

## 1



224en01

# INTRODUCTION TO ACCOUNTING

## MODULE - I

### Introduction and Basic Concepts



#### Notes

You must have seen a shopkeeper selling goods to earn profit. He/she sells goods for cash and on credit, purchases the goods from suppliers, pays for electricity bills, telephone bills, wages to workers etc. These are all business transactions involving money. A large number of such transactions take place daily. A businessman cannot remember all these transactions, he therefore, keeps a record of all these transactions in writing, so that he can make use of this recorded information later on. The trader would like to know at the end of a period (which is generally one year), what he has earned during this period from his business. He would also like to know the amount he has to pay to his suppliers and the amount his customers have to pay to him. He can get various other information of this kind only if he maintains proper record of business transactions, which have taken place during the year. This is called Book Keeping. This information needs, to be recorded, classified and summarized in a systematic manner. It is called 'Accounting'. In this lesson you will learn the meaning, objectives and uses of Book-keeping and Accounting.



### OBJECTIVES

**After studying this lesson, you will be able to:**

- explain the meaning of business transactions;
- explain the meaning of book-keeping;
- identify the need of book-keeping;
- describe the objectives of book-keeping;
- define the term 'accounting';
- explain the branches of accounting;
- discuss the objectives of accounting;
- describe the advantages and limitations of accounting;
- distinguish between book-keeping and accounting and
- identify the users of accounting information and understand the various uses of accounting information.

## MODULE - I

### Introduction and Basic Concepts

In your own house, you see many transactions taking place, for example, buying 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 to the shop, registers and pays money for it. Then, another customer comes, he buys a book and pays for it. After sometime, a third customer comes to the shop, he buys different stationery items like writing pads, pencils, pens, etc., he buys them on credit. Then, a supplier comes, he supplies 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 the 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. Business transactions have some important features which are as follows:

- Business transactions are business activities.
- These involve exchange of goods or services like transportation, storage, packaging, etc for money or money's worth.
- These are monetary in nature.
- In cash business transactions, goods or services are exchanged for money.
- In credit business transactions, goods or services are exchanged for a promise that money is received or paid at a future date.
- All business transactions are recorded in the books of accounts.

You might have noticed that all the above business transactions are between the OUTSIDERS. Sometimes, business transactions pertain to the OWNER. For example, Abhishek starts a small shop with an investment of ₹1,00,000/-. In exchange, the owner (Abhishek) gets an ownership right against the business. Take another example, Abhishek withdraws goods worth ₹5,000/- from the shop for his own use. It is a business transaction. Here, the owner gives goods worth ₹5,000/- while, the business gets a right to receive money from the owner. Thus you may say that business transactions pertain to the outsiders as well as 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 includes exchange of money also. In simple words, it includes all events and activities of a 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 watch 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 accounts.

## MODULE - I

### Introduction and Basic Concepts

books of the business. Owner's personal transactions where the money of the business is not affected, are not recorded anywhere in the books of the business. This separation of business transactions and personal transactions is very helpful in recording business transactions.

- i. Shifting of goods from one place to another within a shop is business transaction.
- ii. Profit is the reward to the owner for his business activities.
- iii. Purchase of vegetables for use at home is not business transaction.
- iv. Purchase of goods on credit for personal use from his friend is personal transaction.

- i. Rahim starts business with Cash ₹1,00,000/-
- ii. He deposits money into the Bank ₹50,000/-
- iii. He buys goods for Cash ₹10,000/-
- iv. He takes out money from the shop and gives it to his wife for buying a saree ₹1,000/-
- v. He attends a family function and gets present ₹1,000/-
- vi. He pays salary to his domestic servant ₹500/- out of his pocket.

Some people take book-keeping and accounting as synonymous terms, but they are different from each other. Book-keeping is mainly concerned with recording of financial data relating to the business operations in a systematic and orderly manner. Book-keeping involves the systematic recording of financial transactions and the maintenance of the correct & up-to-date records of the organization. Accounting is primarily concerned with the systems for recording, classifying and summarizing the data and interpreting for internal and external end users. Accountants often direct and review the work of the book-keepers.

It is significant for a business to have transparent record keeping system. It would make the transaction clear. The need of book-keeping can be understood with the help of the following points:

Recording the business



transactions would be helpful to businessman for monitoring the f

## MODULE - I

### *Introduction and Basic Concepts*

Businessman is interested in knowing the total sales and total purchases of business which help him in taking decisions regarding sales strategies.

Businessman would like to know how much and to whom he owes and how much and who owe to him. Book-keeping records will help in it.

Quantity and value of stock is required to manage stock levels. This can be ascertained by maintaining proper books of accounts.



- i. Book-keeping is concerned with recording of business transactions in a systematic and significant manner.
- ii. Book-keeping and accounting are synonymous terms.
- iii. Book-keeping is a broader term than accounting.
- iv. Book-keeping helps in preparing budget of the business.



Accounting has rightly been termed as the language of the business. The basic function of a language is to serve as a means of communication. Accounting communicates the result of business operations to various parties who have some stake in the business. With the help of accounting records the business is able to ascertain the profit or loss and the financial position of the business at the end of a given period and communicate such information to all interested parties. The function of accounting is to provide quantitative information, primarily of financial nature, about economic entities, that is needed to be useful in making economic decisions.

The meaning of accounting was given by the American Institute of Certified Public Accountants (AICPA) in 1961 when it defined accounting as :

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 :

American Accounting Association (AAA) defined Accounting as:

Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information .















## MODULE - I

### Introduction and Basic Concepts

5. Explain the advantages and limitations of accounting.
6. What is a business transaction? Give five examples of business transactions.
7. Explain the different branches of Accounting.
8. Explain how accounting is useful to employees.



i) False      ii) True      iii) True      iv) True

i) Business      ii) Business, iii) Business, iv) Non-business,  
v) Non-business,      vi) Non-business

i) True      ii) False      iii) False      iv) False

i) Business      ii) Financial      iii) Book-keeping  
iv) Financial accounting      v) Book-keeping

i) c,      ii) c,      iii) b,      iv) c,      v) a,      vi) b, vii) d,      viii) c.



- Visit two small business organisations and meet their Accountant. Senior Accounts officers and identify their accounts maintaining accounts.