

FUNAMENTALS OF ACCOUNTING

Chapter One

Basics of Accounting

Unit Introduction

Every profit or nonprofit organization needs a reliable accountability system. A business accounting system offers this accountability by tracking all operations generating cash inflows from sales revenue and cash outflows from operating activities. The accounting system provides the financial data required to assess the efficacy of past and current activities. In particular, the accounting system stores the data necessary to generate reports displaying the state of the corporate entity's financial assets, creditor obligations, and ownership equity. In the past, most of the work necessary to operate a successful accounting system consisted of laborious, irritating, and time-consuming manual labor. Individual effort was required to continuously record transactions, add, subtract, analyze, and verify for faults in such systems (Muniroh & Yuliati, 2021).

The fast development of computer technology has enhanced operational speed, storage systems, and dependability while reducing costs significantly. Affordable microcomputers and accounting computer programs have improved to the point that the computer program can swiftly offer posting, computations, error checks, and financial statements.

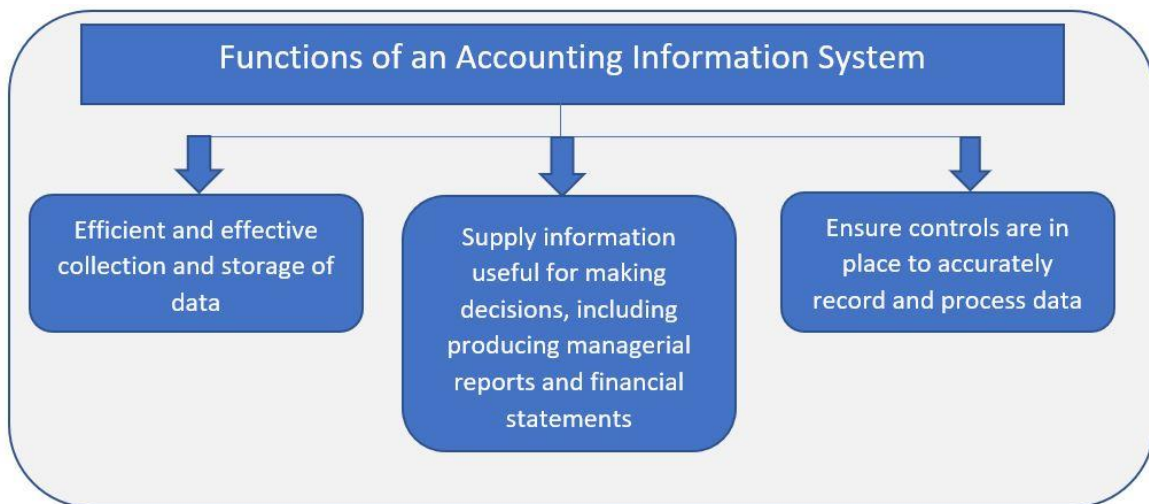


Figure 1.1. Schematic of the functions of an Accounting Information System (Source: Tally Solutions, Creative Commons License).

Financial accounting entails the monitoring and analysis of financial transactions to aid in the formulation of corporate decisions. Management accounting is focused on giving executives accountability for overseeing and regulating activities within business-specific secret communications.

Internal knowledge is the foundation for planning different short- or lengthy actions to be taken and determining which action to pursue (Makar et al., 2013). The implementation of the chosen plan of action is described in detail.

The accounting terminology provided by the American Institute of Certified Public Accountants (AICPA) is apparent. According to this definition, accounting is

"The art of recording, classifying, and summarizing in a significant way and regards to money, transactions as well as events that are, at minimum in part, of a financial nature and evaluating the outcomes thereof."

The term accounting highlights the following characteristics (Rayburn, 1986):

1. Accounting is an art. Accounting is considered an art since it assists in determining the economic outcomes, that is, operational profit and financial position, by analyzing and interpreting financial information, which needs specialized knowledge, expertise, and discretion.

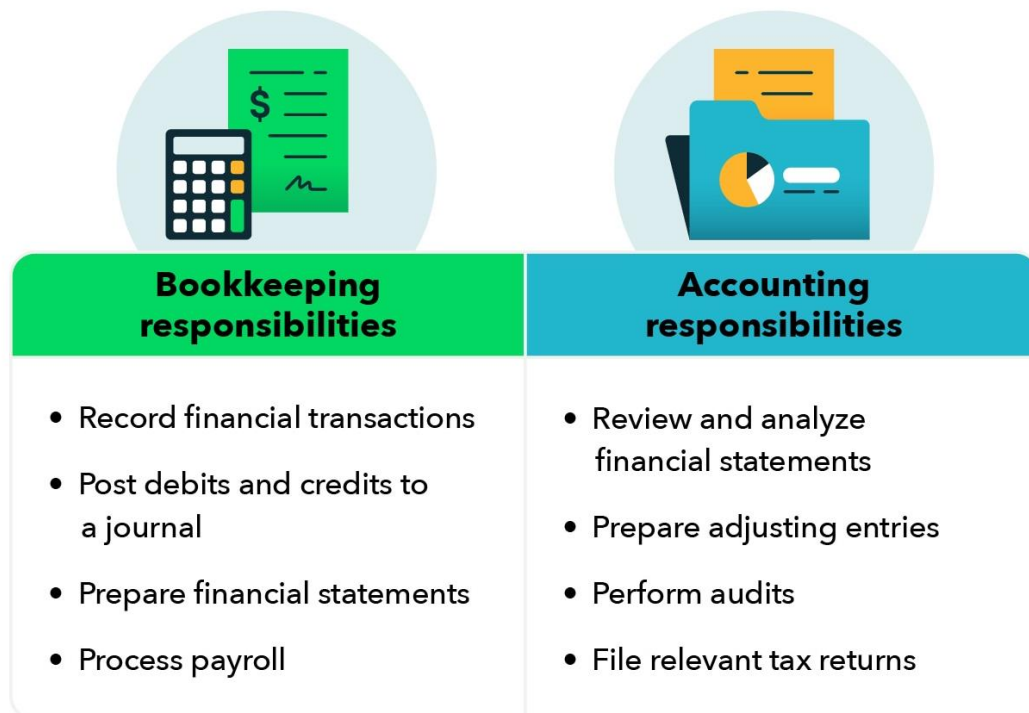


Figure 1.2. Diagram representing the difference between Bookkeeping and Accounting (Source: Quickbooks, Creative Commons License).

2. It entails documenting, categorizing, and summing up. Recording entails systematically noting activities and occurrences in account books as soon as they occur. Classifying is the practice of gathering together transactions or items of a similar kind in one location. This is accomplished

by opening accounts in a book known as a ledger. The production of summaries and declarations from the classified material (ledger) that are intelligible and beneficial to leadership and other interested individuals is summarization. This includes the production of final accounting, including a statement of profits and losses and a balance sheet.

3. It documents transactions in monetary terms. All transactions are logged using a standard unit of measurement, capital, that enhances the comprehension of the status of the business.
4. It solely documents transactions and occurrences that have a financial nature. If an occurrence has no economic implications, this would not be quantified concerning money and will not be registered.
5. It is the skill of assessing the outcomes of activities to assess the enterprise's financial status, progress, and the job it is doing.

Accounting consists of the following steps (Rapp, 2010):

1. Identified and documented are the activities of a firm that are of minimum a partial financial nature.
2. The recording is carried out in a manner that recognizes the various transaction categories and kinds.
3. The resulting data are presented so that company owners and other relevant individuals can view the cumulative consequences of all transactions. The reports produced by the reviewing procedure are referred to as financial statements. They will display the company's loss or profit over time and the total capital the business utilizes. Management uses such financial data to make company choices.

Branches of Accounting

1. There are three primary types or divisions of accounting:
 - a) Managerial Accounting
 - b) Financial Accounting
 - c) Standard costing
2. Financial Accounting entails recordkeeping for the creation of trial balances, profit and loss statements, and balance sheets.
3. Cost accounting is the method of recording and reporting costs. It is a method for systematically calculating the unit cost of an item or activity. The significant purposes of cost accounting include determining the price of a product and assisting management with cost control.
4. Management accounting mainly focuses on the supply of data relevant to managers for decision-making, enhancing the organization's effectiveness, and maximizing profitability (Laughlin, 1981).

Learning Objectives

After studying this chapter, readers will be able to:

1. Explain the need for accounting
2. Understand the objectives of accounting
3. Understand the basics of accounting
4. Define the terms in accounting
5. Discuss the conceptual framework of accounting
6. Understand the accounting conventions
7. Define accounting equation and balance sheet
8. Explain the profit and loss account for noncorporate and corporate entities

Key Terms

1. Accounting Equation
2. Balance Sheet
3. Credit
4. Current Asset
5. Current Liabilities
6. Accounting Policies
7. Accounting Standards
8. Accounting Conventions

1.1. Need of Accounting

Accounting is closely related to private lives as it pertains to each business. Whenever people anticipate what they will do with cash, they all consciously or unconsciously produce accounting-related ideas. People must determine how much money would be spent and how much would be saved. By use of this action, a budget is made (Maskell & Kennedy, 2007). People are acquainted with this commonly accepted idea that money should be spent with caution.

The same applies to businesses. A firm must be aware of the internal and external financial resources and their consequences. Due to the diversity between management and ownership, accounting is necessary for a firm to give information essential for making solid economic decisions (Kavanagh & Drennan, 2008). Accounting also referred to as "The Language of Business," is necessary for a business organization to determine its position.



Figure 1.3. Illustration of the need for Accounting (Source: Lorginee Nagapa Chetty, Creative Commons License).

It is of the utmost importance to establish a foundation for budget planning, as well as dealing with the measure of economic operations and communicating financial information for decision-making. Accounting also aims to safeguard a firm's assets and share the outcomes of the income statement with all parties, such as stockholders, creditors, and investors, while adhering to regulatory obligations (Hopwood, 2009).

Accounting is among the fields that are expanding at a higher rate in the current period. It is dynamic and satisfies the expanding demands of trade, business, and industry. It is crucial to note that the advent

of the industrial age and technical improvements have resulted in the expansion of company opportunities and a change in the accounting field, which is now recognized as a managerial planning tool and regulating processes. Therefore, it is accurate to assert that no economic growth could be conducted efficiently in the modern day without accounting.

The following are the primary accounting features ((Hopwood, 2009):

1. *Keeping Systematic Records:* Accounting is performed to establish a methodical financial transaction record.
2. *Protecting and Controlling Business Properties:* Accounting ensures that none of the firm's assets or materials are used or disposed of in a way that is not allowed by maintaining accurate records. Accounting will provide information regarding money owed to different parties and numerous people. The company can ensure that all funds owed to it are collected promptly and that no payments are paid in error.
3. *Determining the Operational Profit/Loss:* Accounting assists in determining the results of actions during a specific period, often a year, that is, how much loss or profit has been generated. This is done by keeping accurate records of a period's income and spending and comparing the payment to its associated costs.
4. *Ascertaining the Financial Position of the Business:* A balance sheet is generated to determine the company's financial condition after a specific period. It shows the amounts of an organization's assets and obligations.
5. *Facilitating Rational Decision Making:* Accounting aids the gathering, evaluating, and reporting of data at the appropriate time and to the appropriate management hierarchy to aid logical decision-making.

1.2. Scope of Accounting

Accounting has a vast scope and field of application. Its application is not limited to the corporate world but rather permeates all sectors of society and all disciplines (Parker, 1993). Today, all social institutions and professional endeavors must engage in financial transactions regardless of whether they generate a profit. Consequently, there is a requirement for documenting and analyzing such transactions as they happen and determining their net effect at the end of a specific period. In addition, this includes the necessity for interpreting and disseminating this data to the appropriate parties. Only accounting may support resolving these issues (Tillema, 2005).



Figure 1.4. Schematic showing scope of accounting (Source: QS Study, Creative Commons License)