1
CHAPTER

Accounting Theory

NEED FOR ACCOUNTING

Business is one of the sources of earning income. Whenever a business is started, it requires investment of certain amount which is called as capital. With this amount of capital the businessman may deal either with trading business or manufacturing business. In a trading business, he will buy goods at a lesser price and sells the same to others at a higher price. In case of manufacturing business, he has to buy raw materials and incur other expenses in the form of wages and salaries, rent, power, insurance, tax, transport, postal and telephone expenses and so on, in the course of production and distribution of goods. In a small sized business the transactions are simple and less in number. But in a large sized business the transactions are numerous. These business transactions enable the businessman to know the result of his business which can be profit or loss for a given period of time. In order to know the result of his business, a businessman has to remember all the transactions of his business. However, owing to lack of memory it is not possible for anybody to remember all the transactions over a period of time. This has given rise to maintenance of a set of accounting books in which business transactions are chronologically recorded. The systematic recording of business transactions enable the businessman to account for every transaction without missing any item. Such a system of maintenance of a set of accounting books to record business transactions is known as book keeping system.

ORIGIN OF BOOK KEEPING

The practice of record keeping existed ages before the formal recording of history. Barbarians began to keep records by scratching them on rocks. From there crude forms of picture writing, the process of rudimentary bookkeeping began. The Italians were the leading bookkeepers and record makers for centuries. As early as 813 A.D., Bookkeepers were recognised in Italy and from these men came many of the fundamentals of the modern double entry bookkeeping.

In 1911, a Florentine banker devised the first complete bookkeeping system as distinguished from the simple devices previously used. It had all the rudiments of a set of books including a rough plan of cross entries. The first known system of complete double entry was discovered in Genoa in 1340.

The first text book on bookkeeping was written in 1414 by Pacioli, a monk of the order of St. Francis at Venice. Many present day methods were described by this old world mathematician and the ideas he expressed have lived to the present day. Pacioli's treatise is based on the premise that where one wishes to conduct his business properly, he must first have sufficient cash or credit. Secondly, he must be a good bookkeeper. Thirdly, he must possess a proper book keeping system.

The years following Pacioli's treatise were marked by the refinement of the double entry bookkeeping system and by the use of the position of the accountant in the commercial world. Publications were released and some accountants association were formed, but it was not until the 19th century that accounting really became a profession.

It was not until the dawn of the 20th Century that the invention and perfection of the business machines of today took the business of record keeping from the "Shadow of the Pen". A new conception of accounting valuation began to take form and the bookkeeper really became on Accountant. The keeping of books was no longer restricted to the preparation of financial statement. Because of the ease with which facts could be recorded, accumulated and analysed, the accountant began to devote his time to the interpretation of "booked" facts and as a result, became a member of management's team.

MEANING AND DEFINITION OF BOOK KEEPING

The art of recording business transactions in a systematic manner is termed as bookkeeping. It is the name given to a system which is concerned with recording and summarising business transactions accurately so as to know the true state of affairs of a business.

Definition of Book Keeping. R.N. Carter in his book on Advanced Accounting defines book keeping as the Science and art of correctly recording in books of accounts all those business transactions that result in the transfer of money or money's worth". This definition reveals the following features of book keeping.

(*a*) **It is a Science.** Book Keeping is a science as it represents systematised knowledge. It is based upon a set of well defined principles which are followed throughout so that the reason for recording a transaction in a particular manner can be explained fully.

(*b*) **It is an Art.** Book keeping is an art as it deals with a system in which human skills and ability is involved in recording the business transaction according to principles of book keeping.

(*c*) **Money Consideration.** This implies recording of all transactions which can be expressed in terms of money.

Kohler in his "Dictionary for Accountants" defined book keeping as "the process of analysing, classifying, and recording transactions in accordance with preconcieved plan". This definition brings forth the following three aspects of accounting.

(*a*) **Analysis.** It refers to identifying various expenses incurred during a period of time.

(*b*) **Classification.** It refers to grouping of like items of expenses into a common group.

(c) **Recording.** It refers to entering transactions in the basic books and later on posting them into another set of book known as ledger.

B.G. Vickery in his book 'Principles and Practice of Book Keeping' defines book keeping as "the art of recording pecuniary or business transactions in a regular and systematic manner". This definition emphasises the recording of monetary transactions of the business on day-to-day basis and in a systmeatic manner, i.e., according to the set rules and regulations of book keeping.

Scope of Book Keeping

Book Keeping is concerned with two important steps involved in the procedure of accounting. They are : (i) recording of all business transactions in a book known as Journal and (ii) posting all recorded transactions into another book known as a ledger. Subsequently, the various accounts in the ledger are balanced to know the net effect of all transactions. In brief, the subject matter of book keeping includes preparation and maintenance of all records up to the stage of preparation of a statement known as Trial Balance.

DEFINITION OF ACCOUNTING

The American Accounting Association defines accounting as "the process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information". This definition highlights the following aspects :

(*a*) **Identifying the Business Transactions.** Identification of transactions are useful for proper recording of them in books of accounting without missing any of the transactions.

(*b*) **Measurement of Business Performance.** Measurement or evaluation of business performance is necessary to know the progress of business.

(*c*) **Communication of Information.** Communication of information relates to reporting the results of business to all those interested in the business. This enables them to judge the efficiency of the business and to take suitable decisions to improve the business.

According to the American Institute of Certified Public Accountants Terminology committee ; "Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money transactions and events which are in part atleast of a financial character and interpreting the results thereof.

This definition exmphasises the following aspects :

(*a*) It is an art

(*b*) It involves recording transactions in a set of books

(*c*) Classifying which refers to grouping of transactions according to their similarities.

(*d*) Summarising the transactions facilitate easy understanding of results by management of the business and others interested in the business. This step involves preparation of two important statements known as (i) Trading and Profit and Loss Account and (ii) Balance Sheet.

(*e*) Accounting is concerned with transactions capable of expressing in terms of money value. All business transactions of different nature are expressed in respect of money. Thus all assets such as land and building, plant and machinery, stock of goods etc., when expressed in terms of money can give total value of business. The value of a business can be compared with the value of another business.

(*f*) Only transactions of financial characters are recorded in the books of accounts. For example, the good health of a general manager is very essential for the success of a business. But this transaction is not recorded in accounting books. Similarly, cooperation of employees, good working environment etc., are essential for the success of a business. But they are not recorded as they are not of a financial character.

(*g*) Interpreting the results helps in evaluating and in making a rational judgement about the performance of business. For example, an Accountant will estimate the advertising required for increasing the sales. Subsequently, he will judge whether the advertisement expesnes yielded the desired sales. This will help him to decide whether the same amount of advertising expense result in the desired sawles for the forth-coming years.

OBJECTIVES OF BOOK KEEPING

The objectives of book keeping can be summarised under the following headings :-

(A) ***Main Objectives :***

The main objectives of book keeping are as follows :-

(*a*) To know the result of the business over a period of time. The result of a business may be profit or loss.

(*b*) To know the financial position of business at a point of time. This can be known by presenting all assets and liabilities in the form of a statement known as a Balance Sheet.

(*c*) To maintain all records for a given period to serve as permanent reference in future.

(*d*) To know the amount which a business owes to others for having bought goods on credit basis.

(*e*) To know the amount due to business by others on account of goods sold on credit basis.

(*f*) To meet provisions of various laws as in the case of Joint Stock Comapnies which have to prepare accounts according to the Provisions of Companies Act 1956.

(B) ***Other Objectives :***

These include :

(*a*) To improve the business on the basis of past performance.

(*b*) To know the composition of capital in terms of size, the causes for change in capital structure and whether maximum use of the same is made.

(*c*) To exercise control over expenses thereby to increase profitability of the business.

(*d*) To know the position of cash so that in case of need further amount can be arranged.

(*e*) To meet the requirements of tax and legal authorities.

ADVANTAGES OF BOOK KEEPING

Accounting information is useful to the following categories of persons :

(A) ***To the Management of a Business :-***

(*a*) In evaluating various alternative proposals so as to take maximum benefit from the best alternative.

(*b*) In deciding matters such as elimination of an unprofitable activity, department or product, replacement of fixed assets, expansion of business etc.

(*c*) Planning the various activities and planning of revenues and expenses and arranging for finance in case of need.
(*d*) Comparing various year's account to know the progress or deterioration of the business and take actions to improve the business.
(*e*) Accounting information helps in providing evidence in a court of law in case of legal action taken by others.
(*f*) Accounting information helps in assessing the income tax, sales tax and property tax of the business.
(*g*) Accounting information consitututes one of the basis for borrowing loans from external source.
(*h*) It helps to detect errors and frauds that have taken place in the business.

(B) ***To the Investors :***

Accounting provides information regarding :-

(*a*) Types of property owned by the business.
(*b*) Sources and amount of earnings made or losses incurred by the business.
(*c*) Particulars such as stock position, debts owed, debts due etc.
(*d*) Whether rate of earnings is high or low.

(C) ***To the Employees :*** It provides information to employees so as to claim fair wages, bonus, and other welfare facilities.

(D) ***To the Government :***

(*a*) Accounting information helps Government to extend subsidies and incentives and other exemptions to certain types of business.
(*b*) The industrial progress can be known by the Government of the country. It can formulate industrial policies for further growth and development of industries.
(*c*) It enables the Government to assess the income from the industrial sector.
(*d*) It helps in amending various laws or enacting laws governing the functioning of business enterprises.
(*e*) It helps the Government in deciding price control, wage fixation, excise duties, sales tax etc.

(E) ***To the Consumers :*** Customers are not overcharged as selling price is fixed on the total expenses incurred by adding a reasonable rate of profit.

(F) ***To the Prospective Investors :*** It helps the propsective investors in choosing the right type of investment depending upon the profit earning capacity of the business entreprises and the profit earned during past few years.

(G) ***To the Creditors and Suppliers :*** Creditors can decide the solvency position of the business through the accounting information. Similarly, suppliers can also decide whether goods can be sold in future on credit basis.

SYSTEM OF BOOK KEEPING

Book keeping can be prepared and maintained under two systems. They are known as (*a*) Single Entry System ; and (*b*) Double Entry System.

(*a*) **Single Entry System :** Kohler in his book Dictionary for Accountants has defined single entry system as a system of book keeping in which as a rule only records of cash and personal accounts are maintained, it is always incomplete double entry varying with circumtances. This system is adopted by small business enterprises for the sake of their convenience. Under this system only personal accounts of debtors and creditors and a cash book is maintained. This system ignores the two-fold aspect of each transaction. As only one aspect of the transaction is recorded under this system, it is called a Single entry system. So this system is considered as incomplete and unsatisfactory accounting system. Accurate information of the operations of the business is also lacking under this system.

(*b*) **Double Entry System :** This system of accounting is based upon exchange value of money or money's worth. As such we find two aspects in every business transaction viz., the receiving aspect and the giving aspect. Under this system, every transaction is recorded twice, one on the debit side, *i.e.*, the receiving and the other on the credit side, *i.e.*, giving aspect. For example, when a businessman buys goods worth Rs. 10000, he exchanges money for goods. Similarly, when he hires the services of a manager, he gives the money for having derived the service. Thus every transaction has two aspects. One receiving of benefit and another giving the benefit and both these aspects are recorded under this system of book keeping. The features of double entry system can be summarised under the following points :

(*a*) It records the two aspects of a transaction.
(*b*) It records both personal and impersonal aspects of a transaction.
(*c*) While one aspect is debited, its corresponding aspect is credited.
(*d*) Because debit and credit aspects of all transactions are recorded, the total of debit and credit columns are always equal. This ensures the arithmatical accuracy of accounts.

ADVANTAGES OF DOUBLE ENTRY SYSTEM OF BOOK KEEPING

(*a*) It records all the transactions considering both the aspects of the transactions. Hence it gives the complete information about the business.
(*b*) By recording both the debit and credit aspects it ensures the mathematical accuracy or correct preparation of accounts.
(*c*) It enables to prevent misappropriation and frauds involved in recording the transactions.
(*d*) By recording all types of transactions it reveals the correct result of the business for a year.
(*e*) By recording all assets, liabilities and capital it reveals the true financial position of the business.
(*f*) The accounting system satisfies external parties including government, tax authorities etc.

DISADVANTAGES

(*a*) It involves maintenance of many books and ledgers which are very expensive.
(*b*) It involves more of clerical labour.

DIFFERENCES BETWEEN BOOK KEEPING AND ACCOUNTING

Very often the terms Book Keeping and Accounting are used interchangeably. However these two concepts are not identical. They differ from each other in the following aspects.

Book Keeping	*Accounting*
1. In book keeping, financial transactions are recorded in a set of books.	1. In accounting the errors are detected and they are rectified through adjustment.
2. It is the first stage of maintaining accounts and as such it cannot give any conclusions about the performance of business.	2. It is second stage which gives useful information to draw conclusions about the performance of business.
3. Book keeping does not show the result and financial position of the business.	3. Accounting shows the results and financial position of the business.
4. Book keeping is undertaken by clerks whose responsibility is less.	4. The accounting is undertaken by accountant whose responsibility, is more.
5. It is concerned with posting the entries in the ledgers.	5. It is concerned with checking whether posting is accurately done.
6. It is concerned with totalling of Journal and ledgers and to find out balances in all the accounts.	6. It is concerned with preparation of a Trial Balance with the help of balances of ledger accounts.
7. Book keeping does not require special knowledge and ability.	7. Accounting requires special knowledge and ability.

BRANCHES OF ACCOUNTING

There are three branches of accounting. They are :

(1) **Financial Accounting.** Financial accounting refers to a branch of accounting which deals with financial transactions of a business. It is mainly concerned with preparation of two important statements, viz.,

(*a*) *Income statement or profit and loss account.*
(*b*) *Positional statement or Balance Sheet.* This information serves the needs of all those who are not directly associated with the management of business. Thus financial accounts are concerned with external reporting as it provides information to external authorities. In this book the entire study relates to financial accounting. However financial accounting suffers from certain limitations. These limitations are as follows :

(*a*) It provides only past data.
(*b*) It reveals only over all result of the business.
(*c*) It is static in nature.
(*d*) There is a possibility of manipulation of financial account.
(*e*) It fails to exercise control over resources of the business.
(*f*) It fails to provide adequate data for managerial decision making.
(*g*) It fails to provide adequate data for price fixation.
(*h*) It does not use any technique to reduce expenses which is responsible for decrease in profit.

To overcome there disadvantages the other branches of accounting was evolved.

(2) **Cost Accounting.** Kohler in his Dictionary for Accountants defines cost accounting as that "branch of accounting dealing with the classification, recording, allocation, summarisation and reporting of amount and prospective costs". An analysis of this definition reveals the

following aspects of cost accounting.

(*a*) Classification which refers to grouping of like items of costs into a common group.
(*b*) Recording, which refers to posting of cost transactions into various ledgers maintained under cost accounting system.
(*c*) Allocation, which refers to allotment of costs to various products or departments.
(*d*) Summarisation which refers to condensing cost information for quick interpretation and for taking prompt action for improving the inefficiencies.
(*e*) Reporting, which refers to furnishing of cost data on a regular basis so as to meet the requirements of management.

(3) **Management Accounting.** The terminology published by the Institute of Cost and Management accounting, London, defineds management accounting as "the application of professional knowledge and skill in the preparation and presentation of accounting information in such a way as to assist management in the formulation of policies and in the planning and control of the operation of the undertaking. It is a branch of accounting which furnishes useful data in carrying out the various management functions such as planning, decision making and controlling the activities of a business enterprise.

ACCOUNTING CONCEPTS AND CONVENTIONS

Before accounting concepts and conventions are discussed, it will be appropriate to know the meaning of the term "accounting principle". In olden days when size of the business was small and less complicated, the accounting information was felt only by the proprietor of a business. In modern days, with the growth of the business organisations, the transactions have become more in number. Unless these transactions are recorded according to a definite principle by all the business enterprises it is difficult to maintain uniformity in accounting system. Such uniformity is also necessary because many parties such as investors, creditors, employees, government and general public are interested to know the affairs of the business. If every business follows its own accounting practices, the final accounts may not be understandable to all such parties. So there is a scope for misinterpreting the position of the business by all persons interested in the business. Hence there is a need to follow a uniform accounting principles from the stage of recording the transactions up to the stage of preparing final accounts.

Definition of Accounting Principle

The terminology committee of American Institute of Certified Public Accounts defines the term principles as a general law or rule adopted or preferred as a guide to action, a settled ground or business of conduct or practice.

In the words of A.W. Johnson accounting principles are the assumptions and rules of accounting, the methods and procedures of accounting and the application of these rules, methods and procedures to the actual practice of accounting.

Accounting principles are accepted by all if they possess the following characteristics :

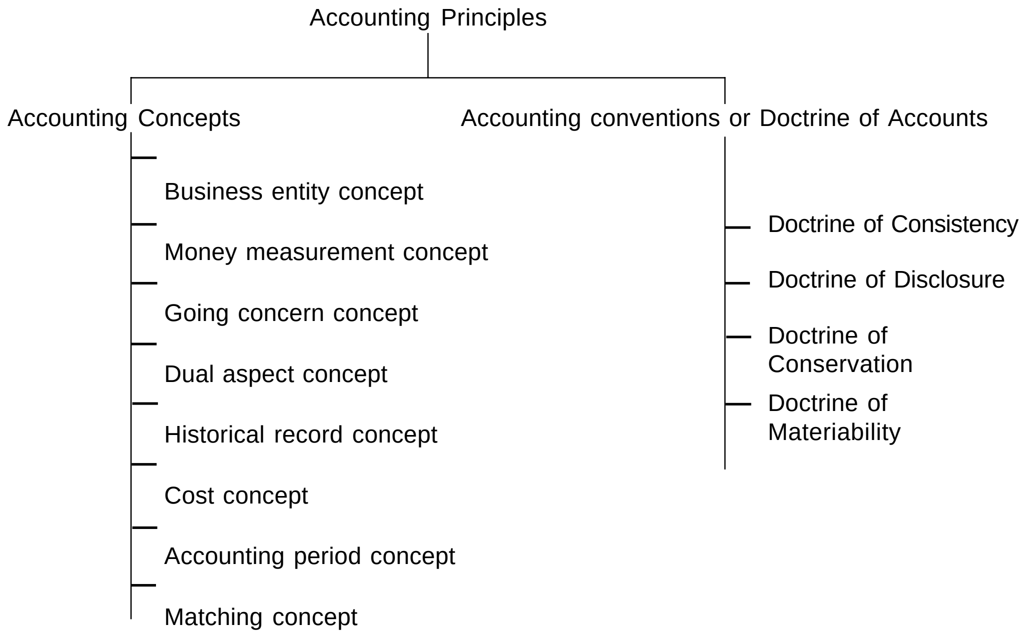
(*a*) ***Objectivity.*** It must be based on facts and impartial attitude ought to have been adopted by it. If it is so, the principle is said to possess objectivity.
(*b*) ***Application.*** If the application of the principle is possible, it is regarded as a good principle. In case theoretically principle is sound but its application is difficult, then

the principle has no value.

(*c*) ***Use.*** The principle should be such by whose "use" utility of accounting record is increased. Suppose a principle has objectivity and it is applicable also but there is no use of this principle in accountancy record then the principle is useless.

(*d*) ***Simplicity.*** The principles should be simple and easily understood by all.

Accounting principles are divided into two classes. This is shown in the following chart :



ACCOUNTING CONCEPTS

The term concept refers to assumptions and conditions on which accounting system is based. It denotes the propositions on which principles are formulated. The principles are formulated on the basis of economic and political environment of the business. There is no exhaustive list of accounting concepts. However, the following are considered as the important accounting concepts.

1. Business Entity Concept. The business enterprise is treated as a separate organisation which is quite distinct from the owner of the business. It implies that the business transactions must be kept completely separate from the private affairs of the proprietor. This enables the proprietor to ascertain the true picture of the business.

2. Money Measurement Concept. While preparing accounts in a business, only those transactions which are capable of expressing in terms of money alone are recorded. Other transactions which are not capable of measuring in terms of money consideration are outside the purview of accouting. For example, efficient leadership is essential for the success of the business. But leadership ability cannot be expressed in terms of money. Hence leadership aspect is ignored in accounting. Another important aspect of this accounting concept is that the transactions are recorded only at their original value of money. Subsequent change in the value of money or the purchasing power of the money is ignored. This is based on the assumption that the value of money remains always stable and does not fluctuate from time to time. However, this assumption does not hold good today. Recording of transactions at its original value is justified as it facilitates the addition of all assets of the business to know the total value of assets as on a given period of time.

3. Going Concern Concept. While maintaining accounts it is presumed that the business enterprise will continue to exist for an indefinite period of time. This assumption helps in two respects. Firstly, it facilitates classification of expenditure into capital expenditure and revenue expenditure. While capital expenditure benefits the business for a longer duration, revenue expenditure relates to short duration. If this classification is not made, all expenditure is treated at revenue expenditure which is not proper while preparing accounts. Secondly, because of this assumption, fixed assets are shown at its original cost, less its depreciation.

4. Dual Aspect Concept or Equation Concept. Under this concept, each and every transaction is split up into two aspects. One aspect relates to receiving the benefit and other aspect relates to giving the benefit. For example, when a machinery is bought by the business it receives the machinery with the help of which it can produce goods or services. For having bought the machinery, the business has to pay cash to the supplier of machinery. Thus every business transaction involves two fold aspects and both these aspects are recorded without exception whatsoever. This concept is based on the maxim that for every action there is always an equal and opposite reaction. According to this concept assets of a business will be equal to liabilities and capital. Expressed in the form of an equation,

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

or

$$\text{Capital} = \text{Assets} - \text{Liabilities}.$$

5. Historical Record Concept or Realisation Concept. According to this concept the sale proceeds of goods or services are realised only when the buyer is legally bound to pay for the delivery of goods or rendering of service. This concept is based on historical events of business transactions and therefore it is also known as historical record concept. To take on example suppose a businessman receives an order on 1st January, 2004 and supplies goods on 10th January and he receives payment on 15th January. In this transaction, the revenue from sale of goods is recorded on 10th January but neither at 1st January nor on 15th January.

6. Cost Concept. According to this concept all transactions are recorded in the books of accounts at the cost price or purchase price. For example, if a building is bought for Rs. 75000 which is actually worth Rs. 100000 then the cost price of Rs. 75000 will only be entered in the books of accounts.

7. Accounting Period Concept. Although it is assumed that the business will exist for a longer duration it is necessary to maintain accounts with reference to a convenient period so that results are ascertained and financial position presented for that period. Usually accounts are prepared for a period of one year which may be a calendar year or a financial year.

8. Matching Concept. One of the objectives of every business organisation is to know its results as on a given period of time. In order to know the profit or loss of the business the costs incurred during a given period is matched against the revenue earned during that period. This helps to know the profit or loss of the business during a period of time. If the revenue exceeds the cost it represents the profit. On the other hand, if the costs exceed the revenue, it represents the loss.

ACOUNTING CONVENTIONS OR DOCTRINE OF ACCOUNTS

Accounting convention refers to the customs and traditions followed by Accountants as guidelines while preparing accounting statement. They are followed so as to make accounting information more meaningful and clear. The important accounting conventions are as follows :

1. Doctrine of Consistency. This doctrine implies that the basis followed in different accounting period should be same. In other words, methods adopted in one accounting year should not be changed in another year. If a change becomes necessary, the change and its effect should be mentioned clearly.

2. Doctrine of Disclosure. According to this doctrine all significant information about the business should be disclosed. The accounting statement should be scrupulously honest. This doctrine implies that the accounting records and statements conform to generally accepted accounting principle.

3. Doctrine of Conservation. According to this doctrine the accounting information should not show a better position than what it actually is. Further the accounting information must include all reasons responsible for a reduction in profit or to incur losses. Such transactions relate to provision for doubtful debts, provision for discount on debtors etc. On the other hand the prospective profits should be ignored as it is uncertain to earn such profit.

4. Doctrine of Materiability. According to this doctrine, only transactions which are more important to the business are recorded. Trivial transactions which do not affect the result of the business drastically should be ignored as the cost of ascertaining such insignificant expenses is more than such a trivial expense incurred.

BASIS OF ACCOUNTING

There are two bases for accounting of business transactions. They are as follows :

(*a*) **Accrual Basis or Mercantile System of Accounting.** It is a system of classifying and summarising transactions into assets, liabilities, capital, cost and resources and recording there of. A transaction is recognised when either a liability or asset is created or impaired. Whether payment is made or received is immaterial in accrued basis accounting. The following are the essential features of accrual basis :

(*i*) Revenue is recognised as it is earned.

(*ii*) Costs are matched either against revenues so recognised or against the relevant time period to determine periodic income.

(*iii*) Costs which are not charged to income are carried forward and are kept under continuous review. Any cost that appears to have lost its utility or its power to generate future revenue is written off as a loss.

(*b*) **Cash Basis of Accounting.** It is a basis of accounting by which a transaction is recognised only if cash is received or paid.

However, accrual basis of accounting is the only generally accepted accounting method for business organisations which are supposed to operate for a long period. Cash basis of accounting is suitable for such business organisations which operate for a short term duration.

ACCOUNTING EQUATION

Accounting equation may be defined as an accounting formula expressing equivalence of the two expressions of assets and liabilities. Expressed in the form of an equation,

Assets = Capital + Liabilities or
Capital = Assets – Liabilities or
Liabilities = Assets – Capital.

The idea behind expressing accounting equation is that business is considered quite different from its proprietor. Whenever a proprietor provides the capital to a business he has a claim over it. It follows from the above statement that whenever an asset comes into business an equal claim arises. The accounting equation has two aspects or two sides, viz., left hand side to record any increase or decrease in the value of asset and right hand side to record any change in the value of liabilities.

Because of two-fold aspect of every business transaction, the following changes in the value of assets and liabilities will take place.

(*a*) Increase in the value of one asset will increase the value of a liability
(*b*) Increase in the value of one asset will reduce the value of other asset.
(*c*) Decrease in the value of one asset will decrease the value of a liability.
(*d*) Decrease in the value of one liability will increase the value of another liability.

The accounting equation as mentioned earlier remains unchanged. The only change that takes place is in the totals on the "Left Side" and "Right Side" of the equation.

Relationship of Accountancy with Other Disciplines

The need for and importance of accounting is felt by all the organisations—whether trading or non-trading. The relationship of accounting with various disciplines are explained below :

(*a*) **Accounting and Business.** Business organisations are run with an object of earning profit. They deal with various persons and other organisations. Unless all the business transactions are properly recorded it is not possible to know the true result of the business. Similarly, unless all assets and liabilities are properly recorded it will not be possible to prepare the financial position of the business. The importance of accounting is so much felt in large sized business, wherein accounting is considered as a separate function of the business. Hence a separate department by name accounting department is created which is incharge of the chief Accountant.

(*b*) **Accounting and Government.** Government which is considered as the biggest form of organisation also makes use of accounting discipline. Budgeting which is one of the important aspect of accounting is prepared by every state and central government. Every government is interested in knowing the total revenue and total expenditure and the balance amount available in the government treasury. In case of deficit balance, the government can raise funds through issue of bonds, bills, etc., for financing projects of national importance. In case of surplus funds it can divert to other key sectors where it lacks adequate funds. The importance of accounting is so much felt by the government that in modern days a new branch of accounting called as government accounting is involved and adopted by most of the government.

(*c*) **Accounting and Medical Science.** Medical science also heavily relies upon accounting information. Hospitals and clinics will maintain accounting books in order to know the rates to be charged to patients. They record all the expenses incurred and revenue received for a given period to know whether hospitals and clinic is run with profit or otherwise.

(*d*) **Accounting and Research.** Research organisations also will maintain a set of accounting books to know the research expenses in conducting various experiments. They evaluate the success of the research activities by knowing the corresponding benefit derived by the production and sale of new products.

(*e*) **Accounting and Education.** The promoters of education and educational institutions also will maintain a detailed accounts of various expenses incurred under different heads such as library, laboratory, sports and cultural activities, salaries payable etc. They also record the fees and donations received from students so as to know maintenance cost of educational institutions.

ROLE OF ACCOUNTANT IN SOCIETY

The accountancy profession is considered to be one of the noblest profession and is held in high esteem in public eyes. By making use of science and out of accountancy an accountant will enable public to know the exact position of a business. The profession of accountancy also enables the management to discharge its functions efficiently based upon the information provided by Accountant. The Accountant also serves the society by virtue of his education, training, analytical mind and experience. A modern Accountant can render useful service not only in the field of taxation, costing, management accounting and company legislation, but also in allied areas such as finance, budgeting, economic aspects.

The various services rendered by an accountant are summarised below

1. Maintenance of Books of Accounts. By maintaining the books of accounts, it is possible to know the result of the business and its financial position.

In the process of maintaining the books of accounts, an Accountant renders the following services :

(*a*) Helps management in planning, decision-making and controlling.
(*b*) Facilitate comparative study to know the efficiency or otherwise of the business.
(*c*) In calculating the tax liability of the business
(*d*) To furnish evidence in court in terms of conflict.
(*e*) To ascertain purchase price of business when it is sold to outsiders.
(*f*) To deal on behalf of an insolvent business.

2. To Conduct Statutory Audit. Auditing the accounts of a Joint Stock Company is compulsory. A Chartered Accountant serves as an auditor to verify the correctness of accounts of a Joint Stock Company.

3. To Conduct Internal Audit. Internal audit is conducted to know whether there is any leakage of revenue or misappropriation of property of the business.

4. Taxation. An Accountant can represent the business or person before tax authorities and settle the tax liability as per the Income Tax Act.

5. Management Accounting. A management Accountant assists management in performing various functions by way of collecting, analysing, interpreting and presenting all accounting information which is useful to the management.

6. Financial Service. These includes :

(*a*) Investment
(*b*) Insurance
(*c*) Business expansion, mergers, acquisitions etc.
(*d*) Investigation, which includes :

(*i*) Make or buy decision
(*ii*) Detecting fraud
(*iii*) Valuation of Shares
(*iv*) Achieve greater efficiency on management
(*v*) Pension and provident fund scheme
(*vi*) Use of mechanical equipments.

7. Management Consultancy Service

This includes :

(*i*) Management information service
(*ii*) Expenditure control and evaluation
(*iii*) M.B.O.
(*iv*) Management of working capital and its best possible use
(*v*) Advising management about O & M studies for effective delegation and planning of work.
(*vi*) Formulating long term plan and setting up objectives of the business
(*vii*) Assist management in conducting feasibility study of new projects
(*viii*) Advise management on the benefits of mechanised accounting system
(*ix*) Use of statistical techniques for business forecasting.

8. Other Services

This includes :

(*a*) Registering share transfers and new issues
(*b*) Company formation
(*c*) Liquidation
(*d*) Arbitration.

QUESTIONS

1. Define Book keeping.
2. Define accounting.
3. What do you mean by single entry system of book keeping ?
4. What do you mean by double entry system of Book keeping ?
5. Define accounting principle.
6. List out the four characteristics of accounting principle.
7. What do you mean by accounting concept ?
8. What do you mean by accounting convention ?
9. Define accounting equation.

SHORT ANSWER QUESTIONS

1. Explain the need for accounting.
2. State the objectives of book keeping.
3. State the advantages of book keeping.
4. State the differences between book keeping and accounting.
5. Explain the various accounting concepts.
6. Explain the various accounting conventions.
7. Examine the relationship of accounting with various other disciplines.
8. Explain the role of Accountant in a society.