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Lecture - 1

What is Accounting

Accounting is an art of recording, classifying and summarizing the monetary transactions in an efficient manner and interpreting the results.

Functions of Accounting

- Identifying:
  Identifying the business transactions from various sources is the first step of accounting.it involves observing all business activities and identifying those which are considered as financial transactions.

- Recording:
  Only those transactions are recorded in books of accounts which can be measured in terms of money. It involves recording them in a journal and keeping a systematic record of all of them.

- Classifying:
  After recording the transactions they are classified. Classification refers to the grouping of all the transactions of same nature at one place.

- Summarising:
  It is the process of putting the balances of all accounts at one place i.e. Trial balance.

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Advantages of Accounting

- Accounting provides permanent records for all business transactions and provides reliable information to various parties.
- Accounting provides the Profit and loss of a business for a given period of time.
- Accounting provides the facility of comparative study of the various aspects of business like profit sales, purchase,etc. with that of previous years and helps businessmen to make decisions.
- Accounting forms a basis in the process of performance evaluation to improve the performance of employees, divisions,activities, etc.
- Accounting records act as an approved evidence in legal matters.

Limitations of Accounting

- One of the major limitations of accounting is that it considers only monetary transactions. Non monetary aspects like quality, honesty, skills are ignored in accounting.

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- It considers only historical transactions and the figures given in the financial statement do not consider price level changes.

- It is influenced by personal judgements and not free from personal bias which affects its credibility.

- It is affected by window dressing which means manipulation of accounts so that financial statements describe a more favourable position than the actual position.

- Financial accounts are unsuitable for forecasting because they are only records of past events.

Qualitative Characteristics of Accounting Information

Accounting information should be prepared and presented in such a way that is able to depict a clear view of business enterprise.

- Reliability:
  It implies that information must be factual and verifiable. And free from errors.

- Relevance:
  Accounting information must be relevant to the objectives of enterprise. To be relevant, information must help the users of accounting information in making decisions.

- Understandability:
  Accounting information should be presented in such a manner that they are understood easily by their users such as investors, employees, etc.

- Comparability:
  It is a very useful quality of accounting information. Financial statements should contain previous year data so that it can be compared with current year so that current performance be compared with past performance.

Accounting Terms

- Business Transaction:
  A Business transaction is an economic activity of business that changes its financial position.

- Account:
  It is a record of all business transactions relating to a particular person or item. It is a T Shaped proforma.

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- Capital:
  It refers to the amount invested by the owner in a business. The amount invested could be in the form of cash, goods, etc.

- Drawing:
  Any cash or goods withdrawn by the owner for personal use made out of business funds are known as drawings.

- Profit:
  It is the excess of total revenue over total expense of a business.
  Profit =Revenue-Expenses.

- Loss:
  The excess of expenses over related revenue is known as loss.
  Loss= Expenses-Revenue.

- Gain:
  It is a monetary benefit resulting from events or transactions which are incidental to business like profit on sale of fixed assets.

- Stock:
  It includes goods unsold on a particular date.

- Purchases:
  It refers to the amount of goods bought by business for resale or use in production.it can be of cash or credit.

- Purchase return:
  When purchased goods are returned to suppliers, it is referred to as purchase return.

- Sales:
  It means transfer of goods or services for money in the normal course of business.

- Sales return:
  When customers return the goods sold to them it is known as sales returns.

- Debtors:
  It refers to those persons whose business has been sold goods on credit and payment has not been received yet.

- Creditors:
  It refers to those persons whose business buys goods on credit and payment has not been done yet.

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- Voucher:
  A voucher is a written document which is created in support of a particular transaction. It may be in the form of a cash memo, invoice or receipt. Voucher is a necessary component of auditing.

- Income:
  It is the difference between revenue and expense.

- Expense:
  It is the amount used in order to produce and sell goods and services.

- Discount:
  It is the rebate given by the seller to the buyer. It is of 2 types:
  Cash Discount and Trade Discount.

- Cash Discount:
  When discount is allowed to customers for making prompt payment.
  It is always recorded in books of accounts.

- Trade Discount:
  This is a type of discount allowed by the sellers to their customers at a fixed percentage on the list price of goods. and also it is not entered in the books of accounts.

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- Bad Debts:

  It refers to the amount that debtor has not paid even after repeated reminders and has no intention of paying in the future.