Unit 1

INTRODUCTION TO ACCOUNTING

Introduction to Accounting

- Business entities and other organisations carry on activities which involve exchange of money or money's worth or economic resources.
- Raising and utilising of finance for various purposes must be recorded systematically, scientifically and uniformly. It is very important because finance is the most important resource next to the human element for any economic activity.
- Accounting is the language of business. The most important function of a language is to facilitate communication.

Evolution of Accounting

- In India, 23 centuries ago, Chandragupta Maurya's Minister Kautilya wrote a book named 'Arthashastra', wherein some references can be traced regarding the way of maintaining accounting records.
- In 1494, Luca Pacioli an Italian developed double-entry book-keeping system.
- In the 20th century, the need for analysis of financial information for managerial decision making

Meaning of accounting:

Accounting is the systematic process of identifying, measuring, recording, classifying, summarising, interpreting and communicating financial information. Accounting gives information on:

(i) the resources available

(ii) how the available resources have been employed and

(iii) the results achieved by their use.

Definition:

According to the **American Institute of Certified Public Accountants** "Accounting is the art of recording, classifying and summarising 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 thereof".

From the above definitions, the following attributes of accounting emerge:

(i) Arts and Science

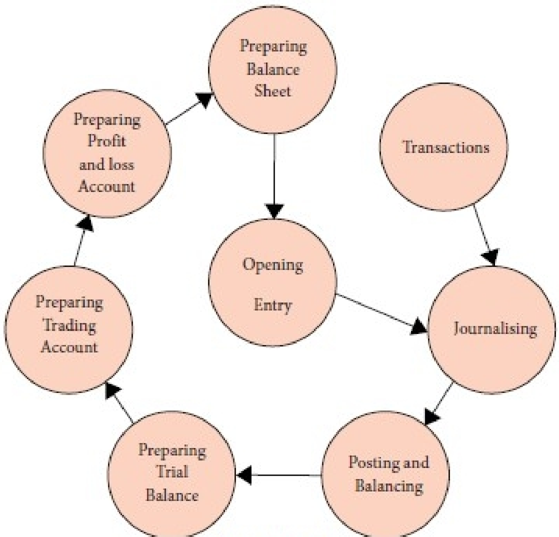
(ii) Recording in terms of money

(iii) Recording final transaction only

(iv) Classifying

Accounting cycle

Accounting cycle is the sequence of steps involved in the accounting process. Accounting cycle starts with the identification and recording of financial transactions of an organisation and ends with the preparation of final accounts for the accounting year. The steps involved are:



Accounting cycle

(i) Identifying the transactions and journalising

The first step in the accounting process is identifying the financial transactions of a business. All the monetary transactions are recorded in the books of original entry called journals.

(ii) Posting and balancing

Transferring the entries from the journal to the ledger is called posting. In the ledger, entries are made in each account after classifying them under common heads.

(iii) Preparation of trial balance

The list of ledger balances namely trial balance is prepared as the next step. On the basis of ledger balances the financial statements are prepared.

(iv) Preparation of trading account

Next step is preparation of trading account for a particular accounting period. All the direct revenues and direct expenses are transferred to trading account. The balance in the trading account is the gross profit or gross loss.

(v) Preparation of profit and loss account

Profit and loss account is prepared next for a particular accounting period. All the indirect revenues and indirect expenses along with gross profit or gross loss are transferred to profit and loss account.

(vi) Preparation of balance sheet

A statement showing the balances of assets and liabilities namely balance sheet is prepared as the final step in the accounting process. It is prepared on a particular date, normally, on the last day of the accounting period.

The results are communicated to the users of accounting information for the purpose of analysis and decision making

Objectives of Accounting

Following are the objectives of accounting:

(i) To keep a systematic record of financial transactions and events

(ii) To ascertain the profit or loss of the business enterprise

(iii) To ascertain the financial position or status of the enterprise

(iv) To provide information to various stakeholders for their requirements

(v) To protect the properties of an enterprise and

(vi) To ascertain the solvency and liquidity position of an enterprise