Introduction to Accounting
Accounting Concepts

SATISH M. HEGDE
Associate Professor,
M.E.S. College of Commerce, SIRSI

Meaning and Definition of Accounting

The American Institute of Certified Public Accountants (AICPA)

- the art of recording, classifying, and summarising 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. (1941)

American Accounting Association (AAA)

- the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of information.(1966)

Accounting Principles Board of AICPA

- the function of accounting is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions. (1970)

Accounting can therefore be defined as 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. In order to appreciate the exact nature of accounting, we must understand the following relevant aspects of the definition:

- Economic Events- Transactions measurable in terms of money.
- Identification, Measurement, Recording and Communication-
- Identification **:** It means determining what transactions to record, i.e., to identity events which are to be recorded. It involves observing activities and selecting those events that are of considered financial character and relate to the organisation.
- Measurement :It means quantification (including estimates) of business transactions into financial terms by using monetary unit, viz. rupees and paise as a measuring unit. If an event cannot be quantified in monetary terms, it is not considered for recording in financial accounts.
- Recording : 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.
- Communication :The economic events are identified, measured and recorded in order that the pertinent information is generated and communicated in a certain form to management and other internal and external users

- Organisation:

Organisation refers to a business enterprise, whether for profit or not-for-profit motive. Depending upon the size of activities and level of business operation, it can be a sole-proprietory concern, partnership firm, cooperative society, company, local authority, municipal corporation or any other association of persons.

- Interested Users of Information:

Accounting is a means by which necessary financial information about business enterprise is communicated and is also called the language of business. Many users need financial information in order to make important decisions. These users can be divided into two broad categories: internal users and external users.

Types of Accounting:

- *Financial accounting* assists keeping a systematic record of financial transactions the preparation and presentation of financial reports in order to arrive at a measure of organisational success and financial soundness. It relates to the past period, serves the *stewardship* function and is monetary in nature. It is primarily concerned with the provision of financial information to all stakeholders.
- *Cost accounting* assists in analysing the expenditure for ascertaining the cost of various products manufactured or services provided by the firm and fixation of prices thereof. It also helps in controlling the costs and providing necessary costing information to management for decision-making.
- *Management accounting* deals with the provision of necessary accounting information to people within the organisation to enable them in decision-making, planning and controlling business operations. Management accounting draws the relevant information mainly from financial accounting and cost accounting which helps the management in budgeting, assessing profitability, taking pricing decisions, capital expenditure decisions and so on. Besides, it generates other information (quantitative and qualitative, financial and non-financial) which relates to the future and is relevant for decision-making in the organisation. Such information includes: sales forecast, cash flows, purchase requirement, manpower needs, environmental data about effects on air, water, land, natural resources, flora, fauna, human health, social responsibilities, etc.
- As a result, the scope of accounting has become so vast, that new areas like human resource accounting, social accounting, responsibility accounting have also gained prominance now a days.

Qualitative Characteristics of Accounting Information

- ***Reliability***
- Reliability means the users must be able to depend on the information. The reliability of accounting information is determined by the degree of correspondence between what the information conveys about the transactions or events that have occurred, measured and displayed. A reliable information should be free from error and bias and faithfully represents what it is meant to represent. To ensure reliability, the information disclosed must be credible, verifiable by independent parties use the same method of measuring, and be neutral and faithful (refer figure 1.3).

Relevance

- To be relevant, information must be available in time, must help in prediction and feedback, and must influence the decisions of users by :

(a) helping them form prediction about the outcomes of past, present or future events; and/or

(b) confirming or correcting their past evaluations.

- ***Understandability***

Understandability means decision-makers must interpret accounting information in the same sense as it is prepared and conveyed to them. The qualities that distinguish between good and bad communication in a message are fundamental to the understandability of the message. A message is said to be effectively communicated when it is interpreted by the receiver of the message in the same sense in which the sender has sent. Accountants should present the comparable information in the most intenlligible manner without sacrificing relevance and reliability.

- ***Comparability***

It is not sufficient that the financial information is relevant and reliable at a particular time, in a particular circumstance or for a particular reporting entity. But it is equally important that the users of the general purpose financial reports are able to compare various aspects of an entity over different time period and with other entities. To be comparable, accounting reports must belong to a common period and use common unit of measurement and format of reporting.

Objectives of Accounting

Primary objectives:

- Maintenance of Records of Business Transactions
- Calculation of Profit and Loss
- Depiction of Financial Position
- Providing Accounting Information to its Users

GAAP (Generally Accepted Accounting Principles):

GAAP refers to the rules or guidelines adopted for recording and reporting of business transactions, In order to bring uniformity in the preparation and presentation of financial statements

GAAP PRINCIPLES:

The GAAP principles are divided into two categories:

1. **Accounting Concepts:** Accounting Concepts are basic assumptions or conditions upon which science of accounting is based.

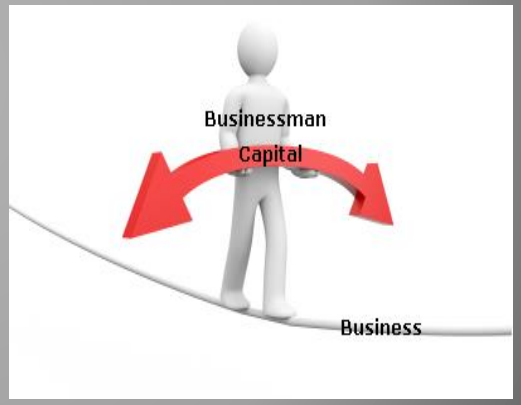
2. **Accounting Conventions:** Accounting Conventions include those customs and traditions which are followed up by an accountant while preparing a financial statements.

GAAP PRINCIPLES

Business Entity concept	Accrual
Money measurement	Full disclosure
Going concern	Consistency
Accounting period	Matching concept
Cost concept	Conservatism
Dual aspect	Materiality
Revenue recognition	

BUSINESS ENTITY CONCEPT

This concept assumes that owners and business are two different entities. It means that for the purpose of accounting, the business and its owners are to be treated as two separate entities.



MONEY MEASUREMENT CONCEPT

states that only those transactions and happenings in an organization which can be expressed in terms of money such as sale of goods or payment of expenses or receipt of income, etc. are to be recorded in the book of accounts

Going Concern Concept

- assumes that a business firm would continue to carry out its operations indefinitely, i.e. for a fairly long period of time and would not be liquidated in the foreseeable future. This is an important assumption of accounting as it provides the very basis for showing the value of assets in the balance sheet.

Accounting Period Concept

- Accounting period refers to the span of time at the end of which the financial statements of an enterprise are prepared, to know whether it has earned profits or incurred losses during that period and what exactly is the position of its assets and liabilities at the end of that period.

Cost Concept

- The cost concept requires that all assets are recorded in the book of accounts at their purchase price, which includes cost of acquisition, transportation, installation and making the asset ready to use.

Dual Aspect Concept

- Dual aspect is the foundation or basic principle of accounting. This concept states that every transaction has a dual or two-fold effect and should therefore be recorded at two places. In other words, at least two accounts will be involved in recording a transaction

Revenue Recognition (Realization) Concept

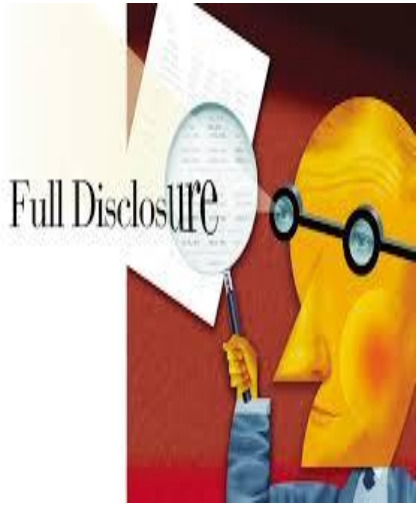
- The concept of revenue recognition requires that the revenue for a business transaction should be included in the accounting records only when it is realized

Matching Concept

- The process of ascertaining the amount of profit earned or the loss incurred during a particular period involves deduction of related expenses from the revenue earned during that period.

Full Disclosure Concept

The principle of full disclosure requires that all material and relevant facts concerning financial performance of an enterprise must be fully and completely disclosed in the financial statements and their accompanying footnotes.



Consistency Concept

- This principle states that accounting policies and practices followed by enterprises are uniform and are consistent over the period of time.

Conservatism Concept

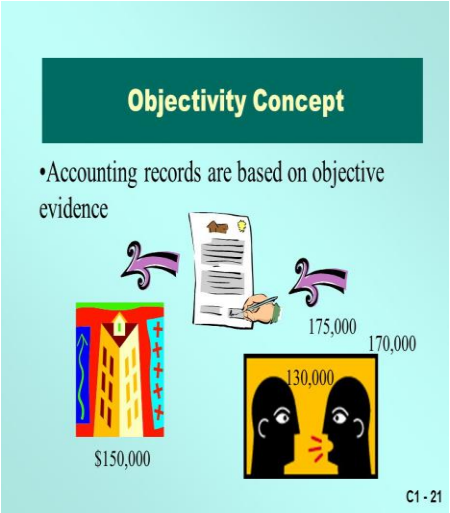
- The concept of conservatism requires that profits should not to be recorded until realised but all losses, even those which may have a remote possibility, are to be provided for in the books of account.

Materiality Concept

- The concept of materiality requires that accounting should focus on material facts. The materiality of a fact depends on its nature and the amount involved.

Objectivity Concept

- The concept of objectivity requires that accounting transaction should be recorded in an objective manner, free from the bias of accountants and others. This can be possible when each of the transaction is supported by verifiable documents or vouchers



THANK YOU