

Reading materials
Accountancy Class XI
Chapter 1

Meaning:

We know that there is a limit to human memory. One cannot remember everything one does or each transaction one enters into. Suppose your mother gives you a crisp Rs. 500 note to buy a number of items from the grocery shop, you will find it difficult to remember the details of various items you purchased. Hence it becomes necessary for you to write them on a piece of paper or a note book. It is still more difficult in case of business which involves a large number of transactions. In business one has to buy and sell more frequently. One makes payments and receives payments every now and then. It becomes almost impossible to remember all these transactions. So, unless one records them properly one cannot obtain any financial information one needs. For instance, one cannot determine the amounts to be received from various Customers to whom the goods were sold on credit. One will not know the profit/loss made during a particular period. It is therefore, necessary to maintain a proper record of all the transactions which take place from time to time. The recording of business transactions in a systematic manner is the main function served by accounting. Whichever the form of business organization-a sole proprietorship, a partnership, a company, or a co-operative society- it has to maintain proper accounts. The accounting information is useful both for the management and the outside agencies like tax authorities, banks, creditors, etc. The management needs it for purposes of planning, controlling and decision making. The banks and creditors require it for assessing the credit worthiness of the business and the tax authorities use it for determining the amount of income tax, sales tax, etc. In fact, accounting is necessary not only for business organizations but also for non-business organizations like schools and colleges, hospitals, clubs, etc.

OBJECTIVES OF ACCOUNTING:

The objectives of accounting can be stated as follows:

- 1. To maintain systematic records:** Accounting helps to maintain a systematic record of all financial transactions like purchases and sales of goods, cash receipts and cash payments, etc. It is also used for recording various assets and liabilities of the business.
- 2. To ascertain net profit or net loss of the business:** Every businessman is interested in determining the net result of his business operations i.e., whether there has been a profit or a loss. A proper record of all incomes and expenses helps in preparing the Profit and Loss Account and ascertain the net result of business operations during a particular period.

3. **To ascertain the financial position of the business:** The businessman is also interested in ascertaining the financial position of his business at the end of a particular period i.e, how much he owns and how much it owes to others. He would also like to know what happened to his capital, whether it has increased or decreased or remained constant. A systematic record of assets and liabilities facilitates the preparation of a position statement called Balance Sheet which provides the necessary information.
4. **To provide accounting information to interested parties:** Apart from the owners of the business, there are various parties who are interested in the accounting information. These are: bankers, creditors, tax authorities, prospective investors, etc. They need such information to assess the profitability and the financial soundness of the business. The accounting information is communicated to them in the form of an annual report.

PARTIES INTERESTED IN ACCOUNTING INFORMATION:

Now, let us see who are the parties interested in accounting information and how they are interested.

- a. **Owners:** Owners contribute the capital and assume the risks of business. Naturally, they are the first ones to be interested in knowing the profits/loss made by business and also its financial position.
- b. **Managers:** Managers use accounting information to plan, control and evaluate the operations of the business. This also enhances their decision making power.
- c. **Lenders:** If the owner's funds fall short of requirement, the business may acquire funds from banks and other lenders of money. Before lending money they would like to know about the solvency (capacity to repay debts) of the business so that they may rest assured that their money will be safe and the repayments will be made on time.
- d. **Creditors:** Creditors are the persons who supply goods and services on credit, i.e., on a deferred payment basis. Like lenders they are also interested to determine the credit worthiness of the business, so as to decide whether credit can be granted or not.
- e. **Prospective investor:** A person intending to become a partner in a firm or a person, who wants to become a shareholder of a company, would like to know how safe and rewarding the proposed investment would be.
- f. **Tax authorities:** Tax authorities are interested in the accounting information so as to determine whether the

business has paid the due tax liability under the prevailing laws of the country.

- g. Employees:** Apart from the salaries and wages, the employees also get some productivity bonus. It is but natural for them to be interested in the accounting information about the business, so as to determine the state of affairs of the organization and to make sure that the employers are paying them a fair return for their efforts.

BRANCHES OF ACCOUNTING:

These are briefly explained below:

- a. Financial Accounting:** It is concerned with recording and processing all transactions with outsiders and events affecting the financial position of the firm. This enables the preparation of the profit and loss account and the Balance Sheet, which are then communicated to the management and other interested parties.
- b. Cost Accounting:** Cost accounting seeks to analyze the expenditure so as to ascertain the cost of various products manufactured by the firm and fix the prices. It helps in controlling the costs and providing necessary costing information to management for decision making.
- c. Management Accounting:** It involves the systematic and regular collection of such information which enables the management in taking rational policy decisions and to evaluate the impact of its decisions and actions.

ADVANTAGES OF ACCOUNTING:

The main advantages of accounting are:

- **Replaces memory:** When a concern keeps accounting records of its financial transactions it has a permanent record of the transactions for present and future reference. Thus, there is no need to rely on "memory".
- **Provides control over assets & liabilities:** Accounting helps the business to keep a record of what it owns (i.e., assets), what it owes (i.e., its liabilities) and what it has invested (i.e., its capital). Information about these matters helps owner(s) and management to make use of the assets and liabilities in the best possible manner.
- **Facilitates the preparation of the financial statements:** Accounting helps a business in maintaining a complete record of business transactions, it has complete information about its expenses and losses, and incomes and gains. This enables a businessman to easily prepare the Profit and Loss account and Balance Sheet.
- **Meets the information requirements:** The various parties interested in accounting information such as owners, creditors,

management, lenders, investors, banks, etc. get the necessary information as and when required by them.

- **Facilitates a comparative study:** Records of the transactions of the business for every year enable it to compare the results of its business from year to year and ascertain its progress.
- **Assists the management in many ways:** It is possible to identify the reasons for the profit/loss made. The identification of reasons helps in taking necessary steps to increase profits further, or to avoid losses. Accounting information can also help in planning and controlling the activities of the business.
- **Difficult to conceal fraud or theft:** Accounting records enable a business concern to detect errors and frauds that have taken place in the past and prevent their recurrence.
- **Tax matters:** The Government levies various taxes such as customs duty, excise duty, GST and income tax. Properly maintained accounting records help in the settlement of all tax matters with the tax authorities,
- **Acts as reliable evidence:** Systematic record of business transactions is generally treated by courts as good evidence in case of disputes.

LIMITATIONS OF ACCOUNTING:

Accounting suffers from the following limitations.

- **Records only monetary transaction:** Accounting records only monetary transactions. Hence it does not reveal the complete picture because facts like quality of human resources, licenses and patents possessed, location based advantage, and business contracts, etc. do not find any place in books of account.
- **Historical in Nature:** The data is historical in nature. The accountants adopt historical cost as the basis in valuing and reporting all assets and liabilities. They do not reflect current values. It is quite possible that items like land and buildings may have much more value than what is stated in the Balance Sheet.
- **May not give exact Information:** Accounting records do not give exact information. They give only approximate information. In many cases, estimates may be used to determine the value of various items. For example, debtors are estimated in terms of collectability, inventories are based on marketability, and fixed assets are based on useful working life. All these estimates depend on personal judgment.
- **Insufficient data provided:** Data provided in the financial statements is insufficient for proper analysis and decision making. It only provides information about the overall profitability of the business. No information is given about the cost and profitability of different activities.

