CBSE Quick Revision Notes and Chapter Summary
Class-11 Accountancy
Chapter 1 – Introduction to Accounting

Introduction

A businessman wants to know how much profit/loss he has made during the year. For this purpose accounts are prepared, so that at the end of accounting period, a businessman can understand that what are the assets and liabilities of the business. There are different steps involved in accounting. Indentifying business transaction is the first step of accounting. These transactions are recorded in the subsidiary books and journal proper. With the help of these books we prepare ledger accounts. The balances shown by ledger accounts are used for preparing trial balance, which serves as the basis for the preparation of financial statements. Financial statements are classified as income statements and position statement. Income statement consists of making account which shows gross profit/loss and profit and loss account showing net profit/loss of the business. Finally, position statement (balance sheet) is prepared which reflects the true position of assets and liabilities of the business. In this way prime object of the business accounting is to measure and report the profitability and financial status of the business.

Meaning of Accounting

Accounting is the process of identifying, measuring, recording and communicating the required information relating to the economic events of an organisation to the interested users of such information. Accounting plays important role in providing quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions.

Definition of Accounting

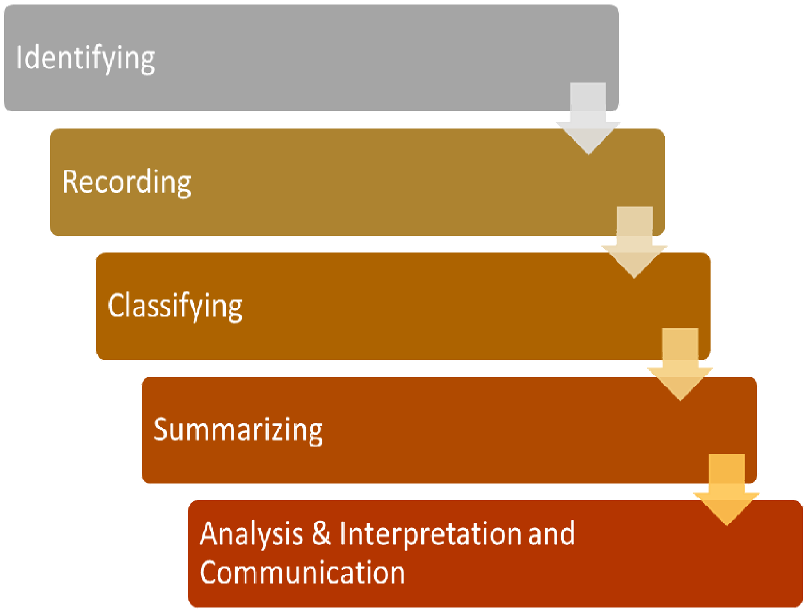
"Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information."

-- (Year 1966) American Accounting Association (AAA)

"Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions."

-- (Year 1970) Accounting Principles Board of AICPA (U.S.A)

Functions of Accounting



Identification : The first step in accounting is to determine what to record, i.e., to idenfity the financial events which are to be recorded in the books of accounts. It involves observing all business activities and selecting those events or transactions which can be considered as financial transactions.

Measurement : In Accounting we record only those transactions which can be measured in terms of money or which are of financial nature. If a transactions or event cannot be measured in monetary terms, it is not considered for recording in financial accounts. There are few events directly or indirectly make affect on the working of a business firm but cannot be recorded in the books of accounts because they cannot be measured in terms of money. For example : appointment of a new managing director, signing of contracts, strikes, death of an employee etc are not shown in the books of accounts.

Recording : A transaction will be recorded in the books of accounts only if it is considered as an economic event and can be measured in terms of money. Once the economic events are identified and measured in financial terms, these are recorded in books of account in monetary terms and in a chronological order. Recording should be done in a systematic manner so that the information can be made available when required.

Classifying : Once the financial transactions are recorded in journal or subsidiary books, all the financial transactions are classified by grouping the transactions of one nature at one place in a separate account. This is known as preparation of Ledger.

Summarising : It is concerned with presentation of data and it begins with balance of ledger accounts and the preparation of trial balance with the help of such balances. Trial balance is required to prepare the financial statements i.e. Trading Account, Profit & Loss Account and Balance Sheet.

Communication : The main purpose of accounting is to communicate the financial information the users who analyse them as per their individual requirements. Providing financial information to its users is a regular process.

Objectives of Accounting

(i) The main objective of the accounting is to keep systematic record of business transactions. That is why, all financial transactions are first recorded in journal and then posted into ledger.

(ii) Accounting is helpful in preventing and detecting the errors and frauds.

(iii) Accounting plays important role in calculating the profit or loss during a particular period by preparing Trading account and Profit and Loss Account.

(iv) Accounting is helpful in ascertaining the financial position of the business.

(v) Accounting provides useful information to its users.

Book Keeping

Recording of business transactions in a systematic manner in the books of account is called book-keeping. It is mainly concerned with the maintenance of books of accounts. It includes identification of financial transactions, measuring these transaction in terms of money, recording these transactions and classifying them into ledger.

According to A.J. Favell *"Book–keeping is the art of recording the financial transactions of a business in a methodical manner so that information on any point in relation to them may be quickly obtained".*

Book-Keeping	Accounting
Book-Keeping is maintained by Junior staff	Accounting is maintained by Senior Staff
Book-Keeping is the Primary stage	Accounting is the secondary stage
It is concerned with recording of day to day transactions	It is based on book keeping

Users of financial statements:
1. **Internal users** :- (Owners, shareholders OR investors, employees, management.)
2 **External users:** - (Regulatory agencies, labor union, stock exchange, public and others)

BRANCHES OF ACCOUNTING

1. Financial accounting (Book Keeping + preparation of financial statement).

2. Cost accounting (Determines the unit cost at different level of production).

3. Management accounting (It blends financial and cost accounting to get maximum profit at maximum cost).

4. Tax accounting (Sales tax and income tax).

5. Social responsibility (Focus on social benefits)

Qualitative Characteristics of Accounting

(i) **Reliability** : Accounting information should be reliable, verifiable and based on facts.

(ii) **Relevance** : Only Relevant information should be disclosed. Information which is irrelevant and useless should be not be the part of financial statements.

(iii) **Understandability** : Accounting information should be presented in a very simple way so that it is easy to understood by its users.

(iv) **Comparability** : Financial Statements should contains the figures of current year as well as figures of previous year so that the current performance of the business can be compared with the performance of previous year.

SYSTEM OF RECORDING

(a) Single entry system : This system ignores the two fold aspect of each transaction as done in double entry system. In this only cash and personal accounts are maintained.

(b) Double entry system : This is that system of book–keeping under which every business transaction is recorded at two places. This system is based on dual concept, which states, "For every debit there is a credit".

ADVANTAGES OF DOUBLE ENTRY SYSTEM OF ACCOUNTING:

a) It helps to keep a complete and systematic record of all business transactions ;

b) Since both the aspects of a transaction are recorded under this system, it facilitates a check on the arithmetical accuracy of the accounting books ;

c) It reveals the results of business activities. By preparing trading and profit and loss account, profit earned or loss suffered by the business is ascertained ;

d) By preparing position statement (Balance sheet), the financial position of the business is correctly estimated.

DISADVANTAGES OF DOUBLE ENTRY SYSTEM :

a) This system fails to ascertain actual profits if there are errors of principle in the records;

b) A mistake committed at the time of journalizing or an omission of a transaction from journalising cannot be disclosed under this system ;

c) There is possibility of fraud and misappropriations in the system.

Accounting Cycle :

Accounting cycle commences with recording of financial transactions and it ends with the communication of financial information's to the users

Is Accounting a science or an art ?

Accounting is an art of recording financial transactions in a set of books; classifying in desired categories and summarizing the information for presentation in a suitable manner to the concerned persons for their benefit. Accounting is also science in the sense that it comprises of rules, principles, concepts, conventions and standards.

Accounting as a source of Information

" Accounting is a service activity. Its function is to provide qualitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions" **--- Accounting Principles Board**

" The Main function of accounting is to provide qualitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions"

--- American Institute of Certified Public Accountants

RULES FOR RECORDING TRANSACTIONS UNDER DOUBLE ENTRY SYSTEM

In book–keeping the basic unit of recording is an account because it is with the help of various accounts that a business concern can prepare its final accounts. For the purpose of recording various business transactions accounts are classified as :

(1) Personal accounts

(2) Real accounts

(3) Nominal accounts

(1) Personal accounts : Accounts dealing with persons and institutions whether incorporated or not are called personal accounts. Persons here mean natural persons like Mohan, Sohan etc. Institutions are classified as artificial persons like HMT (Hindustan Machine Tools) SBI etc.

(2) Real Accounts : Accounts which deal with various assets and properties are known as real accounts, or accounts dealing with tangible goods are termed as real accounts for e.g. cash, goods, bills, receivables etc. However, there are four exceptions to this concept: goodwill, copyright, patents and trademarks are classified as real accounts even if they are intangible.

(3) Nominal Accounts : Accounts dealing with various expenses and losses and incomes and gains are nominal accounts. Example of nominal accounts are : salaries, commission, rent, wages, bad debts, etc.

RULES OF DEBIT AND CREDIT IN VARIOUS ACCOUNTS

Rule for recording a transaction in personal account is "***Debit the Receiver and credit the Giver.***"

Example 1 : If an amount of Rs. 1,000 is paid to Vinod on account, his account will be debited in the books as he is the receiver. Similarly if some money is received from a debtor, his personal account in the books will be credited as he is the giver of this amount.

The rule for real account is "debit what comes in and credit what goes out."

Example 2 : If Machinery worth Rs. 1,00,000 is purchased for cash, then machinery account will be debited as Machinery is coming in the business and cash account will be credited as cash is going out of the business.

The rule for Nominal accounts is "debit all expenses and losses and credit all incomes and gains."

Example 3 : If salaries are paid to employees, salaries account will be debited as salary here is an expenses. If commission is received, commission account is credited as commission in this case is an income for the business.

All the transactions are recorded in the books strictly on the basis of these rules.