1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 01 (Class XI, Semester - 1)
Module Name/Title	Introduction to Accounting – Part 1
Module Id	keac_10101
Pre-requisites	Basic knowledge of process of accounting
Objectives	After going through this lesson, the learners will be able to understand the following: • Need for accounting for business transactions • Objectives of accounting • Accounting as a source of information • Limitations of accounting
Keywords	Accounting, business transactions, economic events, accounting information

2. Development Team

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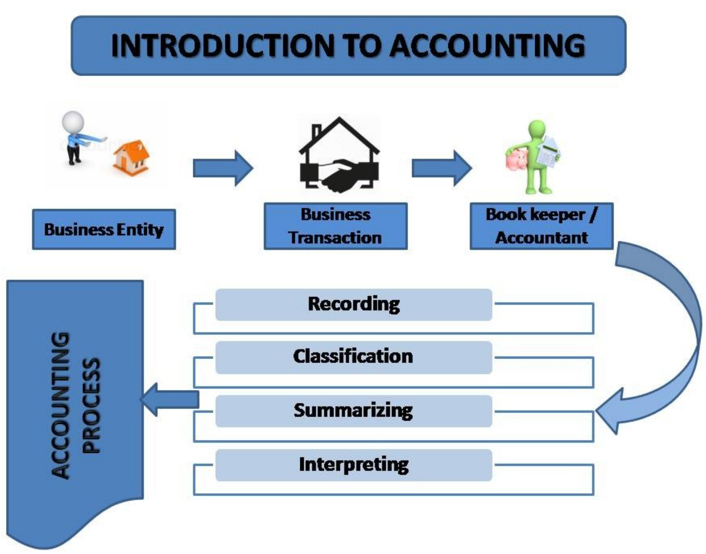
Meaning of Accounting

On the mention of word 'Accounting' , either formally or informally, people immediately start thinking of figures, numbers, adding, subtracting and big lines books dense with complex rules, calculations and uninteresting number crunching. However, with the result of service oriented and technology based economy prevalent in the twenty first century, accounting as an area of study has evolved itself beyond a mere arithmetical application of accounting rules, handling book of accounts and book keeping procedures.

Accounting versus Book keeping

Book keeping and accounting are assumed to be the same, but the two are different:

1. Accounting is a wider concept and includes book keeping
2. Bookkeeping is concerned with recording and classification of financial data.
3. Accounting in addition involves summarizing, analyzing, interpreting and communication of information.



The important aspects of accounting, as reflected above, relates to the following characteristic features of the term ‘accounting’:

Economic Events: are the occurrences that can be measured, expressed in monetary terms and depicts change in the financial position of a business concern. Accounting identifies only that bunch of transactions which relates to economic events, which can be both external and internal economic events. Any business transaction between the outsider and the business organization is an external economic event. For example:

a. Online selling of mobile phone to its customer via firm’s e-store.
b. Annual maintenance (AMC) of Air conditioners by a firm to its consumers.
c. Maintenance and upkeep of Educational cum-Residential complex for cleanliness, hygiene and healthy environment by a service provider on contract.

Internal economic event, on the other hand is entirely between the internal wings of the business entity. For example:

a. Transfer of goods from storage to the assembly plant. The asset account is affected and the change is measurable.
b. Payment of wages and salaries to the employees of a business firm.

It is however pinpointed here that the qualitative measures, even though deemed essential for the effective and smooth functioning of the business are not recognized by accounting since they cannot be quantified in monetary terms. For example:

a. Ethical practices and human values.
b. Hiring and removal of personnel.
c. Signing of contract.
d. Appointment of new managerial director.
e. Change in managerial policies.

Preparing Book of Accounts:

a. The first and foremost step is the *identification and measurement* of business events. i.e., to identify events which are to be recorded and selecting those events that is of financial character and is related to the business entity. If the event fails to be expressed or measured in monetary terms, it is not included in the accounting records of the business organisation.

b. Once the economic events are identified and measured in monetary terms, the following sequence is involved:

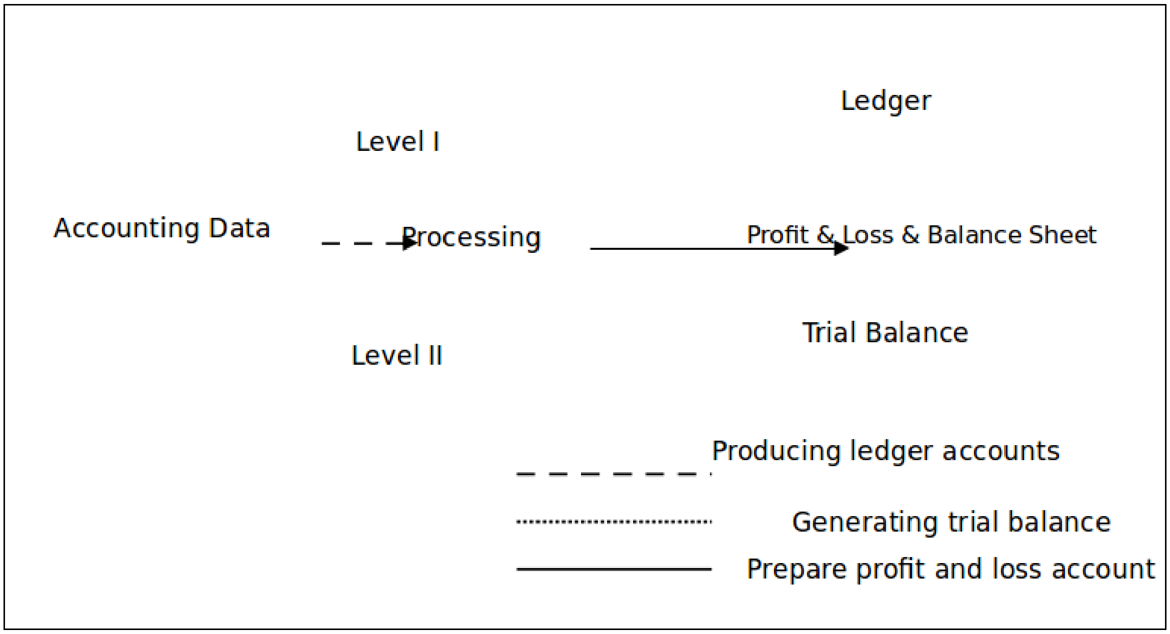
i. *Recording:* Transactions are recorded in the subsidiary books as and when they take plae i.e., in the chronological order. This process is known as ***journalizing.***

ii. *Classifying:* All entries in the journal or subsidiary books are posted to the appropriate ledger account in order to ascertain the total effect of all transactions in a particular account according to their nature i.e., Assets, Liabilities, Revenues/Gains and Expenses /Losses. This process is called **posting**. Then the difference between the total of Debit amount column and the total of Credit amount column of each ledger account is ascertained. This process is called **balancing**.

iii. *Summarizing:* The systematic presentation of accounting data by ascertaining the balances of various ledger accounts is called *summarisation*. As a result, preparation of ledger accounts becomes a prerequisite for preparing the trial balance. **Trial Balance** is prepared to verify that the debit account balances are sum equal to the credit account balances. **Statement of Profit and Loss** is prepared to find out the profit earned or loss incurred during the year. **Balance Sheet** is prepared to ascertain the financial position of the business on a particular date as at the end of the accounting period.

Communication of Accounting Information: Accounting information is economic information, as it relates to financial or economic activities of a business organization. Once the financial statements of a business organization are prepared, it is disseminated to the users of accounting information (refer figure 1).

Figure 1: Processing of accounting data for generation of accounting reports



In the given figure 1, the transaction data is processed to produce ledger accounts. The balances extracted from the ledger accounts act as input data to prepare a summary of balances called, trial balance. The amounts given in trial balance constitute data to produce profit and loss account and balance sheet. It may be noted that processing is required at each level to cause data transformation so that the decision useful information is generated in accordance with the information requirements of a report. An important element in the communication process is the accountant's ability and efficiency in presenting the reliable and relevant information to the users of information. The information is regularly communicated through accounting reports. This defines the role of accounting as a **language of business** which facilitates dissemination and communication of accounting information to its beneficiaries.

There are different users of accounting information using for many diverse purposes, thus, the purpose of financial statements is to cater for the needs of the users that could lead them to make better financial decisions. These users may be inside or outside the organization.

1. *Internal users:* These are people who are dependent on the daily reports for the internal functioning of the business organization. For example, top management, CEO, Financial advisor, employees and supervisors and other decision-makers internal to the business.

2. *External:* These are the people who need periodic reports for decision-making. This category includes shareholders, lenders, suppliers, customers and other people interested in the affairs of the company.

Objectives of Accounting

The main objective of accounting is to generate decision worthy information for the users of accounting information. This objective is achieved effectively through the following:

1. **Systematic Record:** Accounting serves the objective of permanent record keeping by promptly recording all business transactions in the book of accounts.
2. **Measurement:** Accounting helps to measure the past and current operational performance and depicts the financial position of a business enterprise.
3. **Forecasting:** Accounting data is the basis for making forecasting about business future plans.
4. **Evaluation:** Evaluation of an enterprises' performance and financial health is done by adopting accounting procedures. Accounting facilitates in assessing achieved performance with the target set for a given span of time.
5. **Facilitate rational decision making:** The financial statements provide information which help in making rational decisions by the users of accounting information.
6. **Stewardship:** Accounting facilitates the stewardship function and act as a watch dog by safeguarding the interest of its owners and managing the affairs of the business enterprise on its behalf.
7. **Government Regulations and taxation:** Entities such as companies, societies, public trusts etc., are compulsory required maintaining accounts as per the law governing their operations such as the Companies Act, Sales Tax Act, Income Tax Act etc. Accounting data serves the various requirements of government regulations and helps in assessing the correct tax liability.

Role of Accounting

For centuries, the role of accounting has been changing with the changes in economic development and increasing societal demands. It describes and analyses a mass of data of an enterprise through measurement, classification and summarization, and reduces those date into reports and statements, which show the financial condition and results of operations of that enterprise. Hence, it is regarded as a language of business. It also performs the service activity by providing quantitative financial information that helps the users in various ways. Accounting as an information system collects and communicates economic information about an enterprise to a wide variety of interested parties.

Different Roles of Accounting

1) **As a language –** It is perceived as the language of business which is used to communicate information on enterprises;

2) **As a historical record**- It is viewed as chronological record of financial transactions of an organization at actual amounts involved;

3) **As current economic reality**- It is viewed as the means of determining the true income of an entity namely the change of wealth over time;

4) **As an information system –** It is viewed as a process that links an information source (the accountant) to a set of receivers (internal and external users) by means of a channel of communication;

5) **As a commodity**- As an information system the specialized and need based accounting information capable of facilitating the needs of users is viewed as a commodity.

Limitations of Accounting

Accounting procedure serves the lifeline for any business enterprise and is predominantly regarded as a language of a business. Despite this, it suffers from many limitations which are discussed hereunder:

1. Accounting ignores qualitative elements since it is confined to the monetary matters only. The qualitative elements such as Ethics, quality of labour force, public relations etc., are ignored which ascertain the financial performance of business enterprise.
2. Accounting is not free from bias. Under a given situation an accountant has to make a choice from available alternatives such as choosing a method of depreciation, method of inventory valuation etc. Since the subjectivity is inherent, one cannot safely conclude that it is free from biases.
3. Accounting ignores price level changes. Financial statements are prepared on the basis of historical costs. For example Fixed assets are shown in the balance sheet at historical costs less depreciation and not on replacement value which is often far higher than the value stated in the

balance sheet. Hence does not yield comparable results unless price level changes are taken into account.

4. There is always a danger of window dressing in the financial statements failing it to disclose the true and fair view of the results of operations and financial position of a business concern.

Summary with reference to learning objectives

1. **Meaning of accounting:** Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transaction and events which are in part or at least, of a financial character and interpreting the results thereof.

2. **Objectives of accounting:**
   - **i.** Systematic record of business transactions
   - **ii.** Measurement of profit and loss
   - **iii.** Forecasting future operations of business concern
   - **iv.** Stewardship function
   - **v.** Fulfilling government regulations
   - **vi.** Dissemination of accounting information

3. **Role of Accounting**
   - i. Language of business
   - ii. Historical cost
   - iii. Current economic reality
   - iv. Information system

4. **Limitations of Accounting**
   - i. Ignores qualitative elements
   - ii. Subjective measurement
   - iii. Historical Data
   - iv. Danger of window dressing in the financial statements