

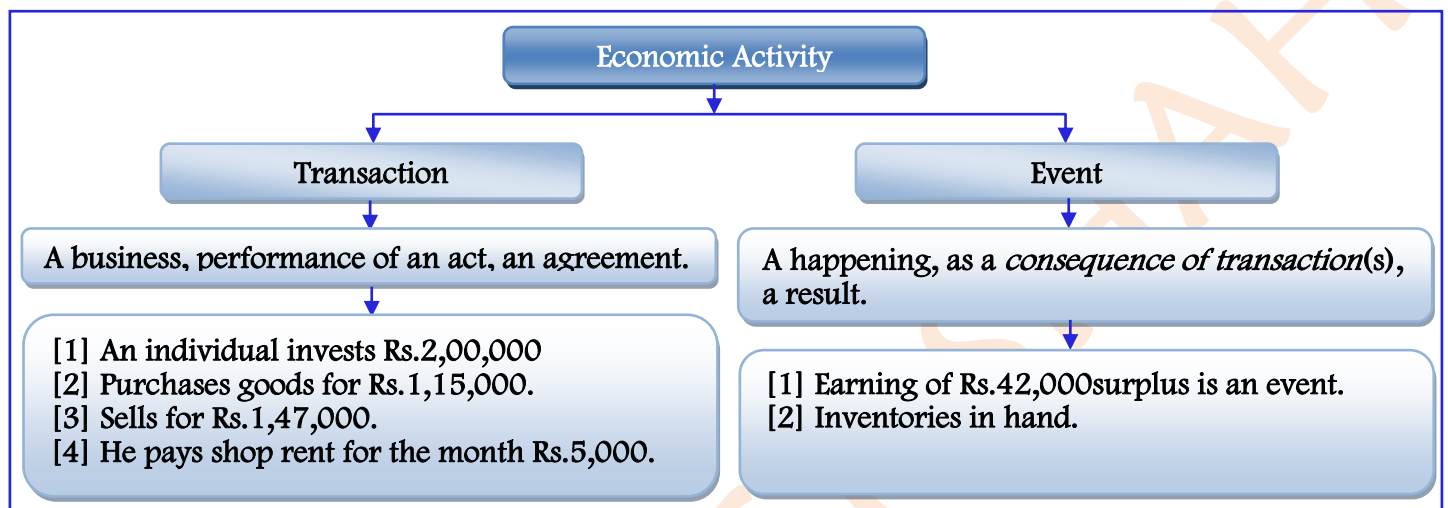


# 1. THEORETICAL FRAMEWORK

## UNIT 1 : MEANING AND SCOPE OF ACCOUNTING

### CONCEPT 1 : INTRODUCTION

- Every individual performs some kind of economic activity.
- Not necessarily all the economic activities are run for any individual benefit; some economic activities may create social benefit i.e. benefit for the public, at large.



- Here raising money through various sources can be termed as transaction and surplus or deficit at the end of the accounting year can be termed as an event.
- So, everybody wants to keep records of all transactions and events as an aid to decision-making.
- Accounting has universal application for recording transactions and events and presenting suitable information to aid decision-making.
- The growth of accounting discipline is closely associated with the development of the business world.
- The aim of accounting is to meet the information needs of the rational and sound decision-makers, and thus, called the language of business.

### CONCEPT 2 : MEANING OF ACCOUNTING

[T.Q. 1]

#### ➤ Definition :

- "Accounting is the art of recording, classifying, and summarising in terms of money, transactions and events of a financial character, and interpreting the result thereof."

#### ➤ Process :

- [1] First identifying the events and transactions and then be recorded in the books of account. This recording is done in Journal or subsidiary books, also known as primary books.
- [2] After recording, they are transferred to secondary books i.e. Ledger. In ledger it is classified in terms of income, expense, assets and liabilities according to their characteristics and summarised in profit & loss account and balance sheet.

#### ➤ Measurement :

- Essentially the transactions and events are to be measured in terms of money.
- Measurement in terms of money means measuring at the ruling currency of a country, for example, rupee in India, dollar in U.S.A. and like.

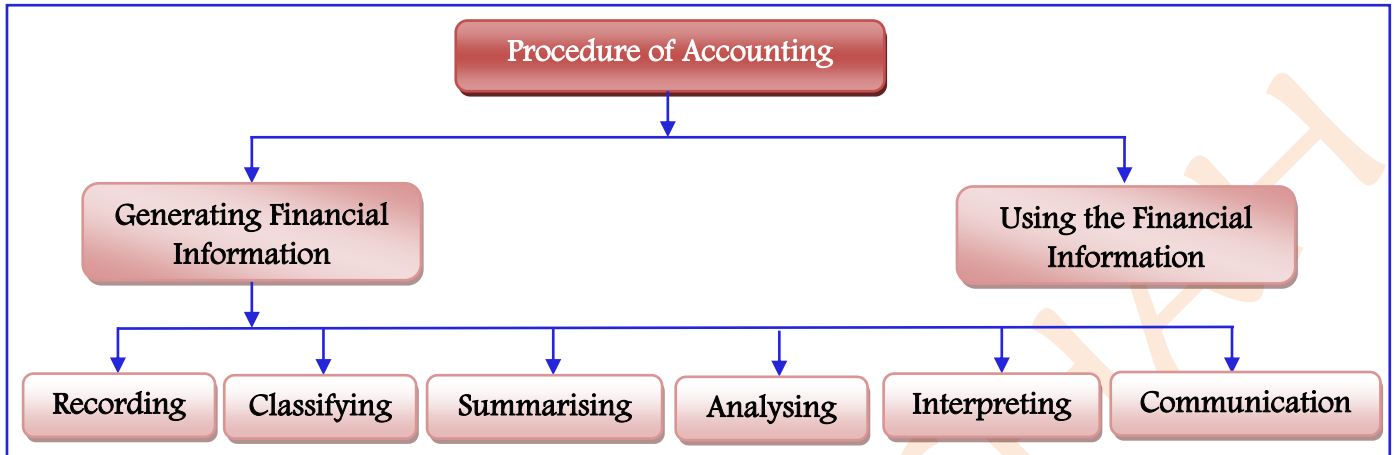


PROCEDURAL ASPECTS OF ACCOUNTING

On the basis of the above definitions, procedure of accounting can be basically divided into two parts:

- [i] Generating financial information and
- [ii] Using the financial information.

The procedural aspects of accounting can be explained with the help of the following chart:



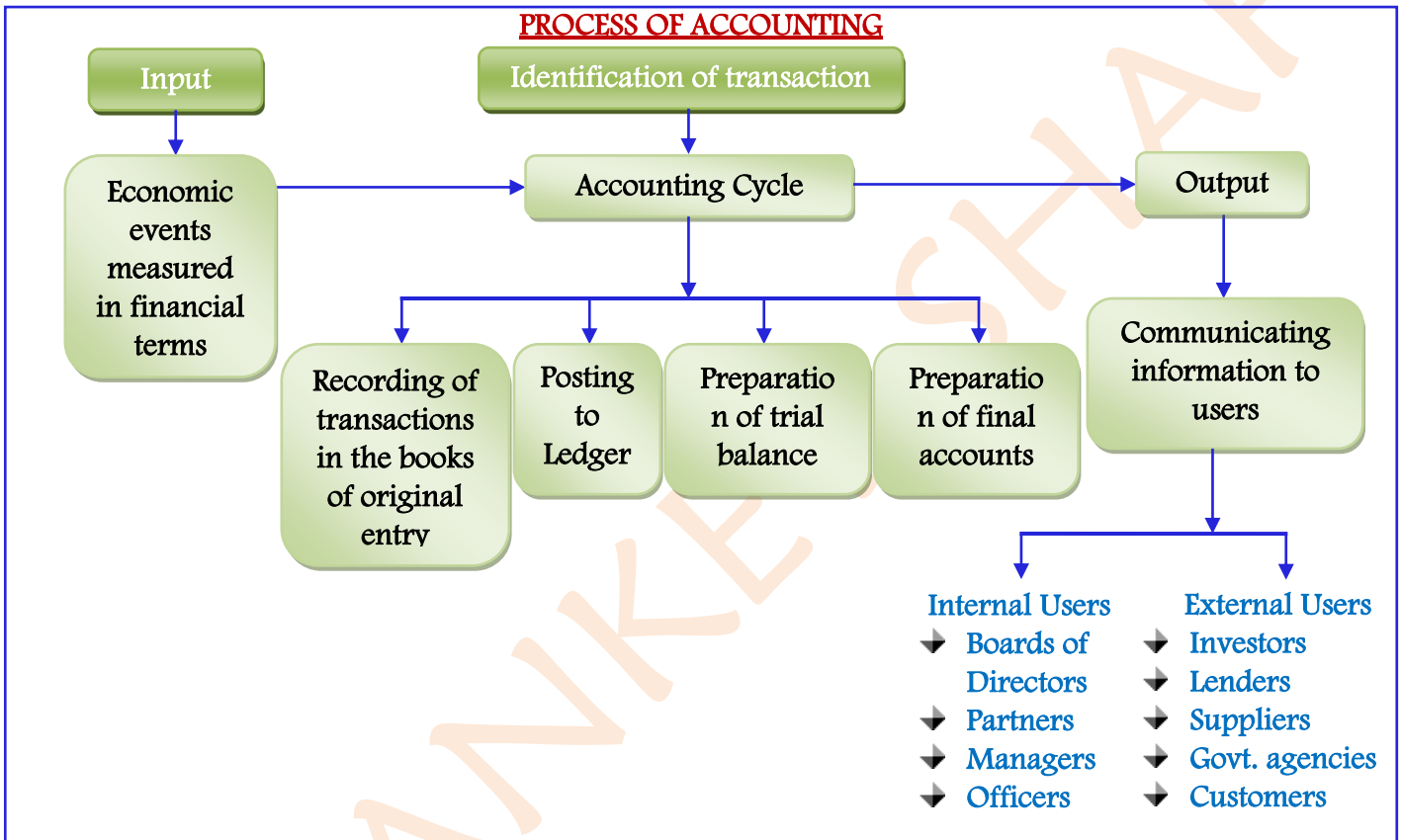
[i] Generating Financial Information

Sr No.	GFI	Explanation
[a]	Recording	<ul style="list-style-type: none"> <li>✦ Basic function of accounting evidenced by sales bill, pass book, salary slip etc. are recorded in the books of account.</li> <li>✦ Recording is done in a book called "Journal."</li> <li>✦ This book may further be divided into several subsidiary books according to the nature and size of the business.</li> </ul>
[b]	Classifying	<ul style="list-style-type: none"> <li>✦ It is systematic analysis of the recorded data.</li> <li>✦ The book containing classified information is called "Ledger".</li> <li>✦ This will help in finding out the total expenditure incurred under each of the above heads.</li> </ul>
[c]	Summarising	<ul style="list-style-type: none"> <li>✦ It is concerned with the preparation and presentation of the classified data useful to the internal as well as the external users of financial statements.</li> <li>✦ This process leads to the preparation of financial statements:               <ul style="list-style-type: none"> <li>[a] Trial Balance</li> <li>[b] Profit and Loss Account</li> <li>[c] Balance Sheet</li> <li>[d] Cash-flow Statement.</li> </ul> </li> </ul>
[d]	Analysing	<ul style="list-style-type: none"> <li>✦ The term 'Analysis' means methodical classification of the data given in the financial statements.</li> <li>✦ The figures given in the financial statements will not help anyone unless they are in a simplified form.</li> <li>✦ For example, all items relating to fixed assets are put at one place while all items relating to current assets are put at another place.</li> </ul>
[e]	Interpreting	<ul style="list-style-type: none"> <li>✦ The recorded financial data is analysed and interpreted in a manner that will enable the end-users to make a meaningful judgement about the financial condition and profitability of the business operations.</li> </ul>
[f]	Communicating	<ul style="list-style-type: none"> <li>✦ It is concerned with the transmission of summarised, analysed &amp; interpreted information to the end-users to enable them to make rational decisions.</li> <li>✦ This is done through preparation and distribution of accounting reports.</li> </ul>



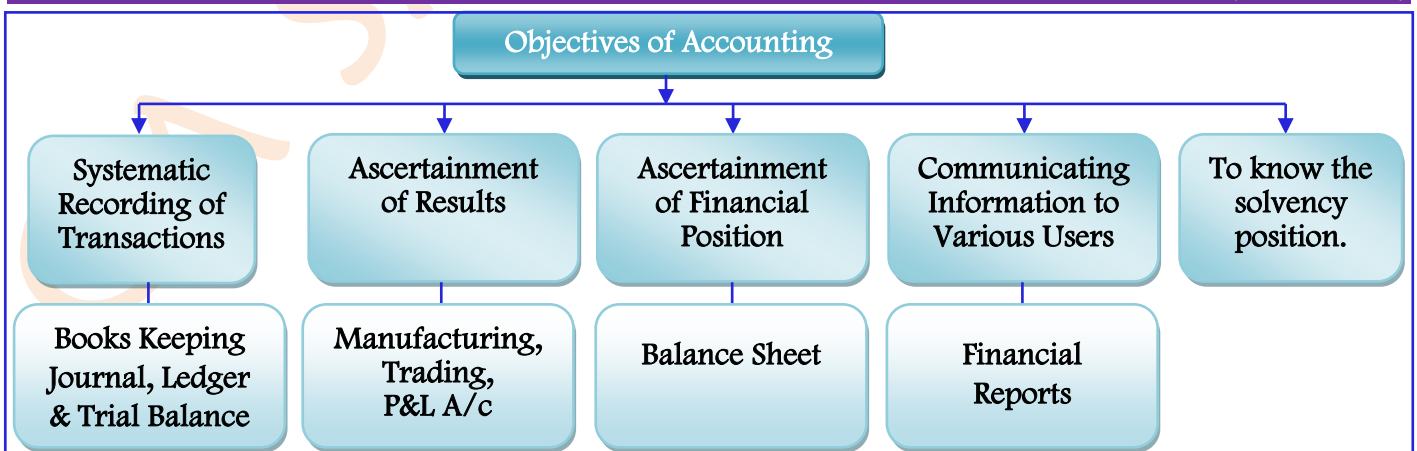
**[ii] Using the Financial Information**

- Earlier it was viewed that accounting is meant for the proprietor or owner of the business, but changing social relationships diluted the earlier thinking.
- Besides the owner include the investors, employees, lenders, suppliers, customers, government and other agencies and the public at large.
- Accounting provides the art of presenting information systematically to the users of accounts.
- Accounting data is more useful if it stresses economic substance rather than technical form.
- Information is useless and meaningless unless it is relevant and material to a user's decision.
- The information should also be free of any biases.



**CONCEPT 3 : OBJECTIVES OF ACCOUNTING**

(SAAP To Know)





**CONCEPT 4 : FUNCTIONS OF ACCOUNTING**  
(Memory technique : MF DC ko Control karta hai & Taxes pay karta hai)

Sr. no.	Functions	Explanation
[1]	Measurement :	✧ It measures past performance and depicts its current financial position.
[2]	Forecasting :	✧ It helps in forecasting future performance and financial position.
[3]	Decision-making :	✧ It provides relevant information to the users of accounts to aid rational decision-making.
[4]	Comparison & Evaluation :	✧ Accounting assesses performance achieved in relation to targets & discloses information regarding accounting policies & contingent liabilities which play role in predicting, comparing & evaluating the financial results.
[5]	Control :	✧ Accounting identifies weaknesses of the operational system and provides feedbacks to check weaknesses.
[6]	Government Regulation & Taxation :	✧ Accounting provides necessary information to the government to exercise control on the entity as well as in collection of tax revenues.

**CONCEPT 5 : BOOK – KEEPING & ITS OBJECTIVES**

➔ Book-keeping is an activity concerned with the recording of financial data relating to business operations in a significant and orderly manner.

**\* OBJECTIVES OF BOOK-KEEPING**

[a] Complete Recording of Transactions :

➔ It is concerned with complete and permanent record of all transactions in a systematic and logical manner to show its financial effect on the business.

[b] Ascertainment of Financial Effect on the Business :

➔ It is concerned with the combined effect of all the transactions made during the accounting period upon the financial position of the business as a whole.

**CONCEPT 6 : DISTINCTION BETWEEN BOOK – KEEPING AND ACCOUNTING**

\* Accounting is a broad subject. It calls for a greater understanding of records obtained from book-keeping and an ability to analyse and interpret the information provided by book-keeping records.

Sr. no.	Point of Distinction	Book – Keeping	Accounting
1]	Meaning	It is a process concerned with recording of transactions.	Process concerned with summarising of the recorded transactions.
2]	Constitutes	It constitutes as a base for accounting	It is considered as a language of the business.
3]	Financial Statements	It does not form part of this process.	It is prepared in this process.
4]	Managerial Decisions	Cannot be taken.	Taken.
5]	Subfield	No sub-field.	Several sub-fields like financial accounting, management accounting.
6]	Financial Position	Cannot be ascertained through book-keeping records.	Ascertained on the basis of the accounting reports.



CONCEPT 7 : SUB – FIELDS OF ACCOUNTING

[T.Q. 1]

Sr. no.	Functions	Explanation
[1]	Financial Accounting	<ul style="list-style-type: none"> <li>↳ It covers the preparation and interpretation of financial statements and communication to the users of accounts.</li> <li>↳ It is historical in nature as it records transactions which had already been occurred.</li> <li>↳ The final step of financial accounting is the preparation of Profit and Loss Account and the Balance Sheet.</li> </ul>
[2]	Management Accounting :	<ul style="list-style-type: none"> <li>↳ It is concerned with internal reporting to the managers of a business unit.</li> <li>↳ To discharge the functions of stewardship, planning, control and decision making, the management needs variety of information.</li> <li>↳ The different ways of grouping information and preparing reports as desired by managers for discharging their functions are referred to as management accounting.</li> </ul>
[3]	Cost Accounting :	<ul style="list-style-type: none"> <li>↳ "The process of accounting for cost which begins with the recording of income and expenditure or the bases on which they are calculated and ends with the preparation of periodical statements and reports for ascertaining and controlling costs."</li> </ul>
[4]	Social Responsibility Accounting :	<ul style="list-style-type: none"> <li>↳ Social responsibility accounting is concerned with accounting for social costs incurred by the enterprise and social benefits created.</li> </ul>
[5]	Human Resource Accounting :	<ul style="list-style-type: none"> <li>↳ Human resource accounting is an attempt to identify, quantify and report investments made in human resources of an organisation that are not presently accounted under conventional accounting practice.</li> </ul>

CONCEPT 8 : USERS OF ACCOUNTING INFORMATION

[T.Q. 2]

↳ Generally users of accounts are classified into two categories,

- [a] Internal management and owners; and
- [b] External users or outsiders.

Sr. no.	Users	Explanation
[1]	Investors :	<ul style="list-style-type: none"> <li>▶ They provide risk capital to the business.</li> <li>▶ They need information to assess whether to buy, hold or sell their investment.</li> <li>▶ Also they are interested to know the ability of the business to survive, prosper and to pay dividend.</li> </ul>
[2]	Employees :	<ul style="list-style-type: none"> <li>▶ Growth of the employees is directly related to the growth of the organisation and therefore, they are interested to know the stability, continuity and growth of the enterprise.</li> </ul>
[3]	Lenders :	<ul style="list-style-type: none"> <li>▶ They are interested to know whether their loan-principal and interest will be paid when due.</li> </ul>
[4]	Suppliers and Creditors :	<ul style="list-style-type: none"> <li>▶ They are also interested to know the ability of the enterprise to pay the dues, that helps them to decide the credit policy for the relevant concern, rates to be charged and so on.</li> </ul>
[5]	Customers :	<ul style="list-style-type: none"> <li>▶ Customers are also concerned with the stability and profitability of the enterprise because their functioning is more or less dependent on the supply of goods.</li> </ul>



[6]	Government & their agencies :	▶ They regulate the functioning of business enterprises for public good, allocate scarce resources among competing enterprises, control prices, charge excise duties and taxes, and so they have continued interest in the business enterprise.
[7]	Public :	▶ The public at large is interested in the functioning of the enterprise because it may make a substantial contribution to the local economy in many ways including the number of people employed.

**CONCEPT 9 : RELATIONSHIP OF ACCOUNTING WITH OTHER DISCIPLINES [T.Q. 3]**

Accounting is closely related with several other disciplines and the Accountant should have a working knowledge of the related disciplines so that he can understand such overlapping areas.

**[a] Accounting and Economics :**

Similarities	Difference	Nexus
* Economics : ▶ It is a science of rational decision-making about the use of scarce resources. ▶ This may be viewed either from the perspective of a single firm or of the country as a whole. * Accounting ▶ It provides data to the users to permit informed judgement and decisions.	▶ In concepts of income and capital.	▶ Accountants got the ideas of value, income and capital maintenance from economists. ▶ Economists think that value of an asset is the present value of all future earnings which can be derived from such assets. ▶ How can you estimate future stream of earnings? So accountants developed the workable valuation base - the acquisition cost i.e., the price paid to acquire the assets. ▶ At the macro-level, accounting provides the database over which the economic decision models have been developed; micro-level data arranged by the accounting system is summed up to get macro-level database.

**[b] Accounting and Statistics :**

▶ In accountancy, a number of financial and outer ratios are based on statistical methods, which help in averaging them over a period of time. ▶ Statistical methods are helpful in developing accounting data and in their interpretation.	[1] In accounts, all values are important individually because they relate to business transactions. [2] Statistics is concerned with typical value over a period of time or degree of variation over a series of observations. [3] Accounting records generally take a short-term view of events (a year) while statistical analysis is more useful if a longer view is taken for the purpose.	▶ Accounting records are based on historical costs of fixed assets, while the current assets are valued at the current values. The new methods of inflation accounting are an attempt to correct this situation. ▶ The correction of values is made on the basis of the current purchasing power of money. ▶ All this would require the use of price indices or the price deflators based on statistical data.
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**[c] Accounting and Mathematics :**

- ▶ Double Entry book-keeping can be converted in algebraic form.
- ▶ Knowledge of arithmetic and algebra is a pre-requisite for accounting computations and measurements. Calculations of interest and annuity are the examples of such fundamental uses.
- ▶ With the advent of the computer, mathematics is becoming a vital part of accounting. Instead of writing accounts in traditional fashion, the transactions and events can be recorded in the matrix form for classifying and summarising data.
- ▶ Presently graphs and charts are being extensively used for communicating accounting information.

**[d] Accounting and Law :**

- ▶ All transactions with suppliers and customers are governed by the Contract Act, the Sale of Goods Act, the Negotiable Instruments Act, etc. The entity itself is created and controlled by laws. Every country has a set of economic, fiscal and labour laws.
- ▶ Transactions and events are always guided by laws.
- ▶ Very often the accounting system to be followed has been prescribed by the law. For example, the Companies Act has prescribed the format of financial statements. Banking, insurance and electric supply undertakings also have to produce financial statements as prescribed by the respective legislations.

**[e] Accounting and Management :**

- ▶ Management is a broad occupational field.
- ▶ Accountants are well placed in the management and play a key role in the management team. A large portion of accounting information is prepared for management decision-making.
- ▶ So the accounting system can be moulded to serve the management purpose.

**CONCEPT 10 : LIMITATIONS OF ACCOUNTING**

[T.Q. 4]

- ↪ The assumptions and conventions, on which the accounting is based, become the limitations of accounting.
- [a] The Balance sheet cannot reflect the value of certain factors like loyalty and skill of the personnel.
- [b] Balance Sheet shows the position on the day of its preparation and not on the future date. Users are interested in knowing the position in the near future and not for the past date.
- [c] Accounting ignores changes in some money factors like inflation etc.
- [d] There are occasions when accounting principles conflict with each other.
- [e] Certain accounting estimates depend on the personal judgement of the accountant, e.g., provision for doubtful debts, method of depreciation adopted.
- [f] Financial statements only consider those assets which can be expressed in monetary terms. Human resources although very important are not shown in the balance sheet.
- [g] Different accounting policies for the treatment of same item add to the probability of manipulations.

☞ It can be said that the language of accounting has certain practical limitations and, therefore, the financial statements should be interpreted carefully keeping in mind all various factors influencing the true picture.

**CONCEPT 11 : ROLE OF CHARTERED ACCOUNTANT IN THE SOCIETY**

[T.Q. 5]

**[A] AREAS OF SERVICE**

- [1] Maintenance of Books of Accounts
- [2] Statutory Audit
- [3] Internal Audit
- [4] Taxation
- [5] Management Accounting and Consultancy Services



**[6] Financial Advice**

- [a] Investments
- [b] Insurance
- [c] Business Expansion
- [d] Investigations
- [e] Pension schemes

**[7] Other Services**

- [a] Secretarial Work
- [b] Share Registration Work
- [c] Company Formation
- [d] Receiverships, Liquidations, etc.
- [e] Arbitrations
- [f] As Regards the Cost Accounts
- [g] Accountant and Information Services

**[B] CHARTERED ACCOUNTANT IN INDUSTRY**

**[C] CHARTERED ACCOUNTANT IN PUBLIC SECTOR ENTERPRISES**

**[D] CHARTERED ACCOUNTANT IN FRAMING FISCAL POLICIES**

**[E] CHARTERED ACCOUNTANT AND ECONOMIC GROWTH**

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