

SUBJECT—ACCOUNTING (BASICS)

LECTURE 1

BY::

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Introduction

Meaning of Accounting

In 1970, the Accounting Principles Board of AICPA also emphasised that the function of accounting is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions.

Accounting can be defined as the process of **identifying, measuring, recording and communicating the required information relating to the economic events of an organisation to the interested users.**

In order to appreciate the exact nature of accounting, we must understand the following relevant aspects of the definition:

- **Economic Events**
- **Identification, Measurement, Recording and Communication**
- **Organisation**
- **Interested Users of Information**

Economic Events

Business organisations involves economic events. An economic event is known

as a happening of consequence to a business organisation which consists of transactions and which are measurable in monetary terms. For example, purchase of machinery, installing and keeping it ready for manufacturing is an event which comprises number of financial transactions such as buying a machine, transportation of machine, site preparation for installation of a machine, expenditure incurred on its installation and trial runs. Thus, accounting identifies bunch of transactions relating to an economic event. If an event involves transactions between an outsider and an organisation, these are known as *external events*.

An *internal event* is an economic event that occurs entirely between the internal wings of an enterprise, e.g., supply of raw material or components by the stores department to the manufacturing department, payment of wages to the employees, etc.

Identification, Measurement, Recording and Communication

Identification : It means determining what transactions to record, i.e., to identify

events which are to be recorded. It involves observing activities and selecting

those events that are of considered financial character and relate to the organisation

Measurement : It means quantification (including estimates) of business transactions into financial terms by using monetary unit.

Recording : Once the economic events are identified and measured in financial terms, these are recorded in books of account in monetary terms and in a chronological order. Recording is done in a manner that the necessary financial information is summarised as per well-established practice and is made available as and when required.

Communication : The economic events are identified, measured and recorded in order that the pertinent information is generated and communicated in a certain form to management and other internal and external users. The information is regularly communicated through accounting reports. These reports provide information that are useful to a variety of users who have an interest in assessing the financial performance and the position of an enterprise, planning and controlling business activities and making necessary decisions from time to time.

Organisation

Organisation refers to a business enterprise, whether for profit or not-for profit motive. Depending upon the size of activities and level of business operation, it can be a sole-proprietory concern, partnership firm, cooperative society, company, local authority, municipal corporation or any other association of persons.

Interested Users of Information

Accounting is a means by which necessary financial information about business enterprise is communicated and is also called the language of business. Many users need financial information in order to make important

decisions. These users can be divided into two broad categories: *internal users and external users.*

Branches of Accounting

The economic development and technological improvements have resulted in an increase in the scale of operations and the advent of the company form of business organisation. This has made the management function more and more complex and increased the importance of accounting information. This gave rise to special branches of accounting.

Financial accounting : The purpose of this branch of accounting is to keep a record of all financial transactions so that:

(a) the profit earned or loss sustained by the business during an accounting period

can be worked out,

(b) the financial position of the business as at the end of the accounting period can be ascertained

Cost Accounting : The purpose of cost accounting is to analyse the expenditure so

as to ascertain the cost of various products manufactured by the firm and fix the

prices. It also helps in controlling the costs and providing necessary costing information to management for decision-making.

Management Accounting : The purpose of management accounting is to assist the

management in taking rational policy decisions and to evaluate the impact of its

decisions and actions.

Objectives of Accounting

As an information system, the basic objective of accounting is to provide useful

information to the interested group of users, both external and internal. The necessary information, particularly in case of external users, is provided in the form of financial statements.

Maintenance of Records of Business Transactions

Accounting is used for the maintenance of a systematic record of all financial transactions in book of accounts. Even the most brilliant executive or manager cannot accurately remember the numerous amount of varied transactions such as purchases, sales, receipts, payments, etc.

Calculation of Profit and Loss

The owners of business are keen to have an idea about the net results of their business operations periodically, i.e. whether the business has earned profits or incurred losses. Thus, another objective of accounting is to ascertain the profit earned or loss sustained by a business during an accounting period which can be easily workout with help of record of incomes and expenses relating to the business by preparing a profit or loss account for the period.

Depiction of Financial Position

Accounting also aims at ascertaining the financial position of the business concern in the form of its assets and liabilities at the end of every accounting period.