Introduction to Accounting

Accounting: Overview, Evolution, Development, Meaning and Features

Objectives

After going through this lesson, you shall be able to understand the following concepts.

• Overview of Accounting
• Meaning of Accounting
• Characteristics of Accounting

Overview

Till now in the previous classes you all have studied the subjects such as Mathematics, Science, Social Studies, Hindi, English, etc. Now, in class XI, you are going to be familiar with some new and fresh subjects such as Accountancy, Economics, Business Studies, etc. All these subjects come under the purview of one stream named as Commerce. Among all these subjects our main focus will be on “Accountancy”.

What is the first thing that comes to your mind when you hear the term Accounting?

Something related to business or something related with mathematical calculations or may be something related to keeping a track of someone’s earnings and spending.

Accounting in very simple sense is maintaining a record of various activities.

Thus, Accounting is something that is used almost by everyone in their daily lives. In our daily life, we maintain the record of various transactions or activities. For instance, a student who gets monthly pocket money may keep a record of his various expenses i.e.

How much he spent on buying books or pens, how much he spent with his friends or how much he has saved. Similarly, a house wife may keep a track of quantities of various grocery items such as pulses, rice, vegetables, flour, etc. Thus, the activities related to keeping a record of some activities or transactions are covered under the head accounting.

Evolution of Accounting

What do you think, accounting is something that is evolved in the modern times? No, it has been in use from the ancient times.

Roots of Accounting can be traced long back in civilisation. Around 4000 B.C., in Babylonia and Egypt, payment of wages and taxes were recorded on clay tablets. As history claims that Egyptians kept the record of gold and valuable deposits and withdrawal from the treasuries.

These records were reported on daily basis by the incharge of treasuries to the *wazir*, who used to forward the monthly reports to the king. Babylonia and Egypt used this method to rectify and remove errors, frauds and inefficiency from the records. Around 2000 B.C., China used sophisticated form of accounting.

In Greece, accounting was used to maintain total receipts and total payments and to balance government accounts. In Rome, around 700 B.C., receipts and payments were recorded in daybook and were posted in the ledger at the end of the month. In 1494, Luca Pacioli wrote the book *Summa de Arithmetica Geometria Proportioni et Proportionalita*. In this, he explained the term debit and credit, which are used in accounting till date.

In India, around twenty three centuries ago, *Kautilya* wrote the book ***Arthshastra***, which described how accounting records had to be maintained.
Book Keeping emerged during the Barter system when there was no cash system and trade was carried by exchanging goods and services. At that time, transactions were kept in individual ledgers and they can be provided as evidence in case of dispute.

Afterwards, when currency and numbers were introduced then the single entry system of book keeping was evolved, where a single column is maintained and all the transactions whether paid or received are recorded in that column. In the 15^{th} Century when Luca Pacioli explained the double entry system, book keeping became more efficient as transactions were recorded separately in the debit and credit column which provided a clear image of the financial position of the business firm.
Earlier, *Munshi ji* or *Munim ji* used to play the role of accountants. They used to

keep account of various activities of various people which is generally known as Bahi khata. At that time, number of transactions was not so huge and can be easily recorded in the books.

Development of Accounting

In ancient times, around 4000 B.C., accounting was used for recording wages and salaries, deposits and withdrawals of valuable goods (such as gold and silver) from the treasures of the king.

Afterwards, it was used to record the receipts and payments and balancing of government financial transactions. During 1500 A.D., accounting was used by business firms for recording transactions related to business. In 1800 A.D., accounting was used to record transactions and also to provide information to various users of financial data.

During the ancient times, accounting was merely concerned with recording of the financial transactions i.e. book keeping. But with the passage of time, the role of accounting has changed. In today's world, the role of accounting is extended to provide relevant information to various users. With the passage of time, as the scope of business increased, their expenditure on different activities inturn increased which lead to a large number of transactions.

To memorise the huge and complicated transactions is beyond the human capacity. Therefore, it becomes necessary to record them properly in the books in a systematic manner so that exact position at the end of the day can be easily ascertained. For this, there arises a need of a sophisticated system which has been fulfilled by Accounting. Therefore, in the modern world, the area of accounting has broadened and is no more limited to the recording of transactions only. Accounting has evolved with the passage of time.

Thus, Accounting, in simple terms, is recording of various transactions, that took place during a particular period, in the books of accounts in a systematic and a proper manner.
Accounting, now-a-days, is just not limited to recording transactions in the books but also to convey useful information to its users.

Meaning of Accounting

Accounting is a process of identifying the events of financial nature, recording them in Journal, classifying them in their respective ledgers, summarising them in Profit and Loss Account and Balance Sheet and communicating the results to its users such as proprietors, government, creditors, investors etc.

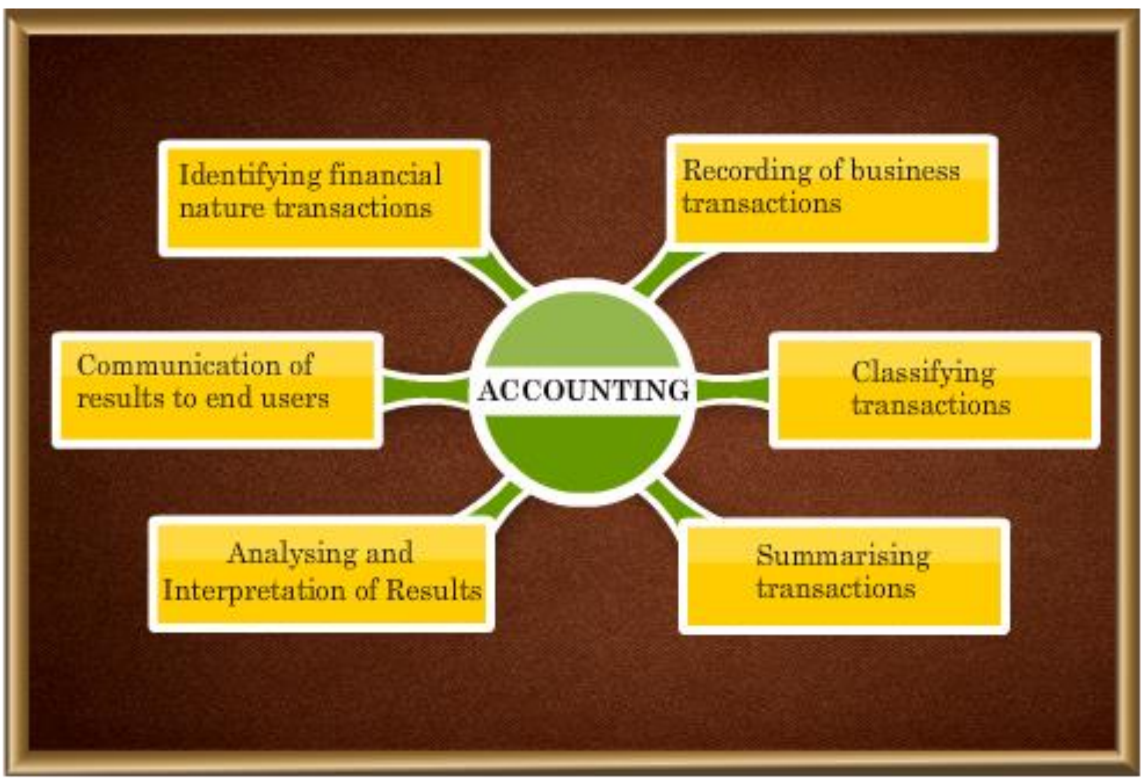
According to the American Institute of Certified Public Accountants, 1941, "*Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money; transactions and events which are, in part at least, of a financial character, and interpreting the results thereof*."

In the words of Bierman and Derbin, "*Accounting may be defined as identifying, measuring, recording and communication of financial information*."
In the opinion of Smith and Ashburne, "*Accounting is the science of recording and classifying business transactions and events, primarily of a financial character, and the art of making significant summaries, analysis and interpretations of those transactions and events and communicating the results to persons who must make decisions or form judgement*."

Accounting is concerned with economic activities of the business. Thus, transactions which can be measured in terms of money are recorded in Accounting. Transactions like purchase of machinery, payment of salaries, wages, purchase of raw material, sale of goods etc. all are examples of economic events. Economic events can be classified as external events and internal events.

If a transaction occurs between an outsider and the organisation it is termed as external event like purchases made from suppliers, sales made to customers etc. When transaction occurs internally i.e. from one department to other or within the organisation then it is termed as internal event like supply of raw material to the other department.

From the above definitions, it can be inferred that in accounting only transactions of financial nature are recorded. Financial transactions are those transactions that involve flow of cash. Accounting is popularly regarded as a communication link between the business and its various users or language of the business. This is because accounting provides important and vital information to its external as well as internal users.



Characteristics of Accounting

Given below are the various characteristics of accounting that can be derived from the meaning of accounting.

1. ***Financial Nature Transactions***- Accounting is the process of identifying and recording the events and transactions of financial character. Financial nature transactions are those transactions which can be measured in terms of money or which involves flow of cash. There may be events which are not financial in nature but are significant for a business. For example, honesty and dedication of an employee is an important factor which cannot be recorded in the books. So, accounting records only financial nature transactions and events. Thus, transactions of non-financial nature are not recorded even if they have substantial effect on the business.

2. ***Art as well as Science*- ** Art is a method of achieving the planned goals. Accounting, in relation to art, is a process, of identifying, recording, classifying, and summarising financial transactions with the help of which a business can achieve its desired goals. It helps in knowing the profitability and financial status of a business. On the other hand, science is an organised and systemised body of knowledge based on some basic principles. In a similar sense, accounting is also like a science as it is based on certain basic accounting principles and standards.

3. ***Measurement in terms of Money*-** In accounting, all the business transactions are recorded in terms of a common unit i.e. money. This implies that the transactions which cannot be measured in terms of money will not be recorded in the books even if they have considerable effects on the earnings of a business.

4. ***Recording*-** Accounting is a process of recording business transactions in the books of accounts. All the financial transactions are first recorded in the Journal or in case of bulky transactions recording is made in various subsidiary books such as Cash Book (*a book for recording cash transactions*), Purchase Book (*a book for recording transactions related to credit purchases*), Purchase Return Book (*a book for recording transactions related to return of credit purchases*), etc and Journal Proper (transactions which cannot be recorded in any above books).

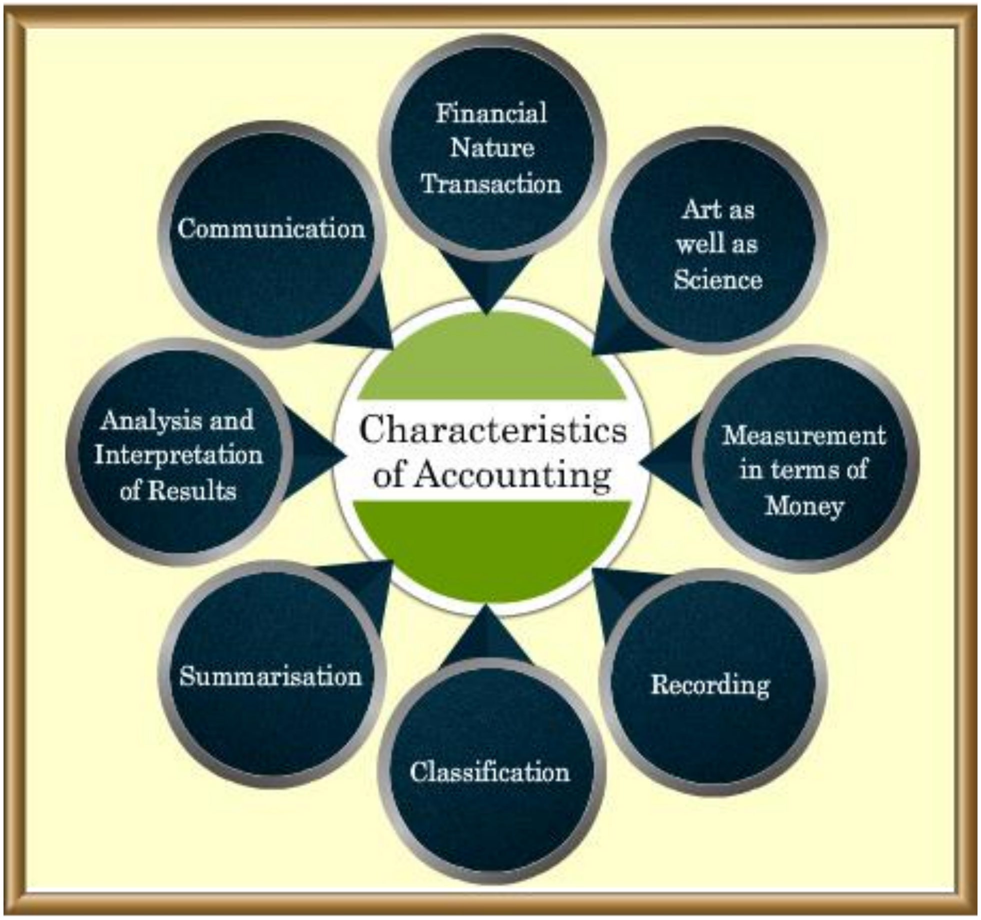
5. ***Classification*-** Transactions of similar nature are classified into different categories according to their nature. This means, transactions of similar nature are collected and recorded at one place that is in the ledger book. For example, all the transactions related to sales are recorded in the Sales Account.

6. ***Summarisation*-** In accounting, financial data is presented in such a manner that it can be easily understood and utilised by its various users such as management, investors, creditors, etc. To fulfil this, Trial Balance, Trading and Profit and Loss Account, Statement of Profit or Loss (in case of companies) and Balance Sheet are prepared. All these statements help the users for the easy understanding of the financial data of a business.

7. ***Analysis and Interpretation of Results*-** The results of a business are interpreted and presented in such a way that the users of financial statements can easily

know about the performance of business in terms of profitability and solvency. It also helps them in assessing the financial status of business.

8. ***Communication*-** In the last, accounting helps in communicating the financial results of a business to its various interested parties who can use the information as per their distinctive needs.



Accounting: Branches, Process, Objectives, Role of Accounting

Objectives

After going through this lesson, you shall be able to understand the following concepts.

• Role of Accounting
• Branches of Accounting
• Objectives of Accounting
• Benefits of Accounting
• Drawbacks of Accounting

Role of Accounting

The role of accounting has changed over the period of time. In the modern world, the role of accounting is not only limited to record financial transactions but also to provide information to the management so that it can be used as a basic framework for decision making, providing relevant information to various users and assist in both short run and long run planning. The role of accounting in the modern world is given below.

- ***Provides assistance to management*** **−** Management uses accounting information for short-term and long-term planning of business activities, to predict the future conditions, prepare budgets and various control measures.

- ***Helps in comparative study*** **−** In the modern world, accounting information helps us to know the performance of the business by comparing current year's profit with that of the previous years and also with other firms in the same industry.

- ***Substitute of memory*** **−** In the modern world, every business involves large number of transactions and it is beyond human capability to memorise each and every transaction. Hence, it is necessary to record transactions in the books of accounts.

- ***Information to end users*** **−** Accounting plays an important role in recording, summarising and providing relevant and reliable information to its users, in the form of financial data that helps in decision making.

Branches of Accounting

In the modern days the scope of accounting is not confined only to the ascertainment of profits or losses of a business during a particular accounting period. Rather, its scope has widen to other areas as well such as providing useful information to the management which helps them in decision making and drafting their future plans. So, in order to fulfil the various requirements of management, accounting can be classified into different branches. These are as follows:

1. **Financial Accounting-** It is mainly concerned with identifying the transactions of financial nature and their recording in the books, classifying, summarising and communicating the business results. The main focus of this branch of accounting is to determine the profit or loss of a business by preparing Trading and Profit and Loss Account. This also helps in assessing the financial position at the end of an accounting period by preparing the Balance Sheet. It also provides useful information to the management and to various other parties interested in the business. Financial accounting starts with recording of business transactions in the books and ends with preparing the financial statements of the business.

2. **Cost Accounting-** It is another branch of accounting which is concerned with ascertaining the cost of production and its various elements. It is a process of

classifying, recording and ascertaining of cost that provides relevant information for controlling the costs in the future and removing inefficiencies from the production process.

3. **Management Accounting-** This branch of accounting helps in presenting the financial data and results in such an easy manner so that the vital and useful information can be easily and clearly available to the management. Management uses this information for drafting their future plans and their decision making. In other words it can be said that, management accounting is a process of accounting under which management uses the information provided by financial and cost accounting for drafting the future policies, controlling, organising and decision-making process.

4. **Tax Accounting-** This branch of accounting is a technique of accounting that is used for the tax purposes. Tax accounting helps in handling the tax issues of a business such as computation of tax liabilities, filing tax returns, etc.

5. **Social Responsibility Accounting-** This is one of the important branches of accounting that studies the effects of business decisions on the society. It is basically concerned with analysing and interpreting the contribution of business to the society. A business can contribute to the society by generating employment, carrying out business without adversely affecting the environment, by making customer friendly products, etc.

Accounting Process or Phases of Accounting

Phases of accounting are as follows:-

1. ***Identifying financial transactions***: First of all, transactions which are of financial nature i.e. transactions which can be measured in terms of money, are to be identified.

2. ***Recording financial transactions***: In the next step, financial nature transactions are recorded in the books of accounts. Thus, transactions of financial nature are recorded in Journal.

3. ***Classifying financial transactions***: Accounting transactions once recorded are classified by collecting the similar transactions and posting them to Ledger i.e. book or account which records transactions of similar nature. For example- all the transactions related to Sales are recorded under one account i.e. Sales Account.

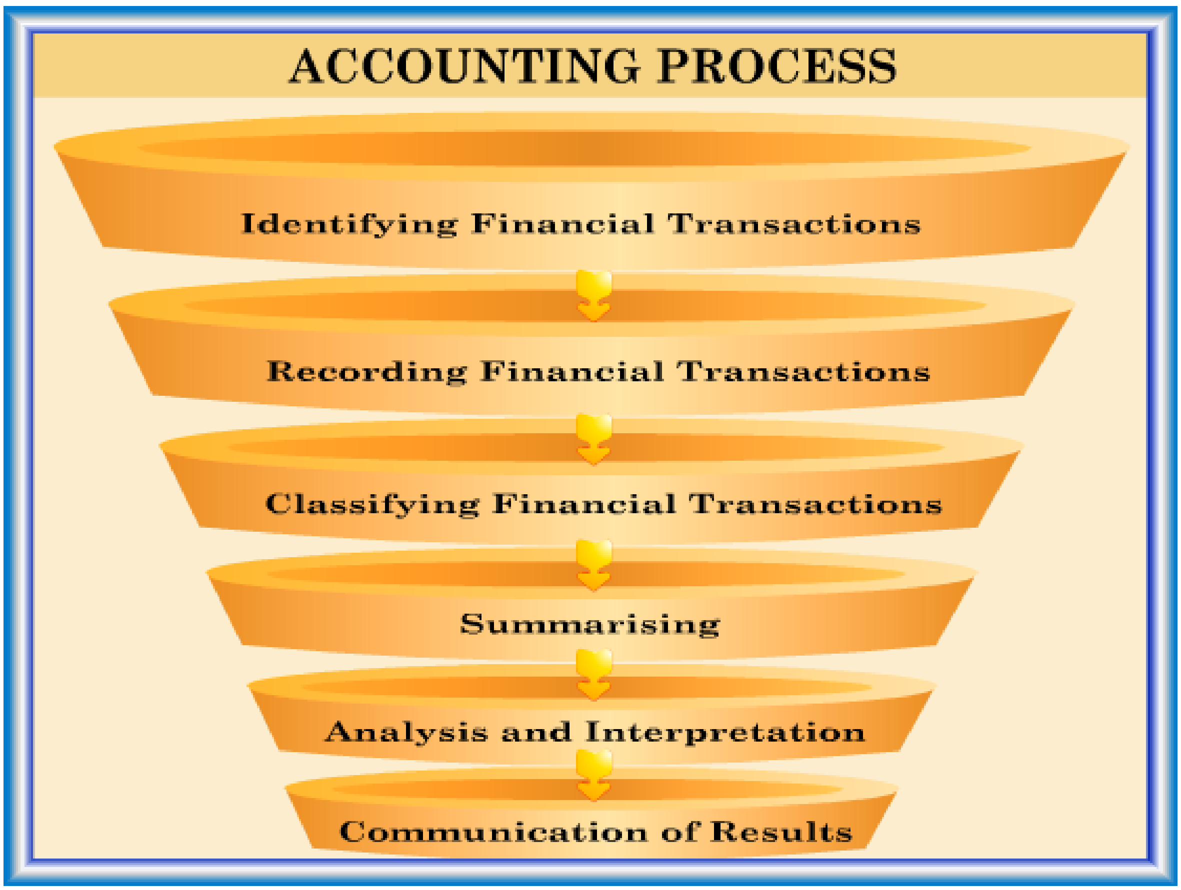
4. ***Summarising***: Accounting transactions are recorded, classified and summarised in a way which can be useful for the users of accounting information. Thus, to make information useful, Trial Balance, Trading Account, Profit and Loss Account or Statement of Profit or Loss (in case of Companies) and Balance Sheet are

prepared. All these statements help the users for the easy understanding of the financial data of a business.

5. ***Analysis and Interpretation of Results***: Results from Financial Statements are analysed and interpreted in a meaningful manner. Such that, those can be used by the users of financial information in order to assess the financial performance of the business.

6. ***Communication***: Finally, results of financial statements are communicated to the various interested parties who can use the information as per their distinctive needs.

Process of Accounting or Phases of Accounting can also be termed as Functions of Accounting or Accounting Cycle.



Objectives of Accounting

The following are the various objectives or needs of accounting.

1. ***Recording Business Transactions Systematically-*** Accounting aims at recording a huge number of business transactions in the books of accounts in a systematic and organised manner. This systematic record of transactions helps in eliminating the chances of errors and frauds in the business that can take place while carrying out business activities.

2. ***Determining Profit or Loss-*** Every business organisation is interested in knowing its net results in terms of profits or losses for a particular accounting period. It is ascertained by preparing the income statements for an accounting period. Income statements include Trading Account and Profit and Loss Account. These statements record various items of revenues and expenses of the business. The difference between revenues and expenses is regarded as profit or loss during the year.

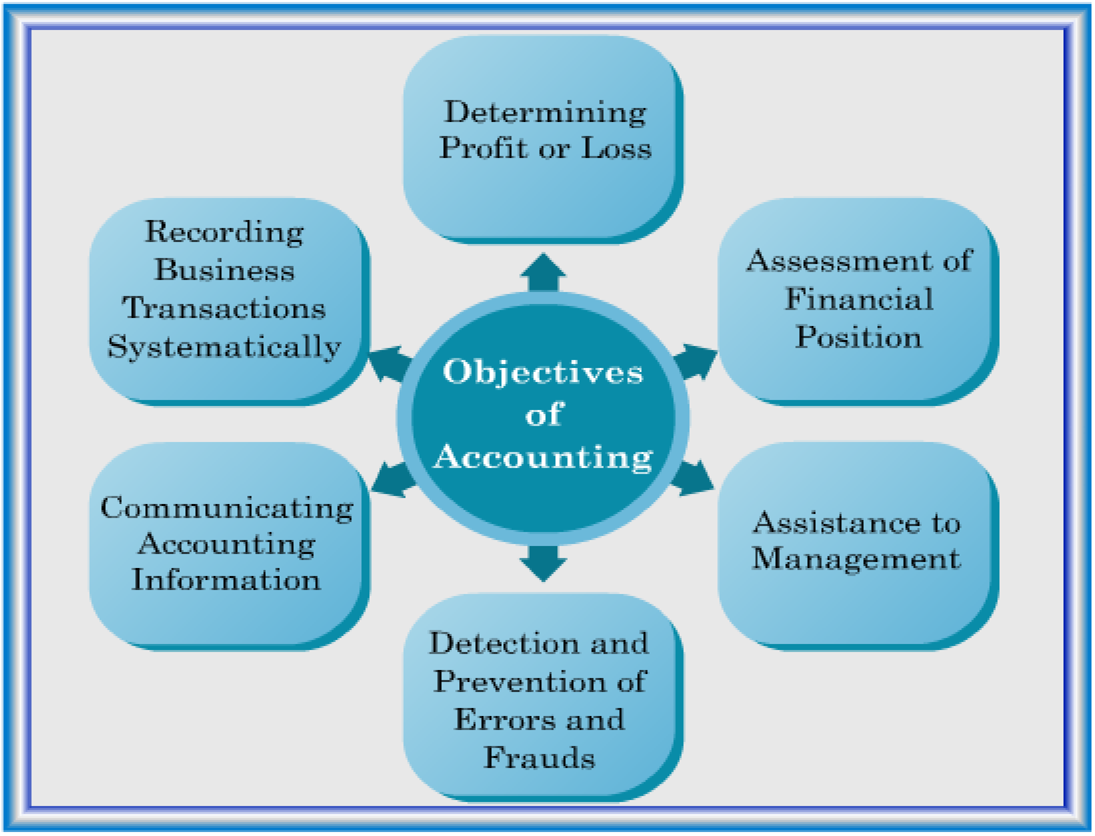
3. ***Assessment of Financial Position-*** Determining only the profits or losses from the business activities is not enough. It is also very important for a business to know about its financial position i.e. strengths and weaknesses of the business. This can be easily assessed by preparing Balance Sheet at the end of an accounting period. Balance Sheet is a statement showing various assets and liabilities of a business prepared for a particular accounting period.

4. ***Assistance to Management-*** One of the important objective of accounting is to assist the management by providing them with vital and relevant information. Management uses this information for their effective decision making, formulating plans, efficient control on business activities, etc.

5. ***Assessment of Progress of Business-*** Accounting helps in comparing the results of two or more periods. This in turn helps in assessing the trend of growth and progress of the business.

6. ***Detection and Prevention of Errors and Frauds-*** There is always a possibility of errors and frauds in the business while carrying out its activities. The chances of their occurrence is minimised to a great extent by maintaining a systematic record of various business transactions.

7. ***Communicating Accounting Information-*** An important step in the accounting process is to communicate the financial and accounting information to its various users including both internal and external users. This assists the users to understand and interpret the accounting data in a meaningful and appropriate manner without any ambiguity.



Functions of Accounting

1. *Record of Transactions:* Accounting provides a systematic record of the financial transactions of a business. This is because the records so maintained follow a well developed system of principles and conventions which render uniformity and authenticity to them. For example: Furniture purchased for cash. This is a financial transaction because here the exchange of an asset (i.e. Furniture) is taking place in lieu of cash. Hence, this will be recorded in the books of accounts and will provide an evidence of the purchase.

2. *Ascertaining the results of the business:* To ascertain how well the business is doing we prepare certain financial statements. They are called statements because they are prepared for a certain period which is usually a year. It is important to prepare them because they provide conclusive evidence that a business is doing well. We prepare the following as our financial statements: a) Profit and Loss Account: It is the income statement of the business and tells about whether a profit or loss has incurred during the accounting year. b) Balance Sheet: As we know, business owns certain items and also borrows funds from the outsiders. The position of these assets (i.e. owned by the business) and liabilities (i.e. owes to outsiders) is determined by the balance sheet.

3. *Compliance with the law:* Accounting provides the desired record needed to pay for indirect and direct taxes as per the law. A well maintained record is accepted by the authorities without a dispute and ensures compliance with the law. For e.g.: An income tax return (i.e. statement declaring the revenues or incomes) can be prepared only when all transactions generating the revenues have been recorded as and when they have occurred.

4. ***Providing information to the users:*** Accounting provides the desired information to the users like shareholders, government, employees, etc.

5. ***Helps with the Managerial Decisions:*** All important decision related to the business are taken by the mangers just like parents take decisions for their kids when they are small. These decisions are taken after deliberation and are supported by the information provided through accounting. For example: the decision to increase price of goods being sold will depend on the previous year's revenue that we want to increase.

Benefits of Accounting

Given below are the various benefits of accounting.

1. ***Financial Results of Business***- The main advantage of accounting is that it helps in determining the net results of a business in terms of profits or losses and reveals the financial status of the business at the end of an accounting period.

2. ***Organised and Systematic Records*****-** It is beyond the human capacity to memorise a large number of business transactions. Accounting helps in recording such large number of transactions in a well organised manner which minimises the probability of erroneous and faulty results.

3. ***Assistance to Management*****-** Accounting helps the management in effective decision making, efficient control on cash management policies, preparing budget and forecasting, etc. by providing them with useful information in an organised manner. Information that is provided by accounting helps the management in planning, controlling and decision making.

4. ***Provides Comparative Study*****-** Accounting helps in maintaining the financial data of a business in a systematic manner for each of the year. This enables the comparison of business performance of one year with another year and finding the reasons of deviation between the two.

5. ***Determining the Tax Liability*****-** A systematic record of business activities helps in ascertaining the tax liabilities of business.

6. ***Acts as Evidence*****-** In case of disputes, systematic record of business transactions can be produced as evidence in the court of law.

7. ***Helps in Selling the Business*****-** In case a person decides to sell his/her business, then properly maintained accounts helps in determining the suitable price at the time of selling of business.

8. ***Helps in Obtaining Loans*- ** Before granting loan to a business enterprise, the banks and financial institutions are interested in knowing the profitability and stability of a business. This information can be easily fetched by properly maintained financial statements of the business.

Drawbacks of Accounting

Although accounting has several benefits but it has certain drawbacks as well which are discussed below.

1. ***Based on Personal Judgement*-** Even though all the business transactions entered in the books are based on proofs but still there are certain transactions that are recorded on the individual judgement of the accountants. For example, method for valuation of stock may differ from person to person. Similarly, method of providing depreciation can be varied. This will lead to different financial results by different people and hence the profit so ascertained cannot be considered as accurate or exact.

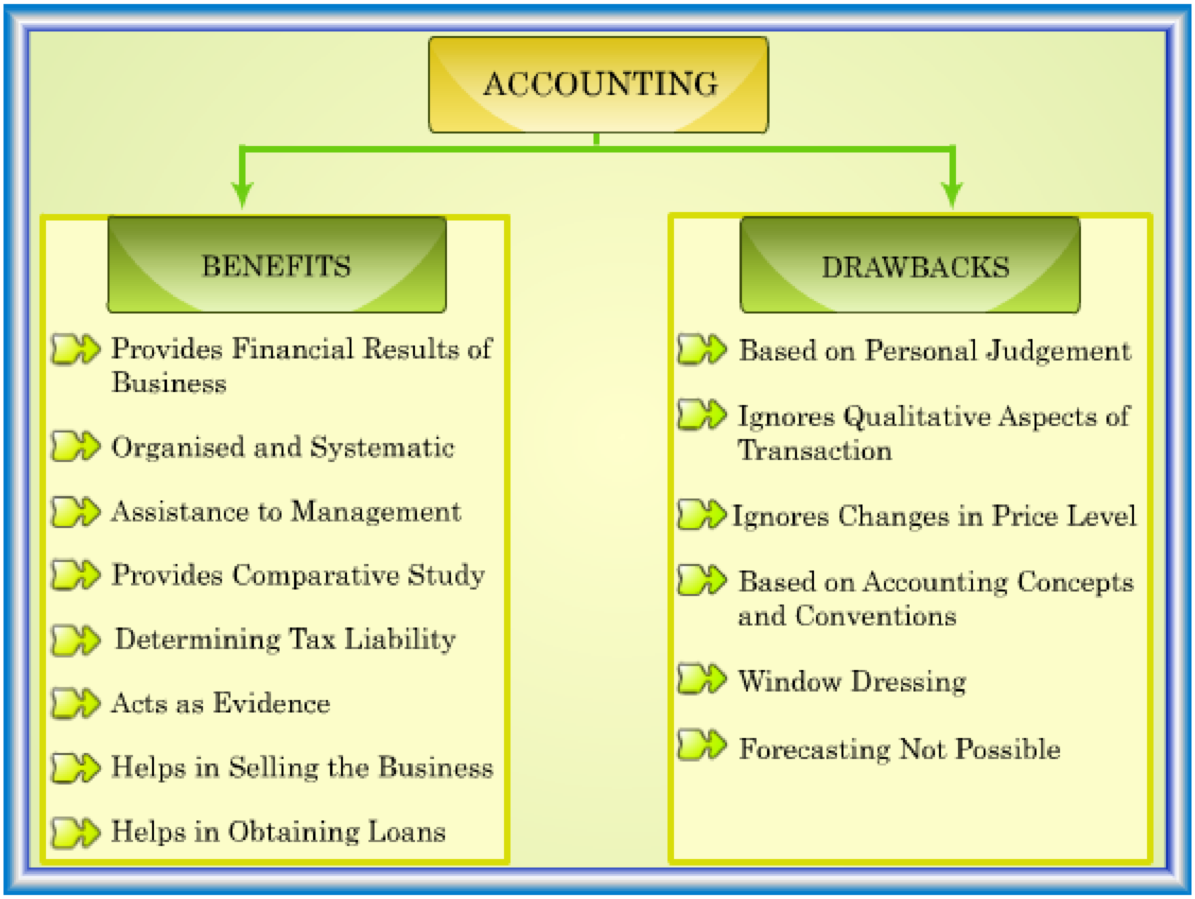
2. ***Ignores Qualitative Aspects of Transaction*-** In accounting, only those transactions are recorded in the books which are capable of being measured in terms of money. The qualitative aspects of transactions are ignored even if they have a significant impact on the business.

3. ***Ignores Changes in Price Level*-** The items are recorded in the books of accounts at their historical costs. It does not take into account the changes in the price level of the items in the market. Thus, the financial results disclosed by such financial statements fail to reveal the true financial position of the business.

4. ***Based on Accounting Concepts and Conventions*-** The accounts of a business are maintained by following various accounting concepts and conventions. Hence, the net results shown by the accounts are not considered reliable.

5. ***Window Dressing*-** Window dressing implies showing of false business results as compared to actual results. The accountant may adopt a practice of showing the manipulated figures in the accounts in order to show a better financial position of the business. In such a situation, financial statements fail to reveal the true and actual financial position of the business.

6. ***Forecasting not Possible*-** Accounting is based on the past events and transactions and does not take into consideration the rapid changes in the market such as change in the demand for product, change in cost of raw materials etc. Thus, it is not appropriate for making forecasting.



Book Keeping and Accounting

Objectives

After going through this lesson, you shall be able to understand the following concepts.

- Meaning of Book-Keeping
- Difference between Book-Keeping and Accounting
- Difference between Accounting and Accountancy
- Systems of Book-Keeping

Book-Keeping and Accounting

The meaning of book-keeping can be found in the term itself. This implies keeping the records of business transactions in the original books of accounts of the business. Book-keeping is mainly concerned with identifying the transactions of financial nature, recording them and maintaining their systematic record in the books.

According to L.C. Cropper, "*Bookkeeping is the science of recording transactions in money or money's worth in such a manner that, at any subsequent day, the nature and* *effect of each transaction, and the combined effect of the transactions may be clearly understood so that the accounts prepared at any time from the records, thus, kept may show the owner of the books his true financial position*."

In the words of Northcott, "*Book Keeping is the art of recording in the books of accounts the monetary aspect of commercial and financial transactions*."
J.R. Batliboi states Book Keeping as "*an art of recording dealings in a set of books*."

From the above explanation, it can be derived that Book-Keeping is a function of:

i. Identifying the transactions and events of financial character

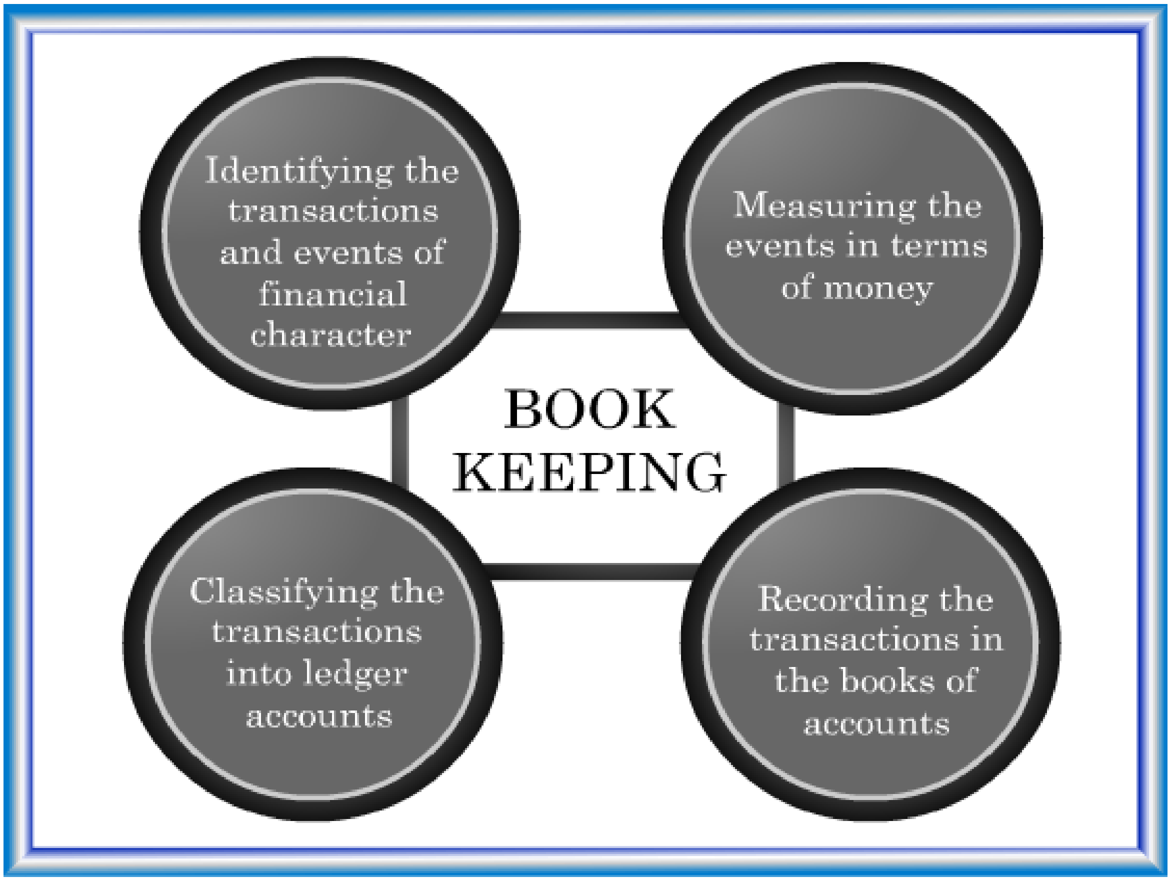
ii. Measuring them in terms of money

iii. Recording them in the books of accounts and

iv. Classifying the transactions so recorded into Ledger Accounts.

Thus, book-keeping helps in keeping the entire and comprehensive record of all the business transactions in an organised manner. It is a small part of accounting but it is very important as it forms the basis for accounting.

Accounting is the secondary stage, whereas, book-keeping is the primary stage. To perform the function of book-keeping, one need not have a specialised and expert knowledge of accounts. This function can be performed by the clerical or junior staff of the business.



Accounting
We have already discussed this term in detail in the previous lesson. It is a process of identifying the events of financial nature, recording them in Journal, classifying them in their respective ledgers, summarising them in Profit and Loss Account and Balance Sheet and communicating and interpreting the results to its various users.

In other words, accounting includes book-keeping and summarises and communicates the financial results to its various users i.e. both internal as well external users. Thus, we can say, accounting is a wider concept and one step ahead of book-keeping. In the way round, accounting starts where book-keeping ends.

Difference between Book-Keeping and Accounting
Book-Keeping and Accounting are two terms that are often regarded as same. But it should be noted that there is a difference between these two terms. Given below are the points on the basis of which these can be differentiated.

Point of Distinction	Book-Keeping	Accounting

Key Area	It is a function of identifying the events of financial character, measuring them in terms of money, recording them in the books and lastly classifying them.	Apart from functions of book-keeping it is concerned with summarising, interpreting and communicating the financial information to the various parties interested in business.
Purpose	Main purpose is to record the financial transactions and events in the books of accounts.	Main purpose is to find out the net results and financial status of the business and communicating the results to its various users.
Stage	It is the first stage that forms the basis for accounting.	It is the second stage and it begins where book-keeping ends.
Nature of Job	It is a routine job.	It is analytical and dynamic in nature.
Performed by	It is performed by lower level staff.	It is performed by the higher level staff.
Knowledge	It does not demand any specialised knowledge of accounts.	It demands a specialised knowledge of accounting rules and principles.
Connection	It provides a basis for starting the process of accounting.	It starts where book-keeping ends.

Accountancy

Generally, the two terms viz. accounting and accountancy are mistakenly regarded as same. However, there lies a difference between both the terms. Accountancy is basically an appropriate knowledge of accounting. It defines how the different techniques and principles of accounting are to be adopted in accounting. It provides us with knowledge of preparing books of accounts, summarising, interpreting and communicating the business results to its users. According to Kohler, "*Accountancy refers to the entire body of the theory and practice of accounting*".

Difference between Accounting and Accountancy

As discussed earlier, there is a difference between the terms Accounting and Accountancy. These are differentiated on the basis of following points:

Point of Distinction	Accounting	Accountancy
Key Area	It is a function of identifying the events of financial character, measuring them in	Accountancy is basically appropriate knowledge of accounting which defines

	terms of money, recording them in the books and lastly classifying them.	how the accounting principles and techniques are to be followed.
Purpose	Main purpose is to find out the net results and financial status of the business and communicating the results to its various users.	Main purpose of accountancy includes explaining principles and techniques that needs to be followed in accounting
Scope	Accounting is narrow in scope. It starts where book-keeping ends.	It is wider in scope because it explains the principles and techniques that are required to be followed in accounting and includes both accounting and book-keeping.

Systems of Book-Keeping

There are two types of systems under which the day-to-day transactions are recorded:

1. Double Entry System
2. Single Entry System

1. Double Entry System

Under double entry system, there are two aspects of every transaction i.e. debit and credit. So, both the aspects of each transaction is recorded. In this system, the transaction is recorded on the debit side and also on the credit side. For example- when goods are sold on cash this transaction involves two aspects i.e. cash is received and goods are sold. Thus, in the double entry system cash account is debited and sales account is credited. This system is based on the dual aspect principle of accounting that for every debit there must be a credit of equal amount.

Stages of Double Entry System

1. Firstly, we record transactions from the vouchers into the Journal which is called the book of original entry.

2. Secondly, transactions in the Journal are classified and then posted to their respective ledger accounts. For e.g.: Rent paid by cash will be recorded in the rent A/c and cash a/c. Then a Trial Balance is prepared to verify the correctness of the ledger accounts.

3. Lastly, final accounts are prepared to ascertain the profit earned or loss incurred as a result of operations.

Characteristics of Double Entry System

1. ***Systematic records*:** Double entry system maintains the systematic and complete records of each transaction.

2. ***Dual aspect*:** This system is a complete method as it recognises and records both the aspects of a transaction.

3. ***Scientific method*:** This is regarded as a scientific method as it follows the rules of debit and credit. Also, with complete records errors can be detected and rectified easily.

4. ***Arithmetical Accuracy*:** This method ensures arithmetical accuracy because the total of debit is equal to the total of credit as one aspect of a transaction is debited and other is credited.

Advantages of Double Entry System

1. ***Scientific method*:** This method follows the rules of debit and credit, thus this system is a scientific method of recording business transactions.

2. ***Helps in comparative study*:** This method helps in comparative study of the results of two financial years because it prepares a systematic record of all the business transactions.

3. ***Helps in bringing arithmetical accuracy*:** Double Entry System helps in bringing numerical accuracy in accounting work. In this system, trial balance is prepared which helps in ensuring the accuracy. However, matching of both sides of the trial balance do not guarantee that the accounts so prepared will be error free.

4. **Maintains complete record of transactions:** Under this system, both aspects of a transaction are recorded, which means it results in showing the true position of Assets and Liabilities.

5. ***Assistance to management*:** This system assists management in decision making as it maintains complete records of business transactions and provides relevant information to the management which helps in taking rational decisions.

6. ***Minimises the possibilities of errors and frauds*:** Since complete record of business transactions is maintained under this system, thus, it minimises the probability of existence of errors and frauds in accounting records.

7. ***Presents financial position of an organisation*:** This system helps in ascertaining the financial position of an organisation because at the end of the accounting period financial statements are prepared under this system of accounting.

8. ***Ascertainment of Profit or Loss*: **Profit earned or loss incurred during a particular accounting period can be ascertained by preparing Trading and Profit and Loss Account.

9. ***Facilitates controlling*: **Under this system, proper record of business transactions is maintained. Thus, information provided under this method helps the management in effective controlling.

Disadvantages of Double Entry System

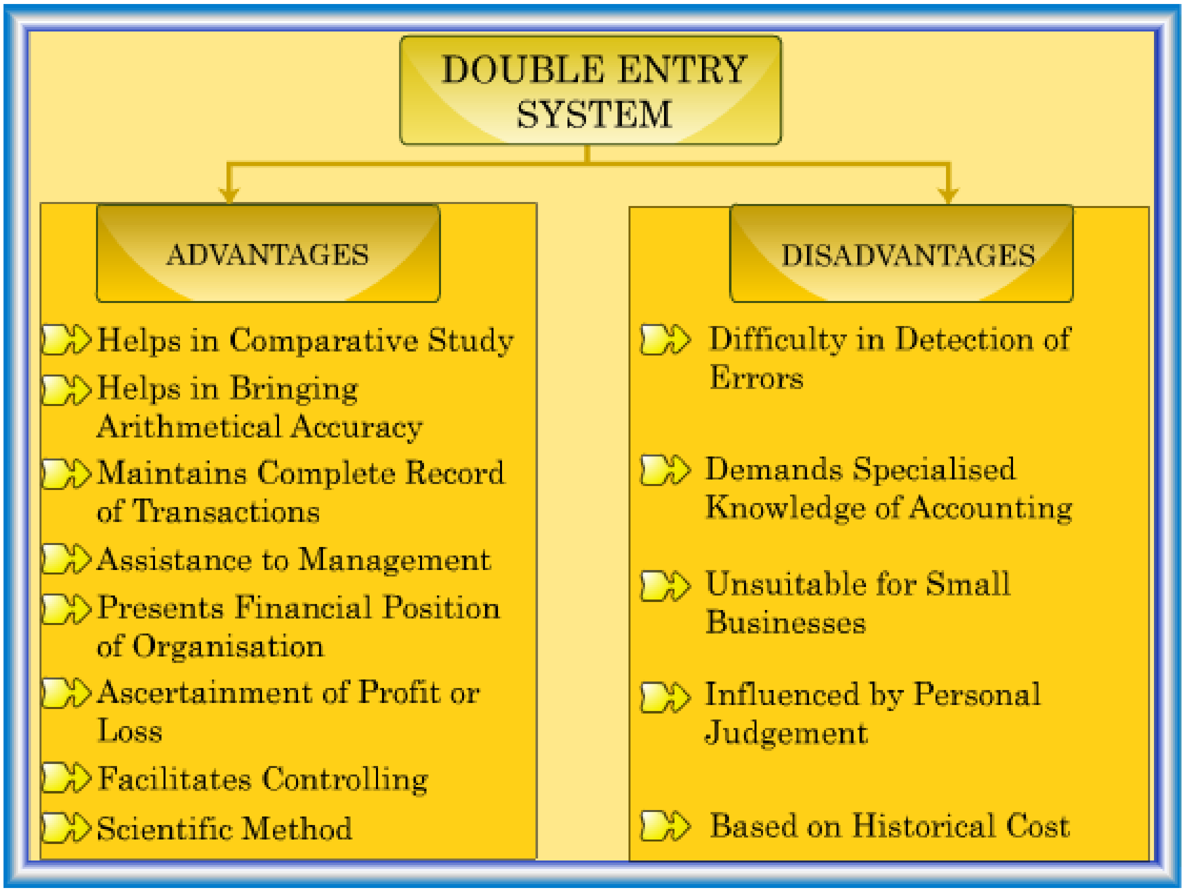
1. ***Based on historical cost*: **Accounting records that are maintained under this system of accounting are based on historical records. Thus, it ignores the effect of inflation and it cannot be ascertained that whether accounts prepared present the true and fair view of business or not.

2. ***Difficulty in detection of errors*: **Double entry system minimises the errors in the accounting records. But, since the records are maintained by humans, there is a possibility that an error may occur i.e. when a transaction is wrongly recorded in the books. Thus, it becomes difficult to detect such errors under this system of accounting.

3. ***Demands specialised knowledge of accounting*: **Double entry system requires specialised knowledge of accounting for the preparation of accounting records properly.

4. ***Unsuitable for small businesses*: **An accountant having specialised knowledge is required for recording of transactions on double-entry basis. So, it becomes difficult for small businesses or sole proprietors to maintain the records according to the double entry system.

5. ***Influenced by personal judgements*: **Sometimes the accounting records maintained under this system of accounting are influenced by the personal judgement i.e. accounts are manipulated to show a better financial position of a business and not the actual position.



2. Single Entry System

Books of accounts can be maintained under Single Entry System also. In this accounting system, the rules of debit and credit are not strictly followed. Unlike the Double Entry System, where we used to record the dual aspect of each transaction (i.e. every transaction affects two accounts simultaneously), here in this system, we record only the single aspect of a transaction. This is the reason, why Single Entry System is commonly termed as *Accounts from Incomplete Records* or *Defective Double Entry System*.

Under Single Entry System, we maintain only cash and personal accounts. On the other hand, real and nominal accounts are completely ignored. In other words, we can say that following the Single Entry System, we do not prepare subsidiary books (such as Purchase Day Book, Sales Day Book, Purchase Returns and Sales Returns Book) and ledgers accounts. Often accountants regard Single Entry System as an unscientific method of maintaining records, as the practice that is followed in this system is unsystematic and unorganised.

Advantages of Single Entry System

1. ***Easy to Maintain*- ** This method of recording transactions is simple. This is because no expert knowledge of accounting is required to maintain books.

2. ***Economical*-** This system is less expensive in comparison to double entry system of accounting as there is no need to hire specialised accountant for maintaining accounting records.

3. ***Suitable for Small Businesses*-** This system is particularly suitable for small business organisations that do not account for a large number of transactions.

4. ***Less Time Consuming*-** It is less time-consuming as only few books are to be maintained.

5. ***Flexible*-** As the rules of Double Entry System are not strictly followed, so, it can be easily adjusted or changed as per the requirement of the proprietor.

6. ***Simple to Compute Profits or Losses*-** The computation of profits or losses under this system is very simple. This is done merely by comparing the capital at the end with that of capital in the beginning.

Disadvantages of Single Entry System

1. ***Does not ensure Arithmetical Accuracy*-** Under this system, Trial Balance is not prepared; therefore, it becomes extremely difficult in verifying and checking the arithmetical accuracy of the books of accounts so prepared. This in turn encourages frauds and manipulations.

2. ***Unsystematic or Unscientific System*-** As the dual aspects of the transactions are not recorded, so this system is considered to be incomplete or unscientific.

3. ***Lack of Control over the Assets*-** As real and nominal accounts are not prepared, so it is difficult to keep a proper account of the assets. This may lead to misappropriation, frauds and embezzlement of assets.

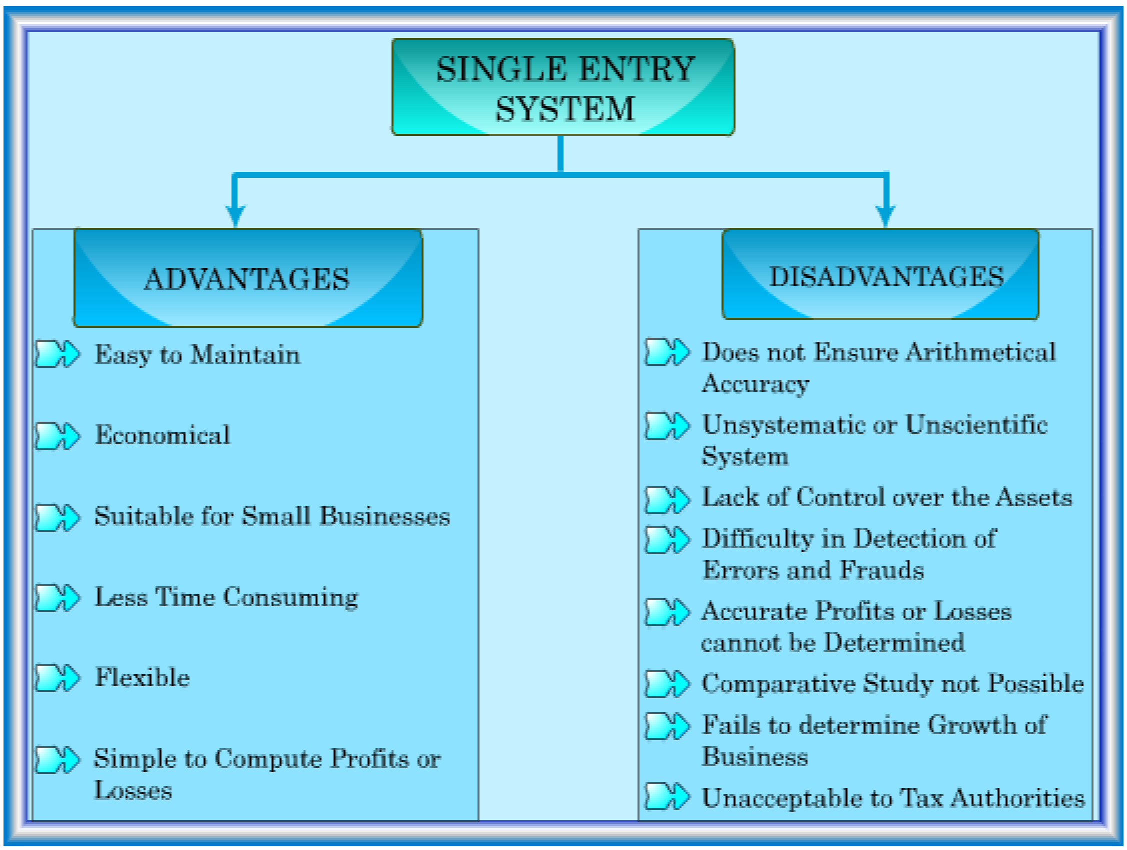
4. ***Difficulty in Detection of Errors and Frauds*-** Since proper accounting system is not followed, the books of accounts fail to reveal the clear financial picture of the business. This may further encourage the probability of undetectable errors and frauds.

5. ***Accurate Profits or Losses cannot be determined*-** Under this system, the profits or losses so determined are merely an approximation and not the actual figures. Thus, Single Entry System is not capable of depicting the true financial position of a business.

6. ***Comparative Study not Possible*****-** One of the major drawbacks of this system is that it fails to compare the current year's performance with that of the previous year. Thus, meaningful comparative studies and analysis cannot be laid.

7. ***Fails to Determine Growth of Business*****-** The actual performance of a business is expressed and measured in terms of profits and losses. Since, Single Entry System is incapable of revealing the actual profit or loss figures; therefore, this system fails to enable the users to assess the actual performance of the business.

8. ***Unacceptable to Tax Authorities*****-** The books of accounts maintained by following Single Entry System is not accepted by the tax authorities on any grounds. This is because these books are not maintained by following universally and lawfully accepted accounting principles.



Accounting Information: Meaning, Users and Qualitative Characteristics

Objectives

After going through this lesson, you shall be able to understand the following concepts.

- Meaning of Accounting Information
- Users of Accounting Information
- Accounting as a Source of Information
- Qualitative Characteristics of Accounting Information

Accounting Information

By now, we all know that accounting is a process of providing relevant accounting information to its users. In short, it is a communication channel between the business and its various users. Before providing the information to its users, accounting first records, classifies, summarises and analyses the business transactions.

That is, it starts with identifying the financial transactions and ends with preparing the financial statements of a business. The financial statements basically consists of Trading Account, Profit and Loss Account and the Balance Sheet. During the whole process of accounting, certain information and facts are generated which may be useful for its users.

This information is considered as accounting information which needs to be exchanged between business and its users. Thus, accounting information can be defined as data and facts produced or revealed by the financial statements of a business. This information is generally available in the form of financial statements, financial reports, etc.

The accounting information may be required by its users for meeting their numerous individual needs. The accounting information can be broadly categorised in the following three categories.

i. *Information Regarding Profit or Loss*- Mostly the users of financial statements are interested in knowing the profits or losses of a business. This information of profits or losses of the business are revealed through the Trading and Profit and Loss Account of a firm. Companies prepare Statement of Profit and Loss which is prescribed in the Schedule VI of the Companies Act, 1956 whereas, Income and Expenditure Account is prepared in case of a Not-for Profit Organisation to ascertain profits or losses. These statements show the net results of the operating activities of a business.

ii. *Information Regarding Financial Position*- Financial position is another information which is important for the users of financial statements. The financial strengths and weaknesses of a business are revealed through the Balance Sheet. In this statement, the various assets and liabilities of a business are shown.

iii. *Information Regarding Flow of Cash*- Cash Flow Statement shows both inflows and outflows of cash during an accounting period or a specific period. This information is of great importance in the business as it helps in knowing its actual cash position. Such information is revealed through the Cash Flow Statement of business. Various important decisions of business depends on the availability of cash.

Users of Accounting Information

There are various parties or users who are interested in the business of an enterprise and require accounting information. These users can be bifurcated in two categories as- Internal Users and External Users.

1. **Internal Users**
   These are the users who are internal to an organisation. Such users have a direct access to the financial statements of a business. The following users are included in the category of internal users.

   i. ***Owners*-** These are the persons who make investment in the business. These are interested in knowing the profit earned or loss incurred during an accounting period. They are interested in assessing the profitability and viability of the capital invested by them in the business. The financial statements prepared by the business concerns enable them to have sufficient information to assess the financial status and financial health of the business.

   ii. ***Management*-** The management is an integral part of an organisation. They are indulged in drafting plans, decision-making process, evaluating the past performances, etc. The financial statements enable the management not only in drafting policy measures and planning but also in efficient implementation of the plans. With the help of information revealed by the financial statements, management can not only enhance the efficiency of the business but also exercise various cost controlling measures to remove inefficiencies.

   iii. ***Employees and Workers*-** They are interested in the timely payment of wages and salaries, bonus and appropriate increment in their wages and salaries. With the help of the financial statements they can know the amount of profit earned by the company and can demand reasonable hike in their wages and salaries. The financial statements also help them to assess their individual career scope and their growth prospects.

2. **External Users**
   External users are those who are outsiders to an organisation and are interested in the financial affairs of the business. These users do not have a direct access to the financial statements of the business. The following parties come under the head of external users.

   i. ***Banks and Financial Institutions*-** Banks provide finance to various businesses in the form of loans and advances. Thus, they need information regarding liquidity, credit worthiness, solvency and profitability to advance loans. The accounting information revealed through the financial statements of business enable them to have access over such information.

ii. ***Investors and Potential Investors*-** These are the parties who have invested or are planning to invest in the business of an enterprise. They are interested in knowing the safety of their investment in the business and regularity of returns on their investments. Hence, in order to assess the viability and prospects of their investments, they need information about the profitability and solvency position of the business.

iii. ***Creditors*-** These are the parties to whom a business owes money on account of credit purchases of goods and services. Hence, creditors require accounting information to enquire about the credit worthiness and liquidity position of the business.

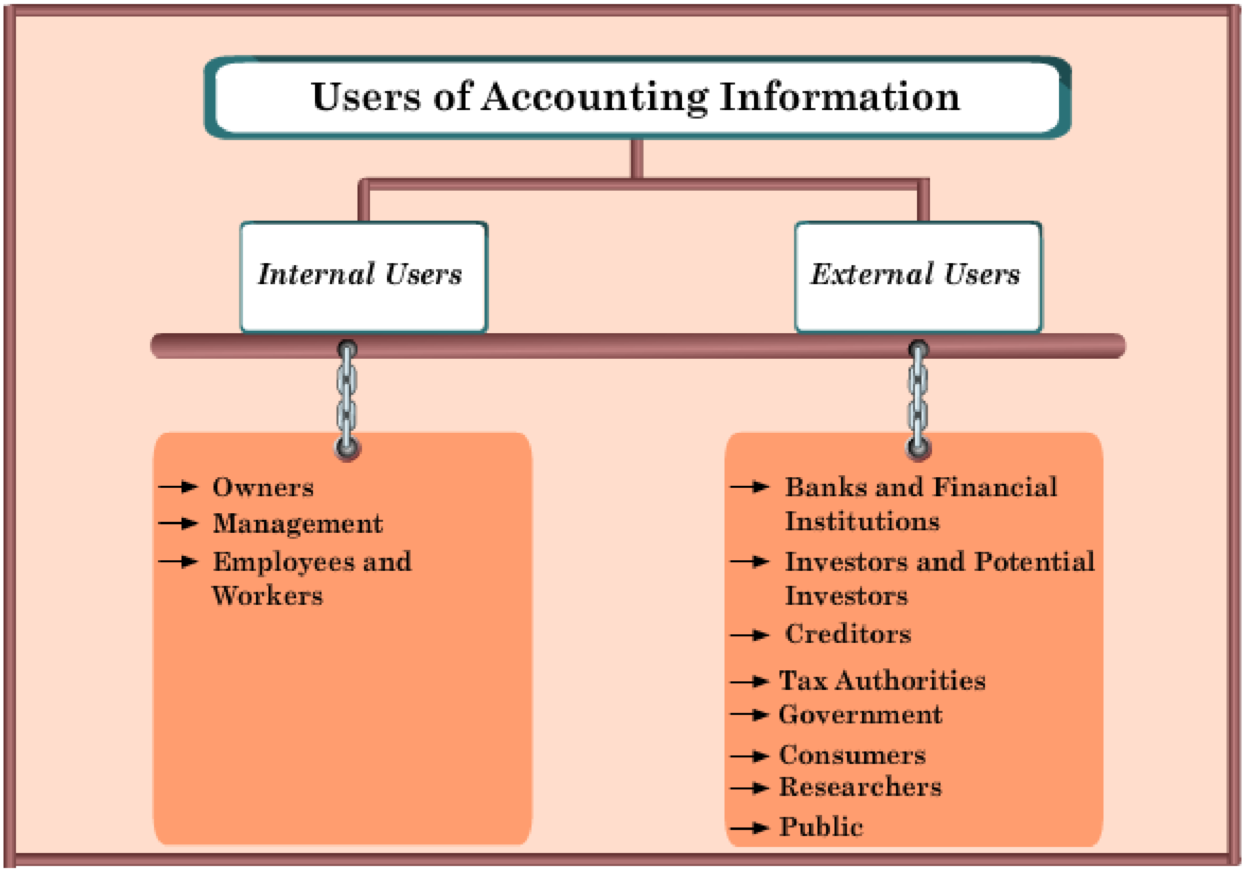
iv. ***Tax Authorities*-** They need accounting information to know whether the amount of sales, production, profits, revenues, etc. are correctly calculated and shown unambiguously in the books. This is very important so that appropriate and correct tax rates (of taxes such as sales tax, excise duty, etc.) are levied on the business.

v. ***Government*-** Government requires information to determine various macro-economic variables such as national income, GDP, industrial growth, etc. The accounting information assists the government in the formulation of various policy measures and to address various economic problems such as unemployment, poverty, etc.

vi. ***Consumers*-** Every business attempts to build-up reputation in the eyes of consumers, which can be created only by supplying better quality products and post-sale services at reasonable and affordable prices. Businesses that have transparent financial records, assists the customers in knowing the correct cost of production and accordingly assess the degree of reasonability of the price charged by the business for its products. Thus, unambiguous and transparent financial statements help in building business reputation.

vii. ***Researchers*-** Various research institutes such as NGOs and other independent research institutions like CRISIL, stock exchanges, etc. undertake various research projects. The accounting information facilitates their research work.

viii. ***Public*-** Public is keenly interested in knowing the proportion of profit that the business spends on various public welfare schemes; for example, making charities, funding schools, etc. This information is revealed by the financial statements of a business.

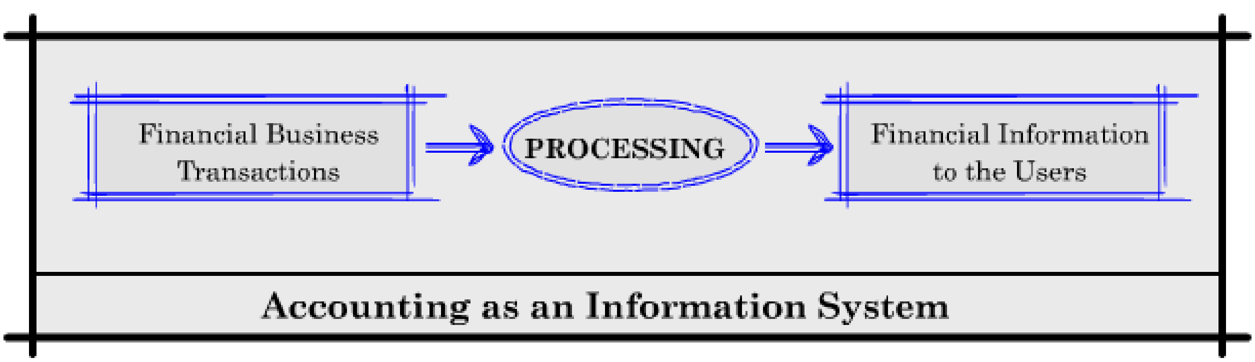


Accounting as a Source of Information

As studied in the last lesson accounting is basically concerned with recording of financial transactions so as to derive some results which can be communicated to the users of accounting information.

Also we know that accounting is a step by step process that begins with analysing transactions of financial nature and ends with communicating the results to the users.

However, in each successive step of accounting some kind of information is generated that may be useful to the users of accounting information. Accounting as source of information can be well understood with the help of following diagram.



Accounting as information system collects data of financial transactions entered into by the business which is processed during different stages of recording (journalizing, subsidiary books, ledger posting, final accounts) and is finally communicated to the users of accounting information in form of financial reports as an output.

Qualitative Characteristics of Accounting Information

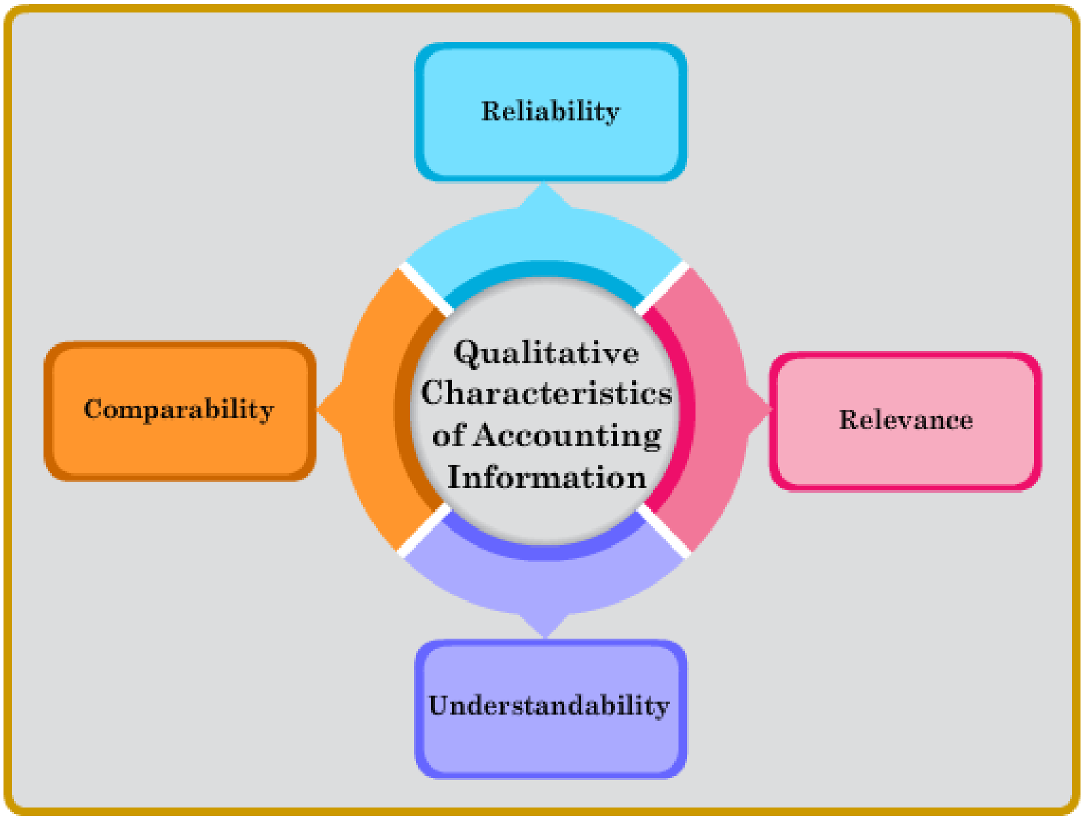
The accounting information revealed through the financial statements of a business is useful and valuable only when it shows true and fair view of the business activities. In order to depict the true and fair picture, accounting information should have the following characteristics.

i. ***Reliability*-** Accounting information should be reliable in such a manner that its users can completely depend on such information. All accounting information should be verifiable and should be verified from the source documents (vouchers) such as cash memos, bills, etc. Hence, the available information should be unbiased and free from any errors and ambiguity.

ii. ***Relevance*-** The users of accounting information need relevant information for effective decision making, planning and predicting the future conditions. For this, it is necessary that the essential and appropriate information is easily and timely made available to its various users. Any irrelevant and useless information should be avoided.

iii. ***Understandability*-** Accounting information should be presented in such a way that every user is able to understand and interpret the information without any difficulty in a meaningful and appropriate manner.

iv. ***Comparability*-** It is the most important quality of accounting information. Comparability means accounting information of a current year can be compared with that of the previous years. Comparability enables intra-firm (i.e. within an organisation) as well as inter-firm (i.e. with other organisations) comparison. It assists in assessing the outcomes of various policies and programmes adopted in different time horizons by the same or different businesses. Further, it helps to ascertain the growth and progress of the business over time and in comparison to other businesses.


Reliability
Qualitative Characteristics of Accounting Information
Comparability
Relevance
Understandability