



INDIAN SCHOOL MUSCAT
DEPARTMENT OF COMMERCE & HUMANITIES
CLASS :11
ACCOUNTANCY

Worksheet No: 1

Chapter Name: Introduction to Accounting (Notes)

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Definition of Accounting

According to the American Institute of Certified Public Accountant “ 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 there of.”

Attributes / Characteristics / Features of Accounting

1. Identifying Financial Transactions and Events:

- It is the process of determining which transactions are to be recorded.
- Accounting records only those transactions which are of financial nature.
- For eg: Purchase of raw materials or sale of goods.

2. Measuring the Identified Transactions:

- Accounting measures the transactions and events in terms of a common measurement units i.e. the currency of the country.
- For eg. Purchase of goods for Cash Rs. 2,00,000.

3. Recording:

- Recording is the process of recording business transactions of financial character in the books of original entry i.e. Journal.
- Journal is further sub-divided into subsidiary books such as Cash Book, Purchase Book, Sales Book etc.

4. Classifying:

- Classifying is a process of collecting similar transactions at one place by opening accounts in the Ledger Book.
- This book contains individual account heads under which all financial transactions of similar nature are collected
- For eg. Rahul’s account, Purchase account etc.

5. **Summarizing:**

- It involves presenting the classified data in a manner which is understandable and useful to internal as well as external users of accounting statements.
- This process leads to preparation of following statements:
 - a. Trial Balance
 - b. Income Statement (Trading and Profit and loss Account)
 - c. Position Statement (Balance sheet)
- They are collectively known as Final Accounts or Financial Statements.

6. **Analysing and Interpretation:**

- Financial data is analyzed and interpreted so that the users of financial data can make a meaningful assessment of the financial performance (profit) and financial position of the business.

7. **Communicating:**

- Finally accounting involves communicating the financial statements to its users (Internal and External).

Objectives of accounting

1) **Maintain Accounting records :**

- The objective of accounting is to record financial transactions and events of the organization in the books of account in a systematic manner following the principles of accountancy.

2) **Determining Profit or Loss:**

- Another objective of accounting is to determine the financial performance i.e profit earned or loss incurred for the accounting period.
- A statement called Profit and loss account is prepared.

3) **Determining Financial Position:**

- Another objective of accounting is to determine financial position.
- A statement called position statement or the balance sheet is prepared.

4) **Providing accounting information to the users:**

- Another objective of accounting is to provide accounting information to users who analyze them as per their individual requirements.

Advantages

1) **Financial information about business:**

- Financial performance during the accounting period i.e. profit earned or loss incurred and also the financial position at the end of the accounting period is known through accounting.

2) **Assistance to management:**

- The management makes the business plans, takes decisions and exercises control over the affairs on the basis of accounting information.

3) **Replaces memory:**

- A systematic and timely recording of transactions obviates the necessity to remember transactions.
- The accounting provides the necessary information.

4) **Facilitates comparative study:**

- A systematic record enables a businessman to compare one year's results with those of others years and locate significant factors heading to change.

Limitations

1) **Accounting is not fully exact:**

- Although most of the transactions are recorded on the basis of evidence such as sale or receipt of cash yet some estimates are also made for ascertaining profit or loss.
- Examples are providing for depreciation etc.

2) **Unrealistic information:**

- The Balance sheet does not show the amount of cash which the firm may realize by the sale of all the assets.
- This is because many assets are not meant to be sold but for use.

3) **Accounting ignores the Qualitative elements:**

- Since accounting is confined to monetary matters only, qualitative elements like quality of staff, industrial relations and public relations are ignored.

4) **Accounting ignores the effect of price level changes:**

- Accounting statements are prepared at historical cost.
- Money as a measurement unit, changes in value. It does not remain stable.
- Unless price level changes are considered while preparing financial statements, accounting information will not show true financial results.

5) **Accounting may lead to window dressing:**

- The term window dressing means manipulation of accounts so as to conceal vital facts and present the financial statements in such a way as to show better position than what it actually is.
- In this situation the profit and loss account fails to provide a true and fair view of the result of operations and balance sheet fails to provide a true and fair view of the financial position.

Role / Functions of accounting

- 1) **Maintaining a systematic Accounting Records:**
 - To Maintain systematic accounting records of financial transactions and events.
 - It means accounting should be maintained following the accounting rules, principles and concepts.
- 2) **Preparation of financial statements:**
 - Financial statement means final accounts prepared at the end of the accounting period.
 - It includes Income statement and Position statement
 - It is a important function as it shows the financial performance (profit earned or loss incurred) and position of the accounting year.
- 3) **Meeting Legal requirements:**
 - Accounting records are accepted as evidence by the court of law if they are maintained systematically following the accounting rules, principles and concepts.
 - Thus it is the function of accounting to meet legal requirements.
- 4) **Communicating the financial information:**
 - Another function of accounting is to communicate the financial information to the users which may be internal as well as external users.
 - Such as Banks, Employees, Government etc.
- 5) **Assistance to management:**
 - Management often requires financial information which is given by the accounting records which in turn helps the management in decision making.
 - It will also help the management in protecting the assets and exercising control.

Accounting information & Types of accounting information

Accounting information refers to the financial statements generated through the process of Book keeping, use of which helps the users to arrive at decisions. The information made available by these statements can be categorized into the following:

- a) **Information relating to Profit or Surplus:**
 - The income statement makes available the accounting information about the profit earned or loss incurred as a result of business operations.
 - A firm prepares trading a part of profit and loss account which provides information about the Gross profit or Gross loss and Profit and Loss account provides information about Net profit and Net loss.
- b) **Information relating to Financial position**
 - The Position statement i.e the Balance Sheet makes available the information about the financial position of the firm

- The position statement provides information about the assets owned by the firm, amounts receivable and the cash and bank balance held by it. These are represented in the liabilities by the amounts owed by the firm towards loans, creditors and amount payables.
- c) **Information relating to Cash flow:**
- Cash flow statement is a statement that shows flow both inflow and outflow of cash during a specific period.
 - It is very important as many decisions such payment of liabilities, payment of dividend, expansion of business are based on availability of cash.

Users of accounting information and their needs

Users of accounting information may be categorized into internal users and external users:

Internal Users:

- 1) **Owners:**
 - Owners contribute maximum capital to the business and are exposed to risks.
 - They are interested in knowing about the profit earned and loss incurred besides safety of their capital.
- 2) **Management:**
 - The management makes extensive use of accounting information to arrive at decisions such as determination of selling price, cost controls and reduction, investment into new projects etc.
- 3) **Employees and workers:**
 - Employees and workers are entitled to bonus at the year end which is linked to the profit earned by the firm.
 - They are also interested as the financial statement reflect whether the enterprise has deposited the dues towards Provident Fund, ESIC etc.

External Users

- 1) **Banks and Financial Institution:**
 - Banks and financial institutions are an essential part of any business as they provide loans to businessmen.
 - They want to know the progress of the business to ensure the safety and recovery of loan advanced
- 2) **Investors and Potential investors:**
 - Investment involves risk and they do not have direct control over the business.
 - They want to know about the earning capacity of the firm and how safe their investment is.
- 3) **Creditors:**

- Creditors are the parties who supply goods on credit.
 - They want to know about the creditworthiness of the firm.
- 4) **Government and its Authorities:**
- They use accounting information to compile national income accounts and to take policy decisions.
- 5) **Researchers:**
- They use the accounting information in their research work.
- 6) **Consumers:**
- They are interested in knowing the accounting information for establishing control so that the cost of production may be reduced with resultant reduction in the prices of the products.

Qualitative characteristics of accounting

- 1) **Reliability:**
- Accounting information must be reliable.
 - Reliability of information means it should be verifiable, free from bias and material error.
- 2) **Relevance:**
- Accounting information must be relevant to the users.
 - Information is relevant if it meets the needs of the users in decision making.
- 3) **Understandability:**
- Understandability means that the information provided through the financial statements must be presented in a manner that the users are able to understand it.
- 4) **Comparability:**
- Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods known as INTRA-FIRM comparison or with the accounting information of other enterprises known as INTER-FIRM comparison.

Systems Of Accounting

The systems of recording transactions in the books of accounts are two namely:

- 1) **Double entry system:**
- Double entry system of accounting is a system of accounting under which both debit and credit aspects of accounting are recorded.
 - A transaction has two aspects – Debit and Credit.
- 2) **Single entry system:**
- Single entry system or Account from incomplete records of recording transactions in the books of accounts may be defined as an incomplete double entry system.
 - In this system all transactions are not on double entry basis.

Branches of Accounting

1. Financial accounting
2. Cost Accounting
3. Management Accounting
4. Forensic Accounting

Book Keeping

Book Keeping is a part of accounting and is concerned with the recording of financial data in the books of accounts.

Difference between Book Keeping and Accounting

Basis	Book keeping	Accounting
Meaning	It is the art of recording, classifying, summarizing business transactions.	Accounting is art of recording financial transaction, summarizing them and communicating the financial information to the users.
Objective	To prepare a original books of accounts restricted to journal, subsidiary books, ledger only.	To record, analyze and interpret business transactions.
Performed by	Junior staff	Senior staff
Sequence/ Stage	Primary stage. Book keeping comes first.	Secondary stage. Accounting starts when book keeping ends.
Scope	Limited scope as concerned with recording only	Wider scope
Nature of Job	Routine in nature	Analytical and dynamic in nature
Special skills	It is a mechanical in nature and thus does not require special skills	It requires special skills and ability to analyze and interpret.