Introduction to Accounting

Accounting can be defined as the subject by studying which the record of all monetary transactions of an individual, non-trading concern, business undertaking and others fora particular period can be satisfactorily maintained and the results of all transactions during a given period can be analysed and measured at the end of the given period. Accounting is now more an information system than a mechanism for recording transactions and ascertaining the result thereof.

Book-keeping is an activity concerned with the recording of financial data related to business operations in a significant and orderly manner. Book-keeping is the record-making phase of accounting. Accounting is based on a careful and efficient book-keeping system.

Accounting information is a statement which provides quantitative information about the effect of transactions and other events on an accounting entity. Accounting information is used for predicting, comparing and evaluating the earning power and financial position of a business enterprise.

Accounting information is required by two sets of people—internal and external. Internal users are associated with management of the concern for which information is sought to be gathered and surveyed. For example, the directors or the partners, managers and officers. The external users consist of several explicit groups:

(1) Investors

(2) Lenders

(3) Suppliers

(4) Customers

(5) Government Agencies

(6) The Public

(7) Employees.

Accounting information must possess some qualitative characteristics. These are the attributes that make the information provided in financial statements useful to users. The four main qualitative characteristics are:

(i) Reliability

(ii) Relevance

(iii) Understandability

(iv) Comparability

Cash basis of accounting is a method of accounting in which transactions are recorded in the books of account when cash is actually received or paid and not when the transactions take place. This method recognises revenues and gains when cash is actually received.

Accrual basis of accounting is an accounting system which records revenues and expenses as they are earned or incurred, not as cash received or paid respectively.

Financial accounting deals with the recording of all financial transactions and preparation of financial statements for the use by management, outsiders like shareholders, banks or other financial institutions, creditors etc.

Cost accounting is concerned with the ascertainment of cost of various products and services and is used as a tool for controlling expenditure.

The branch of **management accounting** provides necessary information to the management for taking decisions at different levels. The main object of this branch of accounting is to provide all the necessary information to the managerial personnel so that they can make informed judgement and take correct decision in respect of various problems of the business and can control the day to day activities of the business.

Transactions which cause changes in the financial condition of a business unit capable of being measured in terms of money are called **business transactions.**

Event is an occurrence, happening, change or incident, which may or may not bring any change in the financial position of a business unit.

An **account** is a formal record, in the ledger, of all transactions relating to changes in a particular item.

Capital is the amount of money invested by the owner in his business.

Drawings are assets (money or goods) withdrawn by the owner(s) of a business unit (other than a company).

Liability is a legal obligation expressed in terms of money, which arises from transactions or other events that have already occurred.

Assets are those resources that the business owns. They refer to some property or legal right owned by a business unit, which can be measured in terms of money.

Capital expenditure is the money spent on buying fixed assets or adding to their value. These assets are expected to provide benefits to the business for more than one accounting period.

Revenue expenditure is the money spent on running the business on a day-to-day basis. Salaries paid to the employees and payments for miscellaneous expenses are the examples of revenue expenditure.

Deferred revenue expenditure is a revenue expenditure whose usefulness extends over more than one accounting period. It can be defined as that class of revenue expenditure which is incurred during a particular accounting period, but is applicable either wholly or in part to future accounting periods.

Expense represents the cost of the goods and services used up or consumed in the process of earning revenue during a particular accounting period. An expense may be represented by a cash payment, e.g., wages, or by incurring a liability, e.g., outstanding rent.

Balance sheet may be considered as "a statement drawn up at the end of each trading or financial period setting forth the various assets and liabilities of a concern as at that date." It is designed to show the state of affairs of the business as on the closing date of an accounting period.

Equity refers to the 'Owner's Claim' from the entity. It implies capital invested plus any profit earned minus any loss sustained.

Revenue means gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an entity. It is earned by way of performing regular operations such as, sale of goods, and rendering of services.

Gains refer to those profits that are not generated through regular business activities. They result in increase in owner's claim. They may be categorized into two types—Operating and Non-operating Gain. Ex. Gains arising from sale of short-term marketable securities—Operating Gain. Gains arising from sale of fixed/ non-current assets—Non-operating Gain.

Loss refers to that part of cost which has been incurred, but from which no benefit accrues to the entity. They adversely affect the operating results (i.e. profit/ loss) of the entity by decreasing the value of resources/assets. It may be of two types:

Normal Loss: The loss that cannot be avoided even after taking all the possible precautions is referred to as 'Normal Loss'. In other words, such a loss is unavoidable in nature such as evaporation of petrol, spillage of liquids while in transit, etc.

Abnormal Loss: The loss which could have been avoided by taking adequate precautions is referred to as 'Abnormal Loss'. In other words, such a loss is avoidable in nature such as loss by fire, pilferage of goods/cash, etc.

Accounting Equation reflects equality between the resources and utilisation of finance in an organisation.

Statement: Accounting Equation states the relationship among Assets, Liabilities and Equity. It is expressed as: Assets = Liabilities + Equity.