

What is Accounting



**“** *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 financial character and interpreting the results thereof.* **”**

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American Institute of Certified Public Accountants (AICPA)

## Need For Accounting !

- We need accounting because it is the **backbone of business finances**. It was created in response to the development of trade in medieval times. The first recorded source of accounting entries was in Italy in 1494 by Luca Pacioli, a Franciscan monk.
- It is simply not for providing information to tax authorities and government agencies but to **identify and record all the activities that impact an organization** in a financial manner.
- It is also **useful for the employees and customers** in order to know the condition of the business entity.

# Users of Accounting



## Accounting Cycle

Transaction

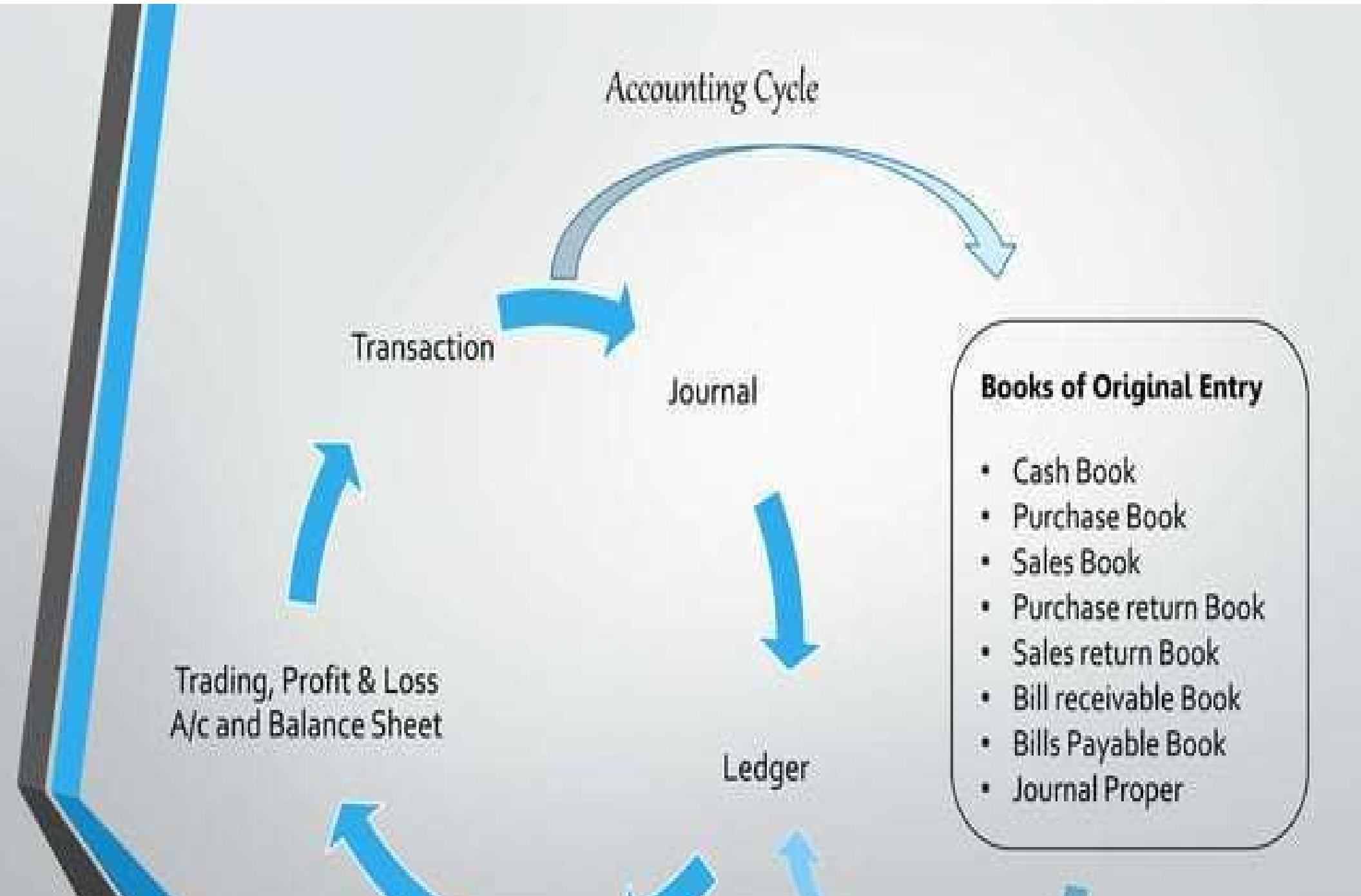
Journal

### Books of Original Entry

- Cash Book
- Purchase Book
- Sales Book
- Purchase return Book
- Sales return Book
- Bill receivable Book
- Bills Payable Book
- Journal Proper

Trading, Profit & Loss  
A/c and Balance Sheet

Ledger





# *Characteristics of Accounting*



## □ Accounting is an art as well as a science.

- Accounting is an **art** of recording, classifying and summarising financial transactions. It helps us in achieving our objective of maintaining proper accounts, i.e., to know the profitability and financial position of the business.
- Any organised knowledge is based on certain basic principles in a '**science**'. Accounting is also a science. It is an organised knowledge based on certain basic principles.



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## □ Recording of Financial transactions only

- Only those transactions and events are recorded which are of a financial character.
- There are a lot of transactions in the business which are very important for business but which can't be measured and expressed in terms of money.

## □ Recording in Terms of Money

- Each transaction is recorded in the books in the terms of money only.

## □ Communicating

- Includes the communication of financial data to the users who analyse them.
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## □ Classifying

- Classification is concerned with the systematic analysis of the recorded data, with a view to group transactions or entries of one nature at one place. The work of classification is done in the book termed as "Ledger".

## □ Summarizing

- (1) Trial Balance.
  - (2) Income statement
  - (3) Balance sheet.
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What Are the  
Objectives of  
Accounting ?

**To keep systematic records :**

- In the absence of accounting there would have been terrific burden on human memory which in most cases would have been impossible to bear.

**To ascertain the financial position of business :**

- The profit and loss account gives the amount of profit or loss made by the business during a particular period?

**To Provide Information to the Users :**

- The officers and staff of an enterprise need useful and timely information for making different types of business decisions.

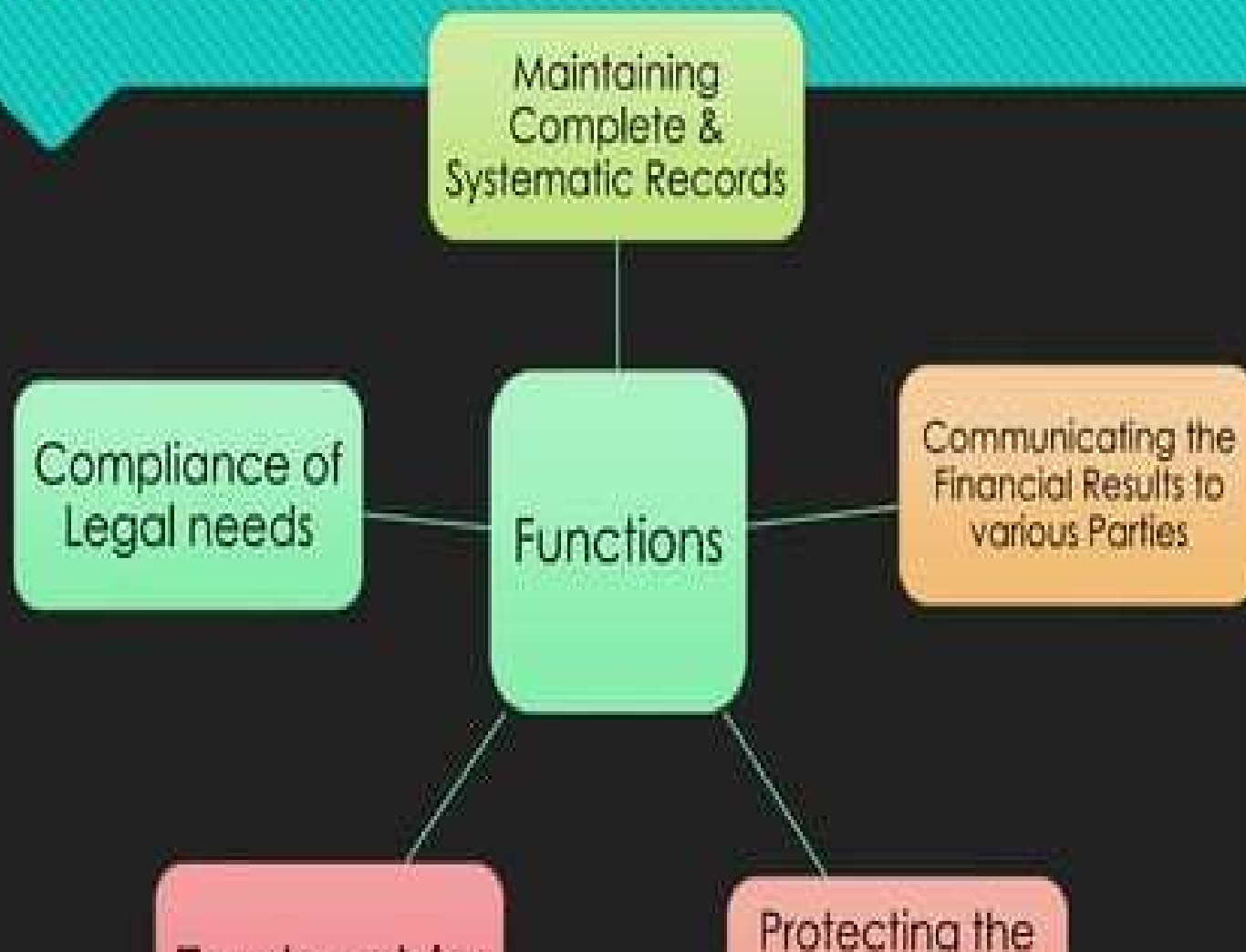
## Some other Objectives

- To know the exact reasons leading to net profit or net loss.
- To ascertain the financial position of the business from year to year.
- To prevent and detect errors and frauds.

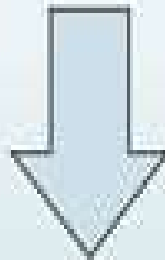
The image features a teal-colored upper section with a fine, repeating geometric pattern. Below this is a solid black section. A decorative notch is cut out from the bottom edge of the teal section, creating a jagged, mountain-like silhouette. The text "Functions of Accounting" is centered in the black section.

# *Functions of Accounting*

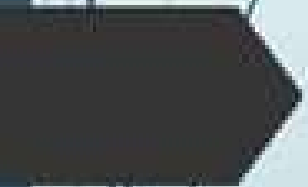
## Functions of Accounting

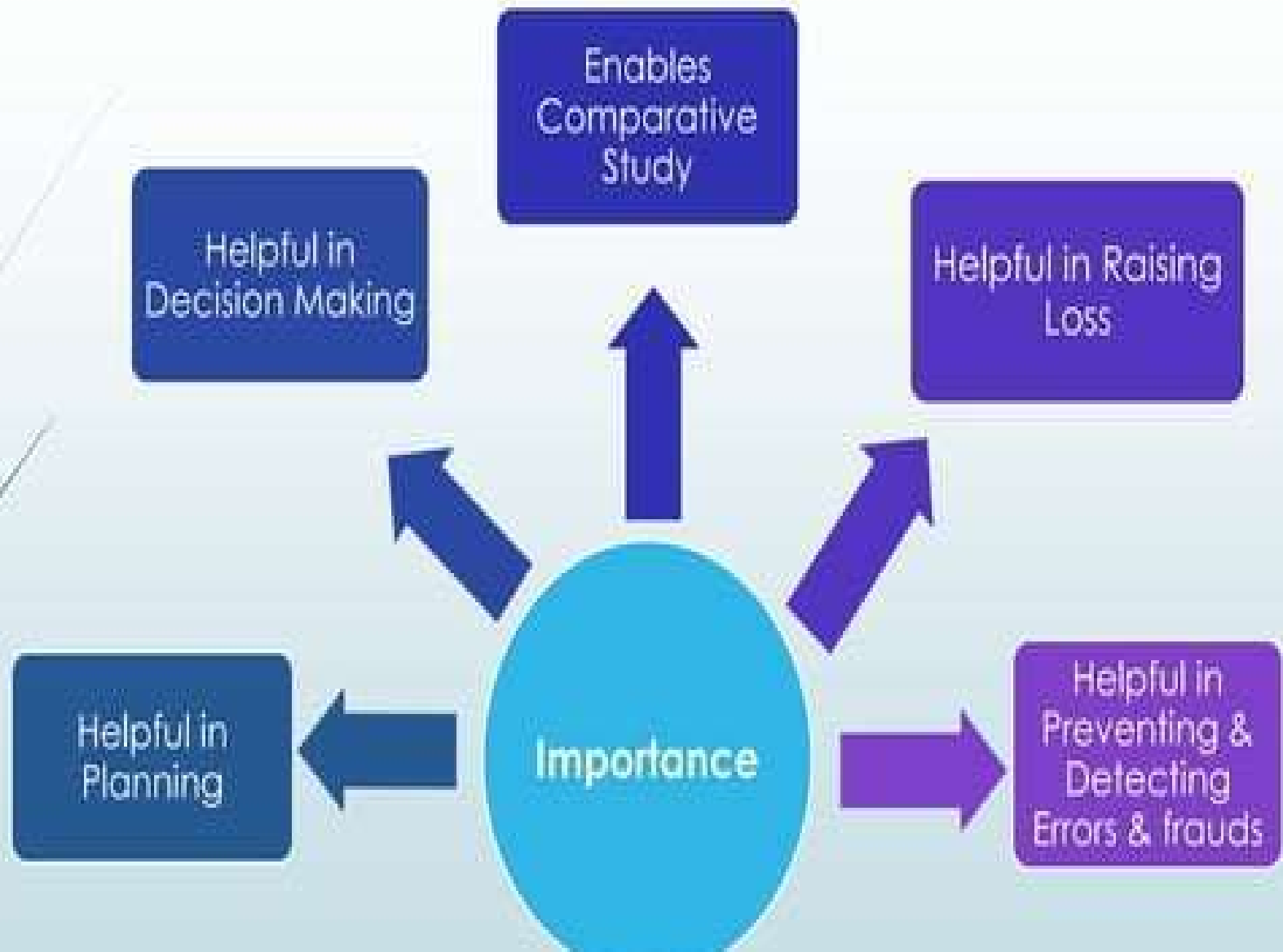


Conclusion



Significance





# ACCOUNTING RULES:

- **Personal Account:** these are the accounts of natural persons such as ram account, gopal account. Artificial person such as udayltd, syndicate bank. And representative personal account.

**Rule:** “Debit---The Receiver  
Credit---The Giver”

- **Real Accounts:** accounts relating to properties or assets of a trader are known as real accounts. It includes tangible assests such as buildings, furniture,. Cash, etc and also intangible assets such as goodwill, trade marks, patent rights.

**Rule:** “Debit---What comes in

- **Nominal Accounts** : account dealing with expenses, losses, gains and incomes are called nominal accounts, eg. Salaries, wages commission account etc.

**Rule:** “Debit----All expenses and losses  
Credit---All incomes and gains”

## **GAAP (Generally Accepted Accounting Principles):**

Accounting principles are the guidelines which provide a procedure to be followed in the process of accounting. But it is very difficult to have principles which are universally acceptable. so we have a set of principles which are general accepted by the makers of financial statements. These principles are called as “Generally Accepted Accounting Principles” (GAAP).

Accounting principles can be broadly divided into two categories

### **A. Accounting Concepts**

1. Business Entity Concept
2. Money Measurement Concept
3. Cost Concept
4. Going Concern Concept
5. Dual-aspect Concept
6. Realisation Concept
7. Matching Concept
8. Accounting Period Concept
9. Objective Evident Concept

### **B. Accounting Conventions**

1. Full disclosure
2. Materiality
3. Consistency
4. Conservation

**1. Business Entity Concept:** business is treated separated from the proprietor. All the transactions are recorded in the books of business and not in the books of the proprietor. The proprietor is also treated as a creditor of business. When he contributes capital, he is treated as person who has invested his amount in the business.

**2. Money Measurement Concept:** only those transactions are recorded in accounting which can be expressed in terms of money. Therefore, in the process of accounting only events which can be expressed and measured in terms of money are recorded.

**3. Cost Concept:** according to this, an asset is recorded its cost in the books of account i.e., the price which is paid at the time of acquiring it. The market value or any other value of an asset is not considered. It is therefore called as “historical cost concept”.

**4. Going Concern Concept:** it is assume that a business organisation will continue to operate for a considerably long period of time. This assumption is very important because sometimes money is spent by the business for a future benefit.

**5. Dual-aspect Concept:** dual mean two. It implies that every transaction will have two aspects. These aspects are giving and receiving.

**6. Realisation Concept:** Every business unit spends money to purchase goods or to manufacture goods for sale. Profit cannot be made only by manufacture sales of goods either for cash or on credit is essential to make earning. Without realisation of sales proceeds, there can be no profit. Unearned/unrealised revenue should not be taken into account.

**7. Matching Concept:** this concept tries to match the revenue and expenditure of an organisation pertaining to a particular period of time i.e., is one year. This will help the users of accounting to understand the functioning of the business in a clear manner.

**8. Accounting Period Concept:** business organisations are believed to have continued existence. But the performance of the organisation should be assessed regularly over a period of time. Normally one year is taken to assess the financial performance of the business.

**9. Objective Evident Concept:** This concept relates with the verification of accounting record with the outside evidence. Outside evidence means study of those documents and vouchers on the basis of which accounting record has been made.

## Accounting conventions:-

**Conventions of full disclosure:** According to this convention, all accounting statements should be honestly prepared to that and full disclosure of all significant information to be made.

**Convention of materiality:** According to this convention, accounting should consist of all the material facts. Material facts are one those which can have an impact on the financial statements of the organisations. Immaterial and irrelevant items should be excluded or merged with other items.

**Convention of consistency:** Accounting rules, practices and conventions should be continuously observed and applied i.e. these should not change from one year to another.

**Convention of conservatism:** According to this convention all incomes or profits if anticipated should not be taken into account. But any anticipated losses should be considered while preparing the accounts of a business.

## Double entry book keeping: -

This system of accounting was invented by 'Lucas Pacioli' of Italy in 1494 in Venice but developed in England. The object of book keeping is to keep a complete record of all transactions that take place in business. The double entry book keeping refers to a system of accounting in which every transaction effects at least two accounts. In double entry book-keeping, the amount of every transaction is written twice, once as debit and again as credit, leading to the conclusion that that in mathematical terms the sum of all accounts will be zero and in terms of accounting equation, the sum total of all assets must be equal to sum total of all liabilities and the owners equity. This equity holds true up to the last stage of accounting process, ending with the preparation of the balance sheet.

Every business transaction having two aspects, one will be treated as debit and other will be treated as credit. This debit and credit will be decided on the basis of nature of aspect. Each aspect comes under personal, real or nominal accounts.



Every business organisation deals with people, assets, pays expenses and receives incomes. Therefore, it is necessary to keep the following accounts in order to keep a complete record of all the transactions.

1. Personal accounts (PA)
2. Real accounts (RA)
3. Nominal accounts (NA)

## Characteristics of Double entry system:

1. Every business transaction affects two or more accounts
2. Every account is divided in two parts
3. Division of amount column as debit and credit
4. Dual aspect of every transaction
5. Based upon accounting concepts and conventions
6. Preparing trial balance
7. Preparation final accounts

## Advantages of double entry system:

1. Scientific system: It is scientific system compared to single entry system.
2. Full information
3. Assessment of profit and loss
4. Knowledge of creditors
5. Arithmetical accuracy
6. Assessment of financial position
7. Comparison of results
8. Maintenance according to incoming tax rules
9. Detection of frauds

## Rules for debiting and crediting:-

The rules of debit and credit depend on the nature of an account. If aspect related to persons, personal account rules, if assets real account rule and if expenses or incomes nominal account rules are applicable.

**Personal accounts:** Personal accounts deal with persons. These include natural persons such as Rama Rao, Latha etc., artificial persons or legal persons such as Tata Company Ltd, Andhra Bank etc and representative personal accounts.

**Rule:** Debit ((Dr) → The receiver

Credit (Cr) → the giver

E.g.:1. Cash received from Raju is Rs 5000/- . Here Raju is personal a/c and he is Cr (giver).

2. Goods sold to Chandra is Rs 7000/- . Here Chandra is personal a/c and he is Dr (receiver).

**Real accounts:** Real a/c deals with assets. These include tangible assets like land, buildings, machinery etc which can be seen touched and intangible assets like goodwill, trademarks etc which cannot be seen but can be measured.

***Rule:*** Dr → what comes in?  
Cr → what goes out?

E.g. goods purchased for cash RS 8000/-. Here goods and cash are real a/c. Goods is Dr(coming) while cash is Cr(going).

**Nominal accounts:** Nominal accounts are deals with expenses like rent, wages, salary, transport etc and incomes like discount received, rent received, commissions received etc.

***Rule:*** Dr → the expenses and losses\_  
Cr → the incomes and gains

E.g. 1. Salary paid by cash Rs 5000/- . Salary is nominal a/c and is Dr (expenditure)

2. Interest received Rs 5000/- .interest is nominal a/c and is Dr (income)