

INTRODUCTION TO ACCOUNTING

INTRODUCTION

Accounting is a system meant for measuring business activities, processing of information into reports and making the findings available to decision-makers. The documents, which communicate these findings about the performance of an organisation in monetary terms, are called financial statements.

Usually, accounting is understood as the **Language of Business**. However, a business may have a lot of aspects which may not be of financial nature. As such, a better way to understand accounting could be to call it **The Language of Financial Decisions**. The better the understanding of the language, the better is the management of financial aspects of living. Many aspects of our lives are based on accounting, personal financial planning, investments, income-tax, loans, etc. We have different roles to perform in life- the role of a student, of a family head, of a manager, of an investor, etc. The knowledge of accounting is an added advantage in performing different roles. However, we shall limit our scope of discussion to a business organisation and the various financial aspects of such an organisation.

When we focus our thoughts on a business organisation, many questions (is our business profitable, should a new product line be introduced, are the sales sufficient, etc.) strike our mind. To answer questions of such nature, we need to have information generated through the accounting process. The people who take policy decisions and frame business plans use such information.

All business organisations work in an ever-changing dynamic environment. Any new programme of the organisation or of its competitor will affect the business. Accounting serves as an effective tool for measuring the financial pulse rate of the company. It is a continuous cycle of measurement of results and reporting of results to decision- makers.

Just like arithmetic is a procedural element of mathematics, book keeping is the procedural element of accounting. Figure 1 shows how an accounting system operates in business and how the flow of information occurs.

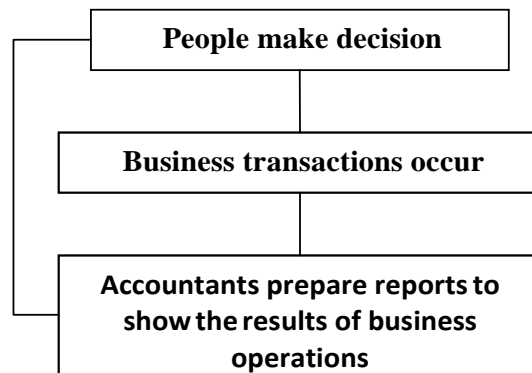


FIG 1: THE ACCOUNTING SYSTEM

Source: Liorngren, Harrison and Robinson, Financial and Management Accounting, Prentice Hall, New Jersey, 1994.

DEVELOPMENT OF ACCOUNTING DISCIPLINE

The history of accounting can be traced back to ancient times. According to some beliefs, the very art of writing originated in order to record accounting information. Though this may seem to be an exaggeration, but there is no denying the fact that accounting has a long history. Accounting records can be traced back to the ancient civilizations of China, Babylonia, Greece and Egypt. Accounting was used to keep records regarding the cost of labour and materials used in building great structures like the Pyramids.

During 1400s, accounting grew further because the needs for information of merchants in the Venis City of Italy increased. The first known description of double entry book keeping was first published in

1994 by Lucas Pacioli. He was a mathematician and a friend of Leonardo Ileda Vinci.

The onset of the industrial revolution necessitated the development of

more sophisticated accounting system, rather than pricing the goods based on guesses about the costs. The increase in competition and mass production of goods led to the rise of accounting as a formal branch of study.

With the passage of time, the corporate world grew. In the nineteenth century, companies came up in many areas of infrastructure like the railways, steel, communication, etc. It led to a rapid growth in accounting. As the complexities of business grew, ownership and management of business was divorced. As such, managers had to come up with well-defined, structured systems of accounting to report the performance of the business to its owners.

Government also has had a lot to do with more accounting developments. The Income Tax brought about the concept of 'income'. Government takes a host of other decisions, relating to education, health, economic planning, for which it needs accurate and reliable information. As such, the government demands stringent accountability in the corporate sector, which forces the accounting process to be as objective and formal as possible.

FUNCTIONS OF ACCOUNTING

A man who is involved in the process of book keeping and accounting is called an accountant. With the coming up accounting as a specialised field of knowledge, an accountant has a special place in the structure of an organisation, because he performs certain vital functions.

The following paragraphs examine the functions of accounting and what role does an accountant play in discharging these functions. An accountant is a person who does the basic job of maintaining accounts as he is the man who is engaged in book keeping. Since the managers would always want to know the financial performance of the business. An accountant prepares profit and loss account which reports the profits/losses of the business during the accounting period, Balance Sheet, which is a statement of assets and liabilities of the business at a point of time, is also proposed by all accountants. Since both statements are called financial statements, the person who prepares them is called a financial accountant. Accounting information serves many purposes. A

part from revealing the level of performance, it throws light on the causes of weakness and deviation from plans (in any). In this way an accountant becomes an important functionary who plays a vital role in the process of management control, which is a process of diagnosing and solving a problem. Seen from this point of view, an accountant can be referred to as a management accountant. Tax planning is an important area as far as the fiscal management of a company is concerned. An accountant has a suggestive but very specific job to do in this regard by indicating ways to minimise the tax liability through his knowledge of concessions and incentives available under the existing taxation framework of the country.

An accountant can influence a company even by not being an employee. He can act as a man who verifies and certifies the authenticity of accounts of a company by auditing the accounts. It is a strictly professional job and is done by persons who are formally trained and qualified for the purpose. They have an educational status and a prescribed code of conduct like the Chartered Accountants in India and Certified Public Accountants in USA.

Information management is another area which keeps an accountant busy. He is the one who classifies the financial information into information for internal use (management accounting function); and information for external use (financial accounting function). Irrespective of the size and degree of automation of a business, information management is a key area and many organisations are known to have perished because they failed to recognise this as an important function of an accountant because information system is imperative for effective cost control, to forecast cash needs and to plan for future growth of the organisation.