



ACCOUNTING IS FUNDAMENTALLY THE PROCESS OF RECORDING, CLASSIFYING, AND SUMMARIZING FINANCIAL TRANSACTIONS TO PROVIDE USEFUL INFORMATION FOR DECISION-MAKING, WITH ROOTS TRACING BACK TO LUCA PACIOLI IN THE 15TH CENTURY.

- It serves key functions like identifying transactions, maintaining records, and communicating results, helping businesses track profits, liabilities, and assets.
- The accounting cycle involves steps from identifying transactions to preparing financial statements, ensuring systematic tracking.
- Core principles (GAAP) guide consistent practices, while the accounting equation ($\text{Assets} = \text{Liabilities} + \text{Equity}$) forms the basis for double-entry bookkeeping.
- Debits and credits follow rules based on account types: increase assets with debits, liabilities with credits.

Introduction to Accounting

Research suggests accounting originated as a way for businesses to track profits and obligations, evolving into a structured system. It seems likely that every business relies on it for daily operations and long-term planning.

Meaning of Accounting Evidence leans toward defining accounting as the art and science of recording financial events in monetary terms, interpreting results for stakeholders like owners and creditors.

Functions of Accounting It appears functions include identifying monetary transactions from sources like invoices, recording them chronologically, classifying into ledgers, summarizing in statements, analyzing strengths/weaknesses, interpreting data, and communicating insights.

Accounting Cycle The cycle typically follows eight steps: identify transactions, record journal entries, post to ledger, prepare unadjusted trial balance, make adjusting



entries, prepare adjusted trial balance, create financial statements, and close books. This ensures accuracy, though variations exist in practice.

Book-Keeping vs. Accounting vs.

Accountancy Book-keeping focuses on routine recording, accounting on analysis and interpretation, and accountancy on principles applied—distinctions that help clarify roles without controversy.

Objectives Objectives seem to include systematic records to prevent fraud, calculating profit/loss, ascertaining financial position via balance sheets, and providing info to parties like governments.

Sub-Disciplines Financial accounting records transactions for reports; cost accounting analyzes production costs; management accounting aids decisions like budgeting.

Art and Science Accounting combines scientific rules with artistic application of principles.

Advantages/Disadvantages Advantages: Protects assets, aids tax settlements, replaces memory, enables comparisons/loans/sales.

Disadvantages: Ignores qualitative factors, potential manipulation, historical cost bias, not fully exact.

Types of Information Relates to profit (income statement), position (balance sheet), cash flow (statement).

Accounting, often called the "language of business," is the systematic process of



identifying, recording, measuring, classifying, verifying, summarizing, interpreting, and communicating financial information about economic entities. This detailed overview draws from established principles and practices, verified through reliable sources, to provide a comprehensive understanding of its basics.

Historical Context and Introduction

Accounting's origins trace back to ancient civilizations, but modern double-entry bookkeeping was formalized by Luca Pacioli in 1494. As businesses aim to earn profits, they need to track earnings, losses, stock, liabilities, and receivables. Systematic recording of transactions answers these questions, preventing omissions and fraud. The American Institute of Certified Public Accountants defines it as "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." This process aids judgment and decision-making for users like owners, creditors, and governments.



Luca Pacioli

Meaning and Functions

Accounting involves processing financial data to reflect business performance. Its functions are:

1. **Identifying:** Spotting financial transactions from documents like invoices and measuring in monetary terms.
2. **Recording:** Chronological entry in journals or subsidiary books.
3. **Classifying:** Grouping similar transactions in ledgers; preparing trial balance for accuracy.
4. **Summarizing:** Using trial balance data for profit/loss accounts and balance sheets.

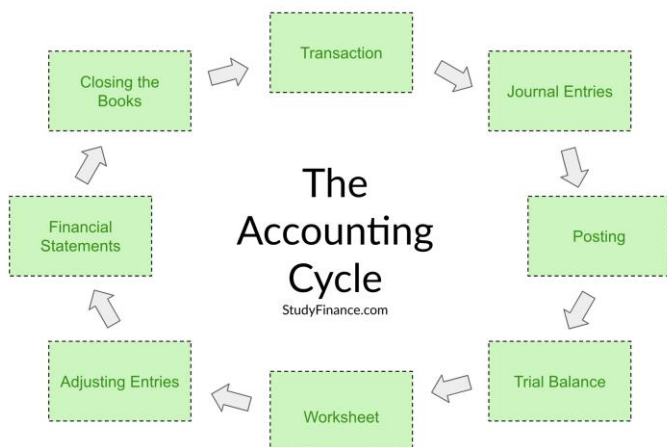


5. **Analyzing:** Establishing relationships to identify strengths/weaknesses.
6. **Interpreting:** Explaining data significance for decisions.
7. **Communicating:** Sharing results with stakeholders.

These align with standard definitions, ensuring reliability.

Accounting Cycle

The accounting cycle is a repeatable process for financial reporting:



ACCOUNTING CYCLE | DEFINITION, STEPS, PROCESS, DIAGRAM & EXAMPLES

Step	Description
1. Identify Transactions	Recognize financial events (e.g., sales, purchases).
2. Journal Entries	Record in chronological order with debits/credits.
3. Posting to Ledger	Transfer entries to individual accounts.
4. Unadjusted Trial Balance	List totals to check equality.
5. Adjusting Entries	Account for accruals, deferrals, etc.
6. Adjusted Trial Balance	Updated list post-adjustments.
7. Financial Statements	Prepare income statement, balance sheet, cash flow.
8. Closing Entries	Transfer temporary accounts to permanent ones.

This cycle restarts, providing periodic insights.



Book-Keeping, Accounting, and Accountancy

- **Book-Keeping:** Routine recording of monetary transactions (identifying, measuring, recording, classifying). Performed by junior staff.
- **Accounting:** Processes data for summaries, analysis, interpretation, communication. Analytical, by senior staff.
- **Accountancy:** Systematic knowledge of principles/techniques.

BASIS	BOOK-KEEPING	ACCOUNTING
Objective	Systematic records	Net results, financial position
Phase	Recording	Summarizing
Stage	Primary	Secondary
Skills	Routine, no special skill	Analytical, special skill
Performed by	Junior staff (book keepers)	Senior staff (accountants)

Objectives

1. Systematic transaction records to avoid omissions/fraud.
2. Profit/loss calculation via trading/profit & loss accounts.
3. Financial position via balance sheets.
4. Information for parties (owners, banks, etc.).

Sub-Disciplines

- **Financial Accounting:** Records transactions for reports on profit/loss, position, cash uses.
- **Cost Accounting:** Analyzes costs for products/services, aiding control/decisions.
- **Management Accounting:** Draws from others for budgeting, pricing, capital decisions.

Accounting as Art and Science

As a science, it follows systematic patterns for knowledge via observation/experiments (e.g., double-entry). As art, it applies principles (GAAP) to present findings.

Advantages and Disadvantages



Advantages:

- Protects assets.
- Facilitates tax settlements (evidence).
- Replaces memory.
- Enables comparative studies.
- Supports loans/sales.

Disadvantages:

- Ignores qualitative elements (e.g., staff quality).
- Window dressing risk (manipulation).
- Historical costs ignore inflation.
- Not fully exact (estimates like depreciation).

Types of Accounting Information

- Profit/Surplus: Income statement shows earnings/losses.
- Financial Position: Balance sheet lists assets/liabilities (General Fund for non-profits).
- Cash Flow: Statement tracks inflows/outflows for decisions.

BASIC ACCOUNTING TERMS

TERM	DEFINITION	EXAMPLE
Capital	Owner's investment.	Rs.1,00,000 invested.
Drawings	Withdrawals for personal use.	Rs.5,000 cash withdrawn.
Liabilities	Amounts owed.	Loans, creditors.
Assets	Owned resources.	Cash, land.
Expenditure	Outlays for assets/goods.	Capital (long-term) vs. Revenue (routine).
Expense	Expired value.	Salaries paid.
Income	Profit over time.	Revenue - Expense.
Profit/Gain	Excess revenue.	Sales > Costs.



TERM	DEFINITION	EXAMPLE
Loss	Excess expenses.	Costs > Sales.
Stock/Inventory	Unsold goods.	Raw materials, finished goods.
Debtors/Creditors	Owed to/from.	Customers/suppliers.
Bad Debts	Irrecoverable.	Written off.
Discount	Trade (list price), Allowance.	Cash (prompt payment).

Accounting Principles (GAAP)

Principles ensure consistency/objectivity:

- Business Entity: Separate from owner.
- Money Measurement: Only monetary transactions.
- Dual Aspect: Every transaction affects two sides.
- Going Concern: Assumes continuity.
- Accounting Period: Divides life into segments (e.g., yearly).
- Historical Cost: Assets at acquisition price.
- Matching: Match revenues/expenses.
- Accrual: Record when earned/incurred.
- Concepts vs. Conventions: Rules vs. customs (e.g., materiality, consistency, disclosure, conservatism).



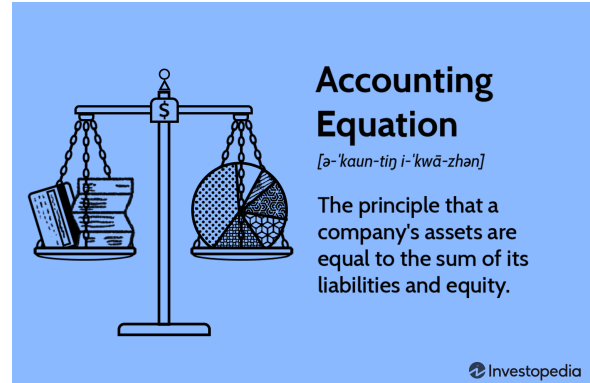
Bases of Accounting

- **Cash Basis:** Records when received/paid. Simple, but ignores accruals.
- **Accrual Basis:** Records when earned/incurred. Accurate for position.
- **Hybrid:** Mix for specific needs.

Basis	Advantages	Disadvantages
Cash	Simple, no adjustments.	No true view, ignores matching.
Accrual	Complete picture, correct profit.	Complex, quick appraisal hard.

Accounting Equation

Assets = Liabilities + Equity. Fundamental balance.



Accounting Equation: What It Is and How You Calculate It

Example: Start with Rs.1,00,000 capital (Assets = Rs.1,00,000; Equity = Rs.1,00,000).
Borrow Rs.50,000 (Assets = Rs.1,50,000; Liabilities = Rs.50,000 + Equity Rs.1,00,000).

Rules of Debit and Credit

Double-entry: Every transaction has equal debits/credits.

Debits and credits system			
DEBIT		CREDIT	
↑	ASSETS	↓	ASSETS
↓	LIABILITY	↑	LIABILITY
↓	EQUITY	↑	EQUITY
↑	EXPENSES	↑	REVENUE

Accounts are increased and decreased with a debit or credit



DEBITS AND CREDITS - ACCOUNTING PLAY

Account Type	Debit (Increase)	Credit (Increase)
--------------	------------------	-------------------

Assets	Yes	No
--------	-----	----

Liabilities	No	Yes
-------------	----	-----

Equity/Capital	No	Yes
----------------	----	-----

Revenue	No	Yes
---------	----	-----

Expenses	Yes	No
----------	-----	----

Personal (debit receiver, credit giver); Real (debit incoming, credit outgoing); Nominal (debit expenses/losses, credit incomes/gains).

Journal

Chronological record of transactions. Format: Date, Particulars, L.F., Debit, Credit.

Example Journal Entries:

- Commenced business: Cash Dr.
Rs.1,00,000; To Capital Rs.1,00,000.
- Purchased goods: Purchases Dr.
Rs.50,000; To Creditor Rs.50,000.

Ledger

Summarizes journal entries by account.

Posted from journal.

Example: Cash Ledger shows receipts/debits, payments/credits.

Subsidiary Books

Specialized journals:

- Cash Book: Cash transactions (single/double/triple columns).
- Purchase/Sales Books: Credit purchases/sales.
- Returns Books: Inward/Outward returns.

Cash Book

Records cash/bank. Types: Single (cash only), Double (cash+bank), Triple (cash+bank+discount).

Petty Cash: For small expenses, often under Imprest system.

Trial Balance

Lists debit/credit balances to check accuracy.



Trial balance

Classifications: Assets (Current/Non-current);
Liabilities (Current/Non-current/Contingent).

TEDDY FAB INC. TRIAL BALANCE 12/31/2100			
	Debit		Credit
Assets	\$	\$	
Cash and cash equivalents	100,000.00		
Accounts receivable	20,000.00		
Inventory	15,000.00		
Prepaid expense	4,000.00		
Investments	10,000.00		
Land	24,300.00		
Buildings and improvements	250,000.00		
Equipment	50,000.00		
Accumulated depreciation		5,000.00	
Intangible assets	4,000.00		
Accumulated amortization		200.00	
Liabilities			
Accounts payable		30,000.00	
Notes payable		10,000.00	
Accrued expenses		5,000.00	
Deferred revenue		2,500.00	
Long-term debt		200,000.00	
Shareholders' Equity			
Common stock		10,000.00	
Additional paid-in capital		20,000.00	
Retained earnings			
Treasury stock		(2,000.00)	
Revenue			
Sales revenue		1,000,000.00	
Expenses			
Cost of goods sold	200,000.00		
SG&A	357,700.00		
Interest	20,000.00		
Depreciation	5,000.00		
Amortization	200.00		
Interest income		20,000.00	
Income tax	240,000.00		
BALANCE			
DECEMBER 31, 2100	\$ 1,300,200.00	\$ 1,300,200.00	

Sum of asset, liability, and equity
accounts used to summarize
general ledger accounts

Debits = Credits

Trial Balance: Summarizes All General Ledger
Accounts

Methods: Total (sums sides), Balance (net
balances).

Errors: Omission, Commission, Principle,
Compensating. Rectify via journal/suspense.

Financial Statements

- **Trading Account:** Gross profit (Sales - Cost of Goods Sold).
- **Profit & Loss Account:** Net profit (Gross Profit + Other Income - Expenses).
- **Balance Sheet:** Assets = Liabilities + Equity. Marshalled by permanence or liquidity.