# INTRODUCTION TO ACCOUNTING

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# MEANING OF ACCOUNTING

- Accounting can be defined as a process of reporting, recording, interpreting and summarising economic data. The introduction of accounting helps the decision-makers of a company to make effective choices, by providing information on the financial status of the business.
- The American Institute of Certified Public Accountants (AICPA) had defined accounting as the "art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof".
- Today, accounting is used by everyone and a good understanding of it is beneficial to all. Accountancy act as a language of finance. To understand accounting efficiently, it is important to understand the aspects of accounting.

# DEFINITIONS OF ACCOUNTING

- *According to the Committee of Terminology of American Institute of Certified Public Account:*" Accounting is the art of recording, classifying summarising in a significant manner and in terms of money, transaction, and events which are, in part at least of a financial character and interpreting the results thereof."
- *According to Bierman and Drebin:*" Accounting may be defined as identifying, measuring, recording and communicating of financial information."

# OBJECTIVES OF ACCOUNTING

The main objectives of accounting are:

**1.To maintain a systematic record of business transactions**

- Accounting is used to maintain a systematic record of all the financial transactions in a book of accounts.
- For this, all the transactions are recorded in chronological order in Journal and then posted to principle book i.e. Ledger.

**2.To ascertain profit and loss**

- Every businessman is keen to know the net results of business operations periodically.
- To check whether the business has earned profits or incurred losses, we prepare a "Profit & Loss Account".

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**3.To determine the financial position**

- Another important objective is to determine the financial position of the business to check the value of assets and liabilities.
- For this purpose, we prepare a "Balance Sheet".

**4.To provide information to various users**

- Providing information to the various interested parties or stakeholders is one of the most important objectives of accounting.
- It helps them in making good financial decisions.

# CHARACTERISTICS OF ACCOUNTING

The following attributes or characteristics can be drawn from the definition of Accounting:

**(1) Identifying financial transactions and events**

Accounting records only those transactions and events which are of financial nature, So, first of all, such transactions and events are identified.

**(2) Measuring the transactions**

Accounting measures the transactions and events in terms of money which are considered as a common unit.

**(3) Recording of transactions**

Accounting involves recording the financial transactions inappropriate book of accounts such as Journal or Subsidiary Books.

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**(4) Classifying the transactions**

Transactions recorded in the books of original entry – Journal or Subsidiary books are classified and grouped according to nature and posted in separate accounts known as 'Ledger Accounts'.

**(5) Summarizing the transactions**

It involves presenting the classified data in a manner and in the form of statements, which are understandable by the users.It includes Trial balance, Trading Account, Profit and Loss Account and Balance Sheet.

**(6) Analyzing and interpreting financial data**

Results of the business are analyzed and interpreted so that users of financial statements can make a meaningful and sound judgment.

# DIFFERENT BRANCHES OF ACCOUNTING

The following are the main branches of accounting:

**(a) Financial accounting:**

Financial Accounting is that branch of accounting which involves identifying, measuring, recording, classifying, summarising the business transactions, i.e. it involves the steps from Identifying, Recording of transactions to Summarisation, and communicating the financial data.

**(b) Cost accounting:**

Cost Accounting is that branch of accounting which is concerned with the process of ascertaining and controlling the cost of products or services.

**(c) Management accounting**

Management accounting refers to that branch of accounting which is concerned with presenting the accounting information in such a way that helps the management in planning and controlling the operations of a business and in decision making.

# DIFFERENCE BETWEEN BOOKKEEPING AND ACCOUNTING

| Parameters | Bookkeeping | Accounting |
|---|---|---|
| scope | Bookkeeping involves identifying, measuring, recording & classifying financial transactions in the ledger accounts. | In addition to bookkeeping, Accounting also includes summarizing, interpreting and communicating the financial data to the users of financial statements. |
| Objective | The main aim is to maintain systematic records of financial transactions. | The main aim is to ascertain the profitability and financial position of the business. |
| | | |

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| | | |
|---|---|---|
| Nature of job | This job is in routine and repetitive in nature. | This job is analytical in nature. |
| Level of skills | Bookkeeping does not require special skills. It is performed by Junior Staff. | It requires specialized skill to analyze, so it is performed by senior staff. |

# WHAT ARE THE ADVANTAGES OF ACCOUNTING

- The following are the main advantages of accounting:

**1. Provide information about financial performance**

Accounting provides factual information about financial performance during a given period of time

Like, profit earned or loss incurred over a period and financial position at a particular point of time.

**2. Provide assistance to management**

Accounting helps management in business planning, decision making and in exercising control.

For this, it provides financial information in the form of reports.

**3. Facilitates comparative study**

By keeping systematic records and preparation of reports at regular intervals, accounting helps in making a comparison.

**4. Helps in settlement of tax liability**

Systematic accounting records help in settlement of various tax liabilities. Such as – Income Tax, GST, etc.

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**5.Helpful in raising loan**

Banks and Financial Institutions grant a loan to the firm on the basis of appraisal of the financial statement of the firm.

**6. Helpful in decision making**

Accounting provides useful information to the management for taking decisions.

# LIMITATIONS OF ACCOUNTING

Following are the limitations of accounting:

1. **Accounting is not precise**: Accounting is not completely free from personal bias or judgment.
2. **Accounting is done on historic values of assets:** Accounting records assets at their historical cost less depreciation. It does not reflect their current market value.
3. **Ignore the effect of price level changes:** Accounting statements are prepared at historical cost. So changes in the value of money are ignored.
4. **Ignore the qualitative information:** Accounting records only monetary transactions. It ignores the qualitative aspects.
5. **Affected by window dressing:** Window dressing means manipulation in accounting to present a more favourable position of the business than the actual position.

# USERS OF ACCOUNTING INFORMATION

A**) Internal Users**

**Owners**: Owners contribute capital in the business and thus they are exposed to maximum risk. So, they are always interested in the safety of their capital.

**Management**: Accounting information is used by management for taking various decisions.

**Employees**: Employees are interested in the financial statements to assess the ability of the business to pay higher wages and bonuses.

**(B) External Users**

**Banks and financial institutions:** Banks and Financial Institutions provide loans to business. So, they are interested in financial information to ensure the safety and recovery of the loan.

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Investors: Investors are interested to know the earning capacity of business and safety of the investment.

Creditors: Creditors provide the goods on credit. So they need accounting information to ascertain the financial soundness of the firm.

Government: The government needs accounting information to assess the tax liability of the business entity.

Researchers: Researchers use accounting information in their research work.

Consumers: They require accounting information for establishing good accounting control, which will reduce the cost of production.

# SYSTEM OF ACCOUNTING

**1. System of accounting**

**There are following two systems** of recording transactions in the books of accounts:

**Double Entry System**

**Single Entry System**

**1.Double-entry system**

The double entry system is based on the Dual Aspect Principle.

Every transaction has two aspects, ‘a Debit’ and ‘a credit’ of an equal amount.

This system of accounting recognizes and records both aspects of the transaction.

**2. Single entry system**

Under this system, both aspects are not recorded for all the transactions. Either only one aspect is recorded or both the aspects are not recorded for all the transactions.

# ACCOUNTING CYCLE

# DOUBLE ENTRY SYSTEM

Double entry, a fundamental concept underlying present-day bookkeeping and accounting, states that every financial transaction has equal and opposite effects in at least two different accounts

Assets= Liabilities+ Equity

In the double-entry system, transactions are recorded in terms of debits and credits. Since a debit in one account offsets a credit in another, the sum of all debits must equal the sum of all credits. The double-entry system of bookkeeping standardizes the accounting process and improves the accuracy of prepared financial statements, allowing for improved detection of errors.

# TYPES OF ACCOUNTS

There are three types of Accounts

- Real Account-A real account is a general ledger account that reflects all the transactions relating to assets and liabilities
- Personal Account-A personal account is a general ledger account relating to persons. It can be natural persons like individuals or artificial persons like companies, firms, associations, etc.
- **Nominal Account** nominal account is a general ledger account relating to all business income, expenses, profit and losses. It accounts for all transactions pertaining to one fiscal year.

# RULES OF ACCOUNTING

| Type of Account | Golden Rule |
| --- | --- |
| 1.Personal Account | Debit the receiver,<br>Credit the giver |
| 2.Real Account | Debit what comes in,<br>Credit what goes out |
| 3.Nominal Account | Debit all expenses and losses,<br>Credit all incomes and gains |

# TERMINOLOGY IN ACCOUNTING

- **Accounting Equation** – The Accounting Equation is Assets = Liabilities + Equity. With accurate financial records, the equation balances.
- **Accounting** – Accounting keeps track of the financial records of a business. In addition to recording financial transactions, it involves reporting, analyzing and summarizing information.
- **Asset** – Items of value that are owned.
- **Liability** – Liabilities are the obligations of an entity, usual
- **Profit** – Profit is revenue minus expenses. Reductions for taxes, interest, and depreciation are included financial in nature.

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- **Balance Sheet** – Provides a snapshot of a business' assets, liabilities, and equity on a given date.
- **Credit** – Entered in the right column of accounts. Liability, equity and revenue increase on the credit side.
- **Debit** – Entered in the left column of accounts. Assets and expenses increase on the debit side.
- **journal** – The first place financial transactions are entered. They are entered chronologically.
- **Financial Statement** – Financial Statements detail the financial activities of a business.

# THANKYOU