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LECTER NOTES

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INTRODUCTION

A business basically undertakes economic activities involving regular purchase and sale of goods and services for the purpose of earning profit. Traditionally the accountant was expected to compile and present the financial information to the owners to the entity at the end of the accounting period. Accounting is now considered as a service activity and important tools of management for decision making. This unit attempts to analyse the role of accounting and the accountant keeping this perspective in view.

DEFINITION AND FUNCTIONS OF ACCOUNTING

Meaning of Accounting Every person be he a salaried employee or a businessman, is involved in an economic activity. As the economic activity occurs, the person enters into various transactions and events. To derive the results of the economic activity he has to record such transactions and events and then determine its results. The process of recording transactions and events of a business in a useful manner so as to determine and analyse the financial performance and financial position is called accounting.

Definition of Accounting A committee of the American Institute of Certified Public Accountants has defined Accounting as follows:

“Accounting is 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 a financial character and interpreting the results thereof.” [9] According to R.N.

Anthony “Nearly every business enterprise has accounting system. It is a means of collecting summarizing analyzing and reporting in monetary terms information about business”. According to Smith and A S burn “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 interpretation of these transactions and events and communicating the results to persons who must take decisions or from judgments.”

Functions of Accounting Above definition of accounting explains the main functions of Accounting. These can be summarized as under:

1. **Recording:** Accounting involves recording of financial transactions in a systematic manner, such recording is done through journal or subsidiary books. In it accounting transactions are recorded through supporting vouchers such as purchase bills, payment vouchers, Deposit slips etc.
2. **Classification:** second step in accounting is to put information regarding one type of transactions at one place. This is done by way of posting in the ledger. In it one finds different accounts relating to expenses classified as salary, Advertisement. Thus all expenses which are recorded in journal are classified under different account heads in ledger.
3. **Summarising:** All the transactions recorded in journal and posted in the ledger are summarized in such a manner that these are useful for the user of accounts. This is done by preparing Trial Balance and final accounts.

4. In terms of Money: Accounting records transactions in terms of money. Money represents the currency of the country where accounts are maintained money gives a common basis if measurement.
5. Transactions and Events: In business, both transactions and events are recorded. If business is involved with outsiders, it is a transaction such as buying and selling of goods, taking a loan, paying salary, rent etc. There are a number of happenings, that do not concern outsiders, these are called “Events” such as loss due to fire, depreciation of assets etc. Both transactions and events are recorded in accounts.
6. Financial Character: The transaction or event to be recorded should have monetary value. If it cannot be measured in terms of money it will not be recorded in accounts. Thus, through the salary given to employee will be recorded, but how honestly and efficiently employee has worked will not be recorded.
7. Communication and Interpretation of results: Accounting also involves communication and interpretation of the results of the business. Communication implies reporting to the end users. The accounting information in desired form so as to enable them to understand the historical information e.g. preparation of profit and loss Account to understand the results, Balance Sheet to understand the financial position. Interpretation involves meaningful comparison which simplifies understanding of financial reports.

BOOK KEEPING AND ACCOUNTING

Book keeping is defined as a process of recording business events in a systematic manner. It involves recording of transactions. It refers to the record making stage of accounting. This stage of accounting is mechanical and repetitive. However, maintenance of proper records help a business organization to know its health and performance. Accounting on the other hand, includes not only the maintenance of accounting records but also preparation of summary statements, their analysis and interpretation. Thus book-keeping is only a small and simple part it accounting. But the term accounting is used in a broader sense Covering all the accounting activities including preparation of final statements and their reporting to interested parties. Thus book-keeping is an aspect of the accounting process. It is a sub-field of accounting.

DIFFERECCE BETWEEN FINANCIAL ACCOUNTING AND MANAGEMENT ACCOUNTING

1. Objective: Financial Accounting aims at recording business transaction systematically to ascertain profit or loss and financial position at the end of the financial year. The aims of management Accounting at preparing various statements for material planning, control and decision making.
2. . Time period: In Financial Accounting the accounts are prepared for a particular period. Whereas in management accounting the reports are prepared from time to time to update with the changing business environment.
3. Audit: In Financial Accounting under Company law Financial accounts are subject to compulsory Audit. Whereas in management Accounting audit is optional. However, management is there is to ensure efficiency and productivity of the employees and system.
4. Principles : Financial Accounting is prepared as per Generally Accepted Accounting principles (GAP). In Management Accounting No set of standing principle are followed. However, accounting standards are followed to take managerial decisions more effective.

5. Nature: Financial Accounting is concerned with historical data. It records only those transactions which have already taken place. Thus the accounts prepared here are like postmortem report. The management Accounting is concerned with both historical data and estimated data.
6. Publication: In Financial Accounting, Financial Statements are published annually for external parties interested in the accounting information. In management Accounting the statements and reports are not published. They are meant for internal use of the management.
7. Quickness: In Financial Accounting, reporting is slow and time consuming one has to wait till the end of the accounting year. In management accounting, reporting is very quick as it is meant for decision making.
8. Nature of Information: Financial Accounting is concerned with quantitative information expressed in terms of money. Management Accounting is concerned with both qualitative and quantitative information.
9. Reporting: In Financial Accounting, Financial reports are prepared not only for the organization but for others interested in the accounting information of the business. In management Accounting the reports prepared for internal use only.
10. Legal Comparison : In Financial Accounting, preparation of financial accounts is compulsory to comply statutory requirements. In Management Accounting. It is not compulsory, it helps in the administration and smooth functioning.

IMPORTANCE OF ACCOUNTING

1. Keeps systematic records: All the financial events which occur in a business organization are recorded systematically in the books and therefore, there is no need to rely on memory.
2. Prepares financial statements: With the help of information contained in the accounting records, the financial statements like the Profit and Loss Account and the Balance Sheet can be easily prepared. These financial statements help the users to know the net results of the business operations.
3. Helps decision making: Accounting provides accounting informations to various interested parties such as owners, lenders, creditors etc. which help them in their decision making.
4. Helps in planning and control: Accounting information helps management in planning operations and controlling all business activities.
5. Facilities a comparative study: Accounting information helps to compare the present performance of the enterprise with that of the past and with that of the similar organization. It helps the interested parties to know the performance of the enterprise.
- Provides control over assets: An organization has many assets like cash in hand, cash at bank, the stock of goods, furniture etc. Accounting keeps systematic record of all these assets so that the management can control these assets and use them in the best possible way.
6. Acts as reliable evidence : Systematic accounting record of business transactions is generally treated by courts and tribunals as good evidence in case of disputes.
7. Helps in complying tax matters: The Government levies various taxes such as income tax, sales tax, custom duty and excise duty. Accounting records help the enterprise in filling of tax returns and settlement of tax and other statutory matters.
8. Helps in determining the value of business: The need for ascertaining the value of the business organization arises in the event of its sale or take over by another business house. The accounting records help to determine the purchase or sale price of the business.

9. Helps in detecting errors and frauds : Accounting records are balanced periodically which helps in early detection of errors and frauds.

MEANING OF ACCOUNTING PRINCIPLES

Accounting statements are to be prepared in some standard language and common rules. These rules are called 'Generally Accepted Accounting Principles' (GAAP) . In other words, generally accepted accounting principles, concepts and conventions are the fundamental rules of Accounting which are universally used and accepted by the Accountants all over the world as general guidelines for preparing. Accounting Statements. In other words, the rules and conventions of accounting are commonly referred to as 'Principles'. The word principle is here used to mean 'a general law or a rule adopted or professed as a guide to action; or a settled basis of conduct or practice.' These principles have developed in accordance with usage, experience, historical precedents, professional bodies, government regulations with the passage of time and with changing needs of business.

ACCOUNTING CONCEPTS

Principles which are accepted without any evidence are concepts. They are also known as Axioms. Postulates or Assumptions. Conventions are based on general acceptance. It, is a practice followed by accountants since very long period. Hence let us take them one by one and learn the accounting implications of each as under:

(1) Separate Entity Concept: According to this concept business is treated to have a distinct accounting entity from its owners, who controls the resources of the concern and is accountable therefore. All the accounts are kept for a business entity as distinguished from the persons associated with it. They will record transactions between the owner and the firm; for instance if proprietor withdraws some Cash or Goods, such is treated as drawings but not as business expense. Thus, capital of the owner is reduced by the amount of drawings. This concept is based on the sense that proprietors resources are handed over to the management and the management is expected to use these resources to the best advantage of the firm, and to account for their sources placed at its disposal. The failure to recognize the business as a separate accounting entity, would make it extremely difficult to evaluate the performance of the business alone ; since the private transactions would get mixed and introduce bias in the results.

(2) Money Measurement Concept : In accounting a record is made of only those transactions and events that can be expressed in terms of Money. Those events which can not be expressed in money terms do not find place in the accounts; for instance, salary paid to an employee is recorded in the books but his competence which cannot be expressed in monetary terms is not recorded in books. The applications of this concept makes accounting information and data relevant and easy to understand, homogeneous and comparable. The importance of money measurement concept is that even a layman is able to understand and appreciate the things stated in money. Despite merits stated above, the concepts suffer from the following limitations:

- (i) The value of money is not constant. It changes because of inflation or deflation in the country.
- (ii) All the assets of business cannot be measured in money terms. It is very difficult to calculate the value of goodwill or measure the competency or morale of employees.

(3) Going Concern Concept: This concept assumes that the business will continue for a fairly long period to come. On the basis of this concept acquisitions of assets is recorded on historical cost basis and the increase or decrease in their value is not considered. The going concern concept is based on the following :

(i) the life of business is indefinite

(ii) depreciation of assets is made on the basis of the expected life without caring for their current value

(iii) when new innovations and inventions take place the effect is measured in financial terms and assets are depreciated to allow for such changes.

(4) Dual Aspect Concept: The Dual Aspect concept is based on double entry book-keeping, which means every transaction entered into by a firm or an institution will have two aspects. One entry consists of debit to one or more accounts and another entry consists of credit to some other one or more accounts. However, the total amount debited is always equal to the total amount credited. As such this system of recording transactions on this principle is called, 'Double entry system'. It is because of this principle that both the sides of Balance Sheet are always equal.