

Accounting —An Introduction

1.1 Introduction

You are familiar with the word 'business'. Take the example of a shopkeeper or businessman near your place and observe his activities. He buys different goods from wholesalers or producers and sells them to consumers. Sometimes, he sells goods on credit to known customers. He also makes payments through cheques. Sometimes, he withdraws goods or cash for his personal use. These and many more are his business activities. Now, you ask the shopkeeper how he remembers names of customers, details of goods, etc. He would answer that whenever he sells goods on credit, he notes down the same in a note-book or diary. Similarly, he notes down all credit purchases, etc. These are his records of business activities. Similarly, large business concerns maintain record of business activities. This lesson focuses on recording of business transactions and various aspects of accounting.

1.2 Objectives

After studying this lesson, you will be able to :

- state the meaning of business transactions;
 - cite examples of business transactions;
 - distinguish between the business transactions and the owner's personal transactions;
 - explain the meaning of book-keeping with examples;
 - state the meaning of Accounting;
 - distinguish between Book-keeping and Accounting;
 - identify different Branches of Accounting;
 - state objectives and functions of financial accounting.
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1.3 Business Transactions

In your own house, you would have observed many transactions taking place, for example, purchase of vegetables, paying for school fee, telephone, rent, etc. Just as many transactions take place in a house, many more transactions take place in a business.

Let us observe the activities of a nearby stationery shop. A customer comes. He buys register and pays money for it. Then, another customer comes. He buys a text-book and he also pays for it. After sometime, a third customer comes to the shop. He purchases different stationery items like writing pads, pencils, pens, etc. He buys these items on credit. Then, a supplier comes. He gives various stationery items to the shopkeeper and submits a bill. The shopkeeper keeps the bill and promises to pay after one month. These are some of his important business transactions. There can be many more such activities. You have noticed that these business transactions involve exchange of goods for money or promise for payment in future. These transactions have some important features which are as follows:

- (i) Business Transactions are business activities.
- (ii) These involve exchange of goods or services like transportation, storage, packaging, etc for money or money's worth.
- (iii) These are monetary in nature.
- (iv) In cash business transactions, goods or services are exchanged for money.
- (v) In credit business transactions, goods or services are exchanged but money is received at a future date.
- (vi) All business transactions are recorded in the books.

You might have noticed that all the above business transactions are with the OUTSIDERS. Sometimes, business transactions pertain to the OWNER. For example, Abhishek starts a small shop with cash Rs.1,00,000/-. In exchange, the owner (Abhishek) gets an ownership right against business. Take another example, Abhishek withdraws goods costing Rs.5,000/- from the shop for his own use. It is a business transaction. Here, the owner gets goods worth Rs.5,000/-. While, the business gets a right to receive money from the owner, you may say that business transactions pertain to the outsiders or to the owner. Now, business transaction may be defined as:— "An exchange of goods, services, or any other activity for money or money's equivalent. It involves exchange of money also." In simple words, it includes all events and activities of business which are financial in nature.

You know that a businessman enters into several transactions in a day. Some of these may be meant for his personal purposes. For example, Abhishek goes to a movie with his friends. This is his personal transaction and not the business transaction since a business transaction has an effect on business, therefore, it is recorded in the books of the business. Owner's personal transactions are not recorded anywhere in the books of the business. This separation of business and personal transactions is very helpful in recording business transactions.

Intext Questions 1.1

1. Tick mark (\checkmark) against the correct statement and cross (\times) mark against the incorrect statements in the following:
 - (i) Shifting of goods from one place to another within a shop is business transaction.
 - (ii) Premium is not paid for his business activities.
 - (iii) All owner's personal transactions are business transactions.
 - (iv) Shifting of goods for personal use from his business is business transaction.

 2. Classify the following into business and non-business transactions:
 - (i) Rahim starts business with Cash— Rs.1,00,000/-
 - (ii) He deposits money into the bank— Rs.50,000/-
 - (iii) He buys goods for Cash— Rs.10,000/-
 - (iv) He takes out money from the shop and gives it to his wife for buying a saree— Rs.1,000/-
 - (v) He attends a family function and gets present worth — Rs.3,000/-
 - (vi) He pays salary to his domestic servant— Rs.500/-
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1.4 Book Keeping and Accounting

The foregoing section contains some examples of business transactions. As a matter of fact, a business undertakes many more transactions. Can you guess how many? It depends upon the size of a business concern. The daily business transactions may run into hundreds or thousands. Can a businessman

remember all these transactions? No. Therefore, it becomes necessary to record these transactions systematically. Recording business transactions in a systematic manner in the books of business is known as Book-Keeping. You may define Book-keeping as: **“The art of keeping a permanent record of business transactions.”**

The work of book-keeping is **generally performed by a person** known as book keeper. From book-keeping important details such as total sales, total purchases, total debts, total cash receipts and payments etc. may be ascertained. Now-a-days, much of the book-keeping work is performed by computers and other machines.

As you know, the main objective of doing business is to earn profits. In order to achieve this objective, mere recording of business transaction is not enough. **Accounting involves not only Book-keeping but also many other activities.** Let us study about them:

a) **Classification**

Under this, all recorded transactions which are of the same type and nature are grouped under one head. For example, cash sales, credit sales and sales to owner, etc. are grouped as total sales. Similarly, Cash purchases, credit purchases, etc. are classified as total purchases.

b) **Summarization**

Under this, summary of all important business transactions is presented in a format. This summary format shows business profits and financial position. These are known as financial statements or Profit and Loss account and Balance Sheet (You will study about these financial statements in a Module on ‘Financial Statements’).

c) **Analysis and Interpretation**

With the help of analysis, useful information is obtained from financial statements. The information derived is then interpreted by the users of the information. Such interpretation helps interested parties in taking prompt decisions.

The whole process of **recording, classifying, summarizing and interpreting is known as “Accounting”**. Now you may define Accounting as:

“The art of recording, classifying, summarizing, analysing and interpreting the business transactions systematically and communicating business results to the interested users”.

These interested users may be owner himself or herself, creditors,

government, etc. Accounting is also viewed as discipline. It has its own principles, rules and concepts, which guide accountants in their accounting practices.

Distinction between Book-keeping and Accounting

These two terms have been distinguished below:

Points of distinction	Book-keeping	Accounting
i) Objective	The objective of Book-keeping is to maintain records of business transactions.	Accounting aims at maintaining business records, calculation of business income, depiction of financial position and communication of business results.
ii) Function	The function of Book-keeping is to record business transactions.	The function of Accounting is the recording, classifying, summarizing interpreting business transactions and communicating the results.
iii) Scope	Book-Keeping has a limited scope.	Besides book-keeping, it includes classification, summarization, interpretation and communication. Therefore, its scope is wider.
iv) Level of knowledge	For it, elementary knowledge of accounting rules is enough.	In accounting, advance and in-depth understanding is required.
v) Basis	For recording business transactions, vouchers and other supporting documents are prepared.	Book-keeping serves the basis for accounting information.

Intext Questions 1.2

1. Fill in the blanks with suitable words:
 - (i) Keeping permanent record of business transactions is known as _____.
 - (ii) When recorded transactions of same type and nature are grouped under one head, it is known as _____.
 - (iii) The next stage after classifying is _____.
 - (iv) The whole process of classifying, summarising, analysing and interpreting the results of business transactions is known as _____.

 2. Identify transactions related to "Book-keeping" or "Accounting" and write "Book-keeping" or "Accounting" against each in brackets.
 - (i) Credit Purchases ()
 - (ii) Cash sales ()
 - (iii) Calculation of business profits ()
 - (iv) Finding out business financial position ()
 - (v) Find out total creditors ()
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1.5 Branches of Accounting

There are three important branches of accounting. These are as under:

(i) Financial Accounting

It is an important branch of accounting. It helps in recording, classifying and summarising business transactions. Financial statements are prepared under Financial Accounting. These statements are Profit and Loss Account and Balance Sheet. With the help of these statements, business results are communicated periodically to the interested parties or users.

(ii) Management Accounting

It is that branch of accounting that seeks to furnish accounting information to managers so that they can take appropriate decisions for better management of business.

(iii) Cost Accounting

It is a special wing of management accounting. It involves calculation of the cost of product. Through analysis of the expenses of operating a business, it helps in controlling cost of products. It helps management in fixing a fair selling price.

Objectives and Functions of Financial Accounting

The main objectives of financial accounting are as under:

(i) Finding out various balances

Systematic recording of business transactions provides vital information about various balances like cash balance, bank balance, etc.

(ii) Providing knowledge of transactions

Systematic maintenance of books provides the details of every transactions.

(iii) Ascertaining net profit or loss

Summarization in form of Profit and Loss Account provides business income over a period of time.

(iv) Depicting financial position

Balance Sheet is prepared to depict financial position of business. Position means what the business owns and what owes to others.

(v) Information to all interested users

After analysis and interpretation, business performance and position are communicated to the interested users.

(vi) Fulfilling legal obligations

Vital accounting information helps in fulfilling legal obligations in time eg. sales tax, income tax etc.

Functions

Accounting covers a wide range of FUNCTIONS. The work of accounting begins with the recording of a business transaction and ends with its communication to the users. Following are the important functions of Financial Accounting:

(i) Recording business transactions

The most important function of Accounting is to keep a systematic record of all business transactions.

(ii) Calculation of business income

In Financial Accounting, Profit and Loss Account is prepared for the calculation of business income and Balance Sheet is prepared for ascertaining financial position of business.

(iii) Communication of business income and position

At the end of the period, Financial accounting informs the various users about business performance and financial position.

(iv) Meeting legal obligations

Accounting information provides useful information to fulfil legal obligations on time. For example, sales tax, income tax, etc details can be obtained only when the business has records of these. From accounting records, such details can be easily computed.

Intext Questions 1.3

1. Match Box A (in which accounting function is given) with Box B (in which branch of accounting is given):

Box A
(Accounting Function)

Box B
(Branch of Accounting)

- | | |
|---|---------------------------|
| (i) Preparation of financial statements | (a) Management Accounting |
| (ii) Determination of cost of product | (b) Financial Accounting |
| (iii) Making Managerial decisions | (c) Cost Accounting |

2. Fill in the blanks with suitable words:

- (i) Accounting work begins with _____ and ends with _____ to the users.
- (ii) In Financial Accounting, _____ is prepared for the calculation of business income.
- (iii) To show financial position _____ is prepared.
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1.6 What You Have Learnt

- (i) Business transactions involve exchange of goods or services for money or money's equivalent.
- (ii) All business transactions, whether pertain to the owner or to the outsiders, are recorded in the books of business. But owner's personal transactions are not recorded anywhere in the books of business.
- (iii) Book-keeping is an art of keeping a permanent record of business transactions.
- (iv) The whole process of recording, analysing, classifying, summarising, interpreting and communicating is known as Accounting.
- (v) Three important branches of accounting are — Financial, Cost and Management accounting.
- (vi) Main objectives of financial accounting are:
 - Providing knowledge of transactions
 - Finding out balances
 - Ascertaining Profit or Loss
 - Depicting financial position
 - Providing information to all interested users
 - Fulfilling legal obligations
- (vii) Important functions of financial accounting are:
 - (i) recording business transactions,
 - (ii) calculation of business income,
 - (iii) communication of business income and position and (iv) meeting legal obligations.

1.7 Terminal Questions

1. Answer the following questions in one sentence:
 - (i) Name the process of recording, classifying, summarising, analysing and interpreting the results of business transactions.
 - (ii) Name the branches of accounting.
 - (iii) Name the system of keeping a permanent record of business transactions.
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2. Answer the following questions in 30-50 words:
 - (i) Define Accounting
 - (ii) Write any four important features of business transactions.
 - (iii) Explain the following :
 - (a) classifying
 - (b) summarizing
 - (c) interpretation
3. Distinguish between book-keeping and accounting. (About 100 words)
4. Explain the objectives of financial accounting. (About 100 words)
5. Explain the important functions of financial accounting. (About 100-150 words)
6. Explain the different branches of accounting. (About 100 words)

1.8 Answers to Intext Questions

- 1.1 1. (i) (×) (ii) (√)
(iii) (×) (iv) (√)
 2. (i) to (iv) — Business transactions
(v) to (vi) — Non-business transactions
 - 1.2 1 (i) book-keeping (ii) classifying
(iii) summarizing (iv) accounting
 2. (i) book-keeping (ii) book-keeping
(iii) accounting (iv) accounting
 - 1.3 1 (i) b (ii) c (iii) a
 2. (i) Business transactions, communication
(ii) Profit and Loss A/C
(iii) Balance Sheet
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