Introduction

LESSON 1: Need for accounting

The main aim of the business is to earn profit. For earning profit, a business man will either purchase the goods in one market at certain price & sell it in another market at higher price Or He will convert Raw material into finished goods and sell it in to different customers at a price which will give him profit on cost of production.
But sometimes he may sell goods either at a loss or at a very small margin of profit; however he will be anxious at the end of the year to find out whether he sold goods at a profit or loss and what is his financial position on a particular date.
More over business information is required for planning, control, evaluation of performance and decision making.
This information can be arrived only when business transactions are recorded, classified and summarized properly.
SO in order to record business transactions well devised system is followed; i.e. booking keeping (Maintenance of books) and Accounting (preparation of financial statements)

Life of the accounts starts with a Transaction;
Transaction is an Exchange.
Any exchange of money or money's worth as goods and services between two parties is called a transaction

1ST Rule : Transaction must have two sides or aspects one is debit aspect and other is credit aspect. This is called Dual Aspect that's why we call accounts as double entry

2nd Rule : Transaction has to be in terms of Money, i.e. famous money measure concept If any transaction cannot be measured in terms of money, it cannot be recorded in the Books.

It may relate to purchase and sale of goods, receipt and payment of cash and rendering of services by one party to another. In accounting only business transactions are recorded.

Business transaction is an event which can be expressed in terms of money .

Event : Event is result of transactions; it has to be appearing in balance sheet. An event which cannot be expressed in terms of money. EG: Closing stock, Profit.

When payment of a business activity is made immediately, it is called cash transaction.
But when payment is postponed to future date, it is called credit transaction.

System of Accounting :
Following are two systems of Accounting:

1) Single Entry system:

Under this system, only personal accounts are maintained. This system has no complete record of business transactions done during specified period;

Hence neither the trail balance nor the final accounts can be prepared due to non availability of real and nominal accounts. This system is followed by small concerns where business transactions are few.

2) Double entry system:

This system of accounting is invented by luco pacioli in the year 1494.

We have seen earlier that every transaction has two aspects, i.e, when we receive some thing we give something else in return.

For example: when we purchase goods for cash, we receive goods and give cash in return; similarly in case of credit sale of goods, goods are given to customer and the customer become debtor for the amount of goods sold to him.

This method of writing every transaction in two accounts is known as double entry system of accounting. Of the two accounts, one account is given debit while other account is given credit with an equal amount. Thus, on any date, the total of all debits must be equal to total of all credits because every debit has a corresponding credit.

Factors common to every business:

1) The business has to enter into business dealings with a number of persons or firms. So, an account of each person or firm, with whom business dealings take place is opened. Such accounts are known as personal accounts.
2) The business must have some assets such as stock, cash, furniture etc.., with the help of which the business may be carried on. Therefore, an account of each asset is opened. Such accounts are classified as Real accounts.
3) There must be certain sources from which the income of business is derived. Similarly, certain expenses must be incurred to earn income. Therefore, an account of each expense and income is opened in the books. Such accounts are known as Nominal accounts.

Classification of accounts:

From above it is clear that 3 types of accounts, namely Personal, Real, nominal.

These accounts which are opened to keep a complete record of all financial transactions of the business.

Types of accounts	**1) personal**	**2) real**	**3) nominal**
E.g.	Capital	Land	salary
	Drawings	Building	Wage
	Bank	Plant & machinery	sales
	Debtors & creditors	Cash.	Discount

Rules of accounts:

Debit	Receiver	what comes in	Expenses & losses.
Credit	Giver	what goes out	incomes & gains.

Personal accounts record a business's dealings with persons or firms. The person receiving something is given debit and the person giving something is given credit.

In case of real accounts, assets entering the business are given debit and leaving the business is given credit.

In case of nominal accounts, accounts of expenses and losses are debited and accounts of incomes and gains are credited.

Accounting cycle

Transactions are recorded in journal; Journal is a book of Original entry; it is also known as Secondary book, it consists of 5 columns;

From journal, transaction are posted in ledger, leger is also known as Principal book, it consists of 8 columns,

From ledger balances are extracted to trail balance, Trail balance is a statement which shows arithmetical accuracy.

From Trail balance Nominal a/c are closed and transferred to trading and P&L account, Real accounts are not closed and not balanced and entered in balance sheet.

Preparation of trading, P & l, and B/s is called Final accounts, is the last step of accounting process.
In big companies Final a/c are published as Annual reports (financial statements)
Financial statements consists of trading, P & L, Balance sheet, Cash flow and notes to accounts.

MEANING AND SCOPE OF ACCOUNTING

Accounting is a art of Recording, Classifying, and summarizing the Transactions & Events, And interpreting results thereof. (AICPA)
Generate financial information by Recording, Classifying, and Summarizing.
By using financial information – Analyze, Interpret, and Communicate.

Objectives of accounting

1) Ascertainment of financial performance.
2) Ascertainment of financial position.
3) Providing financial information to users (Financial reports)

Functions of Accounting (M-D-FO-GO-TA-& CO)

1) Measurement 2) Forecasting 3) Decision making 4) Comparison & evaluation
5) Government regulation 6) Taxation

Sub-fields of accounting

1) Financial accounting, 2) management accounting, 3) cost accounting, 4) CSR accounting,
5) HR accounting.

Users of accounting

1) Investors 2) Employees 3) Lenders 4) Suppliers 5) Customers 6) Government 7) Public.

Is Accounting is a science or an Art

Science may be defined as systematic **body of knowledge** based on certain principals which have universal application. scientific knowledge is based on observation, experiments and testing of facts.

Whereas Art is **application of knowledge** comprising of some accepted theories, principle, rules, concepts, and conventions. It helps us to to tell the manner in which we may attain our objectives in best possible way. The more we practice an art the more expert we become in it.

Accounting is a science because recording ,classifying, and summarizing of business transactions is done on the basis of certain principals such as principals of double entry system which are universally applicable.

Accounting is an art, because it tells us manner in which some special objectives like ascertaining trading results for a period and financial position of a business on particular date can be achieved.

Basis of accounting:

1) Cash basis : Under this basis actual cash receipts and actual cash payments are recorded, income or profit of a particular accounting period is ascertained on the basis of cash revenue received and cash expenses paid during the period.

2) Accrual basis : on accrual basis; Income whether received or not but has been earned or accrued during the period forms a part of total income of that period, similarly if a firm has taken benefit of a particular service, but has not paid with in that period, the expenses will relate to the period in which the service has been utilized and not the period in which payment for it is made.

Accounting Equation:

The whole financial accounting is based on the accounting equation.
For a business to operate recourses are required and that these resources are to be supplied to the firm by someone;
The resources supplied by the firm are called Assets & resources supplied to the firm by the owner is called capital & resources supplied to the firm by the outsider is called liability (debt)

Therefore in the two sides of equation ,one side is resources possessed by the firm and on other side sources from which these resources are obtained.

ASSETS = EQUITIES

Equities divided into equities of creditors representing debts of the business known as liabilities and Equities of owner known as capital (NET WORTH) ; Therefore :

ASSETS = LIABILITIES + CAPITAL