interpreting results thereof."

A. Recording: Each and every transaction is recorded as and when it occurs in chronological order. Every entry recorded has to be supported by reliable documentary evidence. The method of recording is adjusted according to the size, and nature of business.

B. Classification: The classification takes the form of accounts in a separate book called as Ledger. Separate ledger accounts are opened for each expenses, income, property and liability. It useful for the segregation of numerous business transactions into identifiable groups.

C. Summarising : Summarising takes place in the form of trial balance, trading account, profit & loss account and balance sheet.

D. Interpretation: It is usually done through flow statements. They are useful in evaluating past performance and providing guidance for future plans and activities

FUNCTIONS:

- To record the business transactions according to their nature
- To analyses the transactions so recording to be easily understood
- To prepare statements of accounts to the entrepreneur to know the financial statements
- To enable the entrepreneur to analyses the statements of accounts for making future projections.

PHASES: Accountancy is basically divided into two main phases.

1. Book-keeping 2. Accounting.

BOOK- KEEPING

Book keeping is mainly concerned with recording of financial data relating to the business operations in a significant manner. A book keeper may be responsible for keeping all the records of a business or only of minor segments such as a portion of the customer accounts in a departmental store. A substantial portion of the book keeper's work is of a clerical nature and is increasingly being accomplished through the use of mechanical and technical devices.

Book-Keeping Objectives:

- Book- keeping provides a permanent record of each transaction.
- Soundness of a firm can be assessed from the records of assets and abilities on a particular date.
- Entries related to incomes and expenditures of a concern facilitate to know the profit and loss for a given period.
- It enables to prepare a list of customers and suppliers to ascertain the amount to be received or paid.

- It is a method gives opportunities to review the business policies in the light of the past records.
- Amendment of business laws, provision of licenses, assessment of taxes etc., are based on records.

ACCOUNTING

Accounting as primarily concerned with the designing the system for recording, classification and summerising the recorded data and interpreting then for internal and external end users. The work of an accountant in the beginning may include some book keeping. An accountant is requires to have a much higher level of knowledge, conceptual understanding and analytical skill then what is required for a book keeper.

Accounting Objectives:

- To facilitates the business concern to know the profit or loss for a given period.
- To provides the most effective way to the management for fixing of objectives of the business.
- To know Financial position
- To provides the systematic and permanent record.
- To facilitates to know the soundness of a business concern by providing balance sheet.
- To enables to prepare a list of customers and suppliers to ascertain amount to be received or paid.
- To gives opportunities to review the business policies in the light of the past records.
- To be useful for business loss, provision of licenses, assessment of taxes etc.
- To prevent errors & frauds
- To know Creditors, Debtors, Capital Invested, cash and stock.

Limitations of Accounting

- Accounting is historical in nature: It does not reflect the current financial position or worth of a business.
- Transactions of non-monetary Nature do not find place in accounting. Accounting is limited to monetary transactions only. It excludes qualitative elements like management, reputation, employee morale, labour strike etc.
- Facts recorded in financial statements are greatly influenced by accounting conventions and personal judgments of the Accountant or Management. Valuation of inventory, provision for doubtful debts and assumption about useful life of an asset may, therefore, differ from one business house to another.
- Accounting principles are not static or unchanging-alternative accounting procedures are often equally acceptable. Therefore, accounting statements do not always present comparable data.
- Cost concept is found in accounting. Price changes are not considered. Money value is bound to change often from time to time. This is a strong limitation of accounting.

Methods of Accounting:

Following are the three methods of accounting:

i. Cash Basis of Accounting: Under this method, all incomes are considered to be earned when they are actually received in cash. Similarly, expenses are deemed to be incurred only when they are actually paid in cash. In other words, importance is attached to cash receipts and payments but non-cash items, such as outstanding, pre-paid expenses, accrued incomes or income received in advance are ignored. This method is adopted in those concerns where only cash transactions take place. Generally this system is followed by individuals like Doctors, Lawyers, Auditors, Engineers, Brokers, and Small Traders etc.

ii. Accrual Basis or Mercantile Basis of Accounting: This method is commonly adopted by business concerns. Incomes are recorded or credited to the period in which they are earned irrespective of the fact whether the same has actually been received or not. Similarly, expenses are charged to the period in which they relate irrespective of the fact that they have actually been paid or not. In other words, all items of incomes and expenditures, both cash items as well as non – cash items such as pre- paid expenses, accrued incomes or income received in advance etc, are taken into account.

iii. Hybrid or Mixed Basis of Accounting: Under this method, both cash basis and accrual basis are followed. Incomes are recorded on cash basis whereas expenses are taken on accrual basis. The net income is ascertained by matching expenses on accrual basis with income on cash basis. This is the most conservative basis of ascertaining income because all possible. expenses relating to the period whether actually paid or not are considered whereas income only received in cash in taken into consideration. This system is followed by professional like Doctors, Lawyers, and Chartered Accountants etc.,

Types of Accounting:
There are two systems of accounting namely Single Entry System and Double Entry System.

Single Entry System: The single entry system is not a really a system because in some cases record may be one – sided; and in some other cases no record is maintained at all. It is more appropriate to call it an incomplete system of recording transactions. Double effect of every transaction is ignored and only the accounts relating to suppliers and customers an cash account are found. Thus, the system is incomplete, inaccurate and unscientific system of recording business transactions.

Double Entry System: The modern system of accounting is based on what is known as double entry principle. It refers to that system of book keeping where each transaction is recorded in both of its aspects. viz.i. receiving of the benefit of the transaction and ii. Giving away of the benefit of the transaction. For a complete record of transactions, it should be presented in both the accounts. Business transactions affect two aspects of the accounts in the opposite direction. If are account receives a benefit there must be another account to give the benefit. It is like the two sides of a coin. Thus, every transaction involves two accounts, one which gives the benefit of the transactions and another which receives the same.

PRINCIPLE OS ACCOUNTANCY

Concepts and **Conventions** are principles of accountancy.

1. Entity concept:
According to this assumption, business is treated as a unit or entity apart from its owners, creditors and others. In other words, the proprietor of a business concern is always considered to be separate and distinct from the business which he controls. All the business transactions are recorded in the books of accounts from the view point of the business. Even the proprietor is treated as a creditor to the extent of his capital

2.Dual aspect concept :
Dual aspect principle is the basis for Double Entry System of book-keeping. All business transactions recorded in accounts have two aspects - receiving benefit and giving benefit. For example, when a business acquires an asset (receiving of benefit) it must pay cash (giving of benefit).

3. Going concern concept :

As per this assumption, the business will exist for a long period and transactions are recorded from this point of view. There is neither the intention nor the necessity to wind up the business in the foreseeable future.

4. Money measurement concept:
In accounting, only those business transactions and events which are of financial nature are recorded. For example, when Sales Manager is not on good terms with Production Manager, the business is bound to suffer. This fact will not be recorded, because it cannot be measured in terms of money.

5. Cost concept:
Under this concept, assets are recorded at the price paid to acquire them and this cost is the basis for all subsequent accounting for the asset. For example, if a piece of land is purchased for Rs.5,00,000 and its market value is Rs.8,00,000 at the time of preparing final accounts the land value is recorded only for Rs.5,00,000. Thus, the balance sheet does not indicate the price at which the asset could be sold for.

6. Accounting period:
The users of financial statements need periodical reports to know the operational result and the financial position of the business concern. Hence it becomes necessary to close the accounts at regular intervals. Usually a period of 365 days or 52 weeks or 1 year is considered as the accounting period.

7. Periodic Matching of Cost and Revenue Concept:
This is based on accounting period concept. Making profit is the most important objective. This makes the proprietor engaged in the business. There are accountants who spend time in evolving the techniques for measuring profit/profitability of the business. To ascertain the profit made during a period, it is necessary to match `revenues' of the period with the `expenses' of that period.

8. Realisation concept:
According to this concept profit should be accounted for only when actually realised. Revenue is recognised only when sale is affected or the services are rendered. Sale is considered to be made when the property in goods passes to the buyer and he is legally liable to pay. However, in order to recognise revenue, receipt of cash is not essential. Even credit sale result in realisation as it creates a definite asset called `account receivable'. Moreover, there are certain exceptions to the concept: like in the case of contract accounts, hire purchase etc. Similarly income like commission, interest, rent etc. are shown in Profit and Loss Account on accrual basis though they may not be realised in cash.

CONVENTIONS:

1. Convention of Conservatism:
Prudence principle takes into consideration all prospective losses but leaves all prospective profits. The essence of this principle is "anticipate no profit and provide for all possible losses". For example,
while valuing stock in trade, market price or cost price whichever is less is considered.

2. Convention of Consistency:
The aim of consistency principle is to preserve the comparability of financial statements. The rules, practices, concepts and principles used in accounting should be continuously observed and applied yearafter year. Comparisons of financial results of the business among different accounting period can be significant and meaningful only when consistent practices were followed

in ascertaining them. For example,depreciation of assets can be provided under different methods, whichever method is followed, it should be followed regularly.

3. Convention of Materiality:
The materiality principle requires all relatively relevant information should be disclosed in the financial statements. Unimportant and immaterial information are either left out or merged with other items.

4. Convention of Disclosure:
The accounts must disclose all material information. The accounting reports should disclose full and fair information to the proprietors, creditors, investors and others. This convention is especially significant in the case of big business like Joint Stock Company where there is divorce between the owners and the managers.

ACCOUNT
Accountancy consists of financial information. They are monetary events. They are called financial transactions. They are compiled to prepare financial reports. For this, at the lowest level, the transactions are classified under a specific financial head. Allocation of a financial head is very sensitive in the point of financial report. For example, salary given to an employee is an expense and advance against salary is not an expense. So, the financial transactions are systematically summarised under a specific head, which is called an Account.

Classification of Accounts
Financial transactions are grouped under various head of accounts. Depending on the name and behavior the accounts are classified.
The head of accounts are primarily classified into two main groups.
A.Personal Accounts B..Impersonal Accounts

(A) personal Accounts
Accounts dealing with persons are called personal accounts. They are further classified as:
- ❖ Naturally personal accounts
- ❖ Artificial personal accounts, and
- ❖ Grouped or representative personal accounts.

(B) Impersonal Accounts
The accounts, which are not personal accounts, are the impersonal accounts. They are further classified into three groups.
- ❖ Real Accounts
- ❖ Nominal Accounts
- ❖ Valuation Accounts

Real Accounts:
There are such transactions under these accounts which are really functioning in the business. Building, machinery, cash balance, stock in hand etc. are the examples. We cannot say that they are not real. They have the money value. The balance values are carried forward from one financial year to another. So, these are real accounts. Real Accounts are further classified as a) Tangible Accounts and b) Intangible Accounts.

Tangible Accounts:
These accounts relate to things that can be touched, felt, measured, etc. It could be fixed or current in nature. Example: Cash, Building, Furniture, Stock etc.

Intangible Accounts:

These accounts represent the things, which cannot be touched, but they can be measured in terms of money. Example: Patents, Goodwill etc.

Nominal Accounts:
These accounts are of expenses and losses, incomes and gains. These accounts are opened in the book to simply explain the nature of the transactions. For example, in a business, rent is paid to the landlord, salary to employees and commission to salesman. The accounts of these items are opened simply to explain how the cash has been spent. Example: Rent, lighting, insurance, dividends etc.

Debit & Credit
Accountancy is a business language. Debit and Credit are two terms of the business language. Concept of these two terms is depending on the class of account. There are rules for understanding these terms. These rules are the Golden Rules of Debit and Credit.

Golden Rules of Debit & Credit		
Class of Account	**Debit**	**Credit**
Personal Accounts	Receiver	Giver
Real Accounts	What comes in	What goes out
Nominal Accounts	Expenses/Losses	Incomes/Gains