

E-Learning Module-1:

Introduction to Accounting

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Course Summary:

This course attempts to discuss about the basic concept of Accounting. This course is mainly designed for the undergraduate students of commerce.

Course Content:

1. Meaning and objectives of Financial Accounting.
2. Branches or types of Accounting.
3. Users of accounting information and their information needs.

Introduction:

With the increase in size and complexity of business, more and more people are getting affected, directly or indirectly, by the operations of business organizations. As a result, these affected parties want to know about the operation of business. Accounting, as a language of business, is directed towards satisfying the diverse financial information needs of various interested parties. Following are some of the definitions of accounting given by renowned accounting professional bodies and accountants:

“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 a financial character and interpreting the result thereof”. - **American Institute of Certified Public Accountants [AICPA]**;

“Accounting refers to the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information”. - **American Accounting Association [AAA]**.

“Accounting is an information system that identifies records and communicates the economic events of an organization to interested users”. - **Weygandt, Kieso and Kimmel**.

“Accounting may be defined as the collection, compilation and systematic recording of business transactions in terms of money, the preparation of financial reports, the analysis and interpretation of these reports and the use of these reports for the information and guidance of management”. - **A. W. Johnson**.

From the above definitions it is understood that accounting is concerned with the process of identifying, measuring, analyzing only financial information, measurable in terms of money and communicating those information to both internal and external parties for their decision making. Accounting is a mixture of both accounting principles and the skill and experience on the part of accountant. Therefore, accounting may be defined as a body of knowledge and practice concerned primarily with identifying, recording, classifying, summarizing and communicating financial information in a summarized form to various users including management for their decision making.

Objectives of Financial Accounting

The financial accounting is concerned mainly with the financial affairs of the organization. The objectives of financial accounting are-

1. To **identify and systematically record** financial transactions in the books of accounts.
2. To **ascertain result of operation** by preparing income statement in case of profit seeking concern or income and expenditure account in case of non-profit seeking concern for a particular period.
3. To **ascertain financial affairs** of a concern by preparing balance sheet on a particular date.
4. To **keep cash book scientifically and accurately** so that misappropriation of cash can be controlled.
5. To **help** owner of the business **to take right steps** to exercise control over assets and liabilities of the business.
6. To **provide useful information** to various interested parties to help them taking right decision at the right time.
7. To **help management** in determining and evaluating appropriate management policies to run business successfully.
8. To **help tax authorities** for easy determination/settlement of tax.
9. To **help testing arithmetical accuracy** of accounts by means of preparing trial balance.

Different types of Accounting

We know accounting is mainly concerned with providing financial information for decision making by various interested parties. Different branches of accounting came into existence depending on the purposes for which accounting information is generated and also various target users of financial information. There are some branches of accounting which are considered traditional, such as, **financial accounting, cost accounting and management accounting** and there are some others, such as, **tax accounting, social responsibility accounting, forensic accounting** etc. which have evolved in recent years as a result of specialized requirements of financial information for other special purposes. Conventionally, accounting is divided into the following three types:

1. **Financial Accounting:** Financial accounting is mainly concerned with the recording of financial transactions, determining profit or loss of business operation for the financial period and disclosing the financial position of the business on a particular date, usually at the end of the financial period. Financial accounting is done by following accepted accounting principles. Financial accounting deals with historical data and as a result, it is also called **historical accounting**.
2. **Cost Accounting:** Cost accounting is that branch of accounting which is concerned with the ascertainment, control and reduction of cost of manufacturing of products or providing of services. Thus, cost accounting is mainly used by manufacturing and service rendering organizations. The cost accounting basically uses costing information and is based on cost accounting principles. It is intended for use by the management of the organization.
3. **Management Accounting:** Management accounting is concerned with the presentation of accounting information to the management in such a way that it helps managers in controlling day to day operation of the business and taking appropriate decisions. Thus, management accounting generates monthly or weekly report based on accounting information by following various methods and techniques of analysis for use by the internal users, i.e. management.

In recent years other branches or types of accounting have also emerged. Some of them are -

1. **Tax Accounting:** Tax accounting is concerned with the calculation of tax liability and preparation of tax returns. It is governed by tax laws which must be followed by companies and individuals while preparing their tax returns. Tax accountants suggest legal ways of minimizing tax liabilities to their clients.

2. **Social Responsibility Accounting:** It cannot be denied that business organizations as a part of the society have some important responsibilities toward the society. Social responsibility accounting is concerned with accounting and reporting of what benefits an enterprise is enjoying from the society and in return what it is giving to the society. In other words, social responsibility accounting tries to find out how the activities of an enterprise affecting the employees, customers, the community and the surrounding natural environment.

3. **Forensic Accounting:** Forensic Accounting is the application of accounting, auditing and investigative skill to analyze financial information for use in a Court of law. It is mainly used to investigate fraud and embezzlement. Etc.

Comparison between different types of accounting

Financial Accounting vs. Cost Accounting

Points of Difference	Financial Accounting	Cost Accounting
Meaning	Financial accounting means recording, classifying and summarizing of transaction and events measurable in terms of money and communicating to various users.	Cost accounting intends to measure cost accurately and also control of cost.
Objective	Main objective is to determine result of operation and present correct financial position of the enterprise.	Main objective is to ascertain, control and reduce cost of production or providing of service.
Scope	Scope of financial accounting is more pervasive than cost accounting.	Scope of cost accounting is limited in comparison with financial accounting. It is mainly intended for use by the management.
Period	Financial statements are prepared at the end of the year covering one financial year.	There is no pre determined period for cost accounting. It is based on requirement of the management.
Estimation	In financial accounting there is no place for estimation. All transactions are recorded based on actual figures.	In cost accounting cost is estimated compared with actual cost for control purpose.

Financial Accounting vs. Management Accounting

Points of Difference	Financial Accounting	Management Accounting
Meaning	Financial accounting means recording, classifying and summarizing of transaction and events measurable in terms of money and communicating to various users.	Management accounting is concerned with providing accounting information by means of various report and statements to the management for their decision making.
Objective	Its objective is to provide financial information to mainly external parties.	Its objective is to provide information to internal parties, that is, management.
Mandatory	It is mandatory	It is not mandatory
Format	Specified formats for preparing financial statements are there.	No specified formats are there in preparing management accounting report.
Period	Financial statements are prepared at the end of the year covering one financial year.	There is no fixed period for preparing management accounting report. The period depends on the nature and purpose of the report.
Dependence	Financial accounting is not dependent on management accounting.	Management accounting has to depend on financial accounting.
Measurement nature	Quantitative in nature	Both quantitative and qualitative in nature.

Cost Accounting vs. Management Accounting

Points of Difference	Cost Accounting	Management Accounting
Meaning	Cost accounting intends to measure cost accurately and also control of cost.	Management accounting is concerned with providing accounting information by means of various report and statements to the management for their decision making.
Scope	The scope of cost accounting is narrow in comparison with management accounting	The scope of management accounting is much broader.
Measuring nature	It is quantitative in nature.	It is both quantitative and qualitative.
Dependence	Cost accounting is not	Management accounting

	dependent on management accounting.	depends on cost accounting information.
Basis	Cost accounting is based on historical information.	Management Accounting is based on both historical and predictive information.
Users	Both management and external parties.	Only management.
Mandatory	It is mandatory for big business houses.	It is not mandatory.

Users of Accounting Information and their information needs:

Accounting information is needed by various users to make their valued decisions regarding present condition and also future course of action. The various users of accounting information include **investors (both present and prospective), lenders, suppliers and other trade creditors, employees, customers, management, Governments and their agencies and public.** The information needs of these users are discussed below:

1. **Investors:** Investors include both present and prospective investors. The present investors as owner of the enterprise want to know whether the income earned by the enterprise is satisfactory or not. They need information to assess the ability of enterprise to pay dividend. They are the internal users of accounting information. The prospective investors want to know the ability of the enterprise to earn sufficient profit in future.
2. **Lenders:** Lenders need information to make them assure that they will get back their loan amount including interest when become due.
3. **Suppliers and other trade creditors:** Suppliers and other trade creditors need accounting information which enables them to determine the ability of the enterprise to pay their dues in time.
4. **Employees:** Employees and their unions need information to know whether the enterprise has ability to pay their remunerations, various employment related opportunities and retirement benefits. Employees are the internal users of accounting information.
5. **Customers:** Customers need financial information to know about whether the enterprise is selling its products at fair price or not. Whether they should associate themselves with the enterprise for a long period of time or not.

6. **Management:** Management as internal users uses accounting information for their decision making.
7. **Governments and their agencies:** Governments and their agencies require financial information to regulate the activities of the enterprise and determine the taxation policies.
8. **Public:** General public use financial information to know about the activities of the enterprise. They want to know how they are affected by the activities of the enterprise in terms of job opportunity, prosperity of the locality, patronage of the local suppliers etc.

Possible Questions:

A. Short Answer Type Questions: (Marks: 2)

1. What is accounting?
2. Write two objectives of accounting.
3. Name four users of accounting information.
4. What are the branches of accounting?
5. Write two differences between financial accounting and cost accounting.
6. Write two differences between financial accounting and management accounting.
7. Write two differences between cost accounting and management accounting.

B. Medium Answer type Question: (Marks: 5)

1. Write about different branches of accounting.
2. Write about the objectives of accounting.
3. Distinguish between financial accounting and cost accounting.
4. Distinguish between financial accounting and management accounting.
5. Distinguish between cost accounting and management accounting.
6. Write about various users of accounting.

C. Essay Types Question: (Marks: 10)

1. Define accounting. Write different objectives of accounting. Who are the users of accounting information?

Suggested Readings:

1. Maheshwari & Maheshwari, Advanced Accountancy, Vol.-1, Vikas Publishing House Pvt. Ltd.
2. Hanif & Mukherjee, Financial Accounting, Tata Mcgraw Hill
3. Debarshi Bhattacharya, Financial Accounting, Lawpoint Publications