Chapter – 1

Introduction to Accounts

Video Lecture Explanation

Video Lecture 1 : Introduction

1. Meaning of Accounting

2. Rule of Dr & Cr

3. Accounting Principle

4. Accounting Equation

Video Lecture 2 : Accounting Theoretical Concept

1. Meaning & Characteristic of Accounting

2. Book Keeping

3. Difference between Book Keeping & Accounting

4. Objective & Limitation of Accounting

5. System of Accounting

Accounting

Accounting is the process of collecting, recording, classifying , summarising and communicating financial information to the users.

Characteristic of accounting :

Collecting : It involve identification & collection of transactions and events of financial / monetary nature.

Recording : Financial transaction are recorded in the primary books of accounts i.e., **Journal** Book in form of Journal entry.

Classifying : It is the process of collecting similar transactions at one place by opening accounts in the **Ledger** Book.

Summarising : It involves presenting the classified data in form of Final Accounts which involve : Preparation of **Trading , Profit & Loss A/c & Balance Sheet.**

Communicating : Finally, Final Account are communicated to its users.

There are two type of users :

Internal Users

(i) Owners: Owners contribute capital in the business and thus are exposed to maximum risk.

(ii) Management: The management makes extensive use of accounting information to arrive at informed decisions such as determination of selling price, cost controls and reduction, etc.

(iii) Employees and Workers: Employees and workers are entitled to bonus at the year-end, which is linked to the profit earned by an enterprise.

External Users

(i) Banks and Financial Institutions: Banks and financial institutions are an essential part of any business as they provide loans to businesses.

(ii) Investors and Potential Investors: Investment involves risk and also the investors do not have direct control over the business affairs.

(iii) Creditors: Creditors are those parties who supply goods or services on credit. It is a common business practice that a large number of supplier remain invested in credit sales.

(iv) Government and its Authorities : The government makes use of financial statements to compile national income accounts and other information.

(vi) Consumer: Consumers require accounting information for establishing good accounting control so that cost of production may be reduced with the resultant reduction in the prices of products they buy.

(vii) Public: They want to see the business running since it makes substantial contribution to the economy in many ways, e.g., employment of people, patronage to supplier etc.

Book keeping

Book keeping is a part of accounting. The process of recording financial transaction in a systematic manner and classifying them into ledgers is termed as Book keeping. Book keeping thus involves:

(i) Identify financial transactions and events,

(ii) Measuring them in terms of money,

(iii) Recording the identified financial transactions and events in the books of accounts, and

(iv) Classifying, i.e., posting them into ledger accounts.

Differentiate between Book keeping & Accounting

Basis	Book keeping	Accounting
1) Meaning	Book keeping is concerned with ➢ Identifying financial transaction & events. ➢ Measuring them in terms of money. ➢ Recording & classifying them	Accounting is concerned with ➢ summarizing the recorded transaction ➢ interpreting the result ➢ & communicate it to the users.
2) Stage	Primary stage	Secondary stage
3) Performance	Junior staff perform this function	Senior staff perform this function
4) Objective	Maintain systematic record of financial transaction	Ascertain financial performance & financial position & communicate the result to its users.
5) Special skills	Book Keeping is mechanical in nature and, thus, does not require special skills.	Accounting requires special skills and ability to analyse and interpret.

Objectives of accounting are:-

1. **Record of Monetary Transactions:** Record monetary transactions of the organisation in the books of accounts following the accounting principles
2. **Prevent error & fraud :** Systematic record of transaction prevent error & fraud.
3. **Replace memory :** A systematic & timely recording of transaction avoid the requirement to remember the transaction.
4. **Determine Profit & Loss:** Determine profit or loss financial performance of the organisation for the accounting period by preparing Trading Account & Profit & Loss Account.
5. **Prepare Balance Sheet** : Determine financial position by preparing Balance Sheet.

4. **Assisting the management :** Assist the management by providing financial information for planning , decision-making, budgeting and forecasting.

5. **Communicating Accounting Information to users :** It Provide accounting information to Internal & external
users as per their individual requirements.

6. **Protecting Business Wealth :** Maintain records of assets owned by the business which enables the management of it's efficient usage & to protect them.

Limitations of Accounting are :-

1. **Accounting is not Fully Reliable :** Many transactions are recorded on the basis of evidence such as credit sale which may not be realised on maturity , display distorted profit or loss performance.

2. **Accounting does not Indicate the Realisable (Sale) Value :** The Balance sheet does not show the amount of cash which the firms may realize by the sale of all the assets.

3. **Conservative Approach :** Due to application of concept of 'conservation' all losses are provided for but no provision is made in the books for prospective profits. Hence conservative approach is another limitation of accounting.

4. **Accounting Ignores the Qualitative Elements :** Since accounting is based on monetary, qualitative elements like honesty , hard work of staff, and public relations are ignored.

5. **Accounting Ignores Price Level Changes :** The most serious limitation of accounting is adoption of historic cost concept for recording various assets irrespective of subsequent change in their prices.

6. **Accounting may Lead to Window Dressing :** Window dressing mean manipulation of account to hide vital facts in such a way as to present the financial statement in better position than than the actual position.
   In this situation , information given by the accounting is not true and faithful or may be manipulated by the accountants

System of recording

There are two system of recording business transaction :

1. **Single Entry system :**

This system record only one aspect of transaction is debit or credit.
It maintain incomplete record of transaction.

2. **Double entry system**

This system recognize & record both aspects of transaction ie., debit & credit. It maintain complete record of each transaction.
For example :
At the time of purchase of building :
Building is debited
Cash is credited

Advantage of double entry system :

1. **Complete record of transaction** : Under this system both aspect of transaction are recorded hence it is complete record of business transaction.

2. **Ascertainment of business performance** : The profit or loss incurred during the year can ascertained by preparing profit & loss a/c. The financial position of business can ascertained by preparing financial statement.

Disadvantage of double entry system

1. **Sound knowledge** : It require sound knowledge of books of accounts & principle of accounting.

2. **Costly :** It require professional staff who prefer high salary.