Financial Accounting I

As per new B Com CBCS syllabus 2017 for CU

REVISED SECOND EDITION

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Foreword

The subject of Accounting has undergone manifold changes in the recent past, which necessitates constant updating and modifications of course content of this discipline.

The book titled 'Financial Accounting I', authored by Soumya Mukherjee and Abhik Kumar Mukherjee, has been written keeping an eye on the current syllabi of the University of Calcutta. The lucid presentation of the conceptual aspects and the graded illustrations are expected to develop interest of the students in the subject and also help them understand the subject easily.

I firmly believe that this book will fulfil the need of the student community and will also be of great interest to the academicians associated with this discipline.

I take this opportunity to congratulate the authors for their sincere efforts in preparing the book and I hope that such endeavour of the authors will be successful in serving the purpose for which it has been written.

D R Dandapat

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Features of

5.2 ACCOUNTING THEORY

5.2.1 Meaning of Accounting Theory

- The term 'Accounting Theory' is made up of two terminologies—'Accounting' and Theory'. Therefor before starting the discussion on accounting theory we highlight these two very important concepts.
- **Accounting** refers to the art and science of recording economic events (i.e. transactions) in a metho ological manner with the objective of ascertaining the operating results (profit/surplus or loss/defici which have accrued during a specific period and present the state of affairs of the entity at a particul point of time.
- **Theory** is a systematic statement of the rules, principles, and methodology that underlie a set of phenon ena and provides explanation to the phenomena. According to Kerlinger, *'Theory is a set of inter-relat constructs (concepts), definitions and propositions that present a systematic view of phenomena by specifyi relations among variables with the purpose of explaining and predicting the phenomena.'*[1]
- **Accounting Theory** is a discipline of study which sets and examines the assumptions, methodologies, ar frameworks of financial accounting principles. According to Prof. Hendriksen, *'Accounting Theory may defined as logical reasoning in the form of a set of broad principles that provide a general frame of reference which accounting practice can be evaluated and guide the development of new practices and procedures.'*[2]

Theory explained in lucid language using unique bulleted format

The theoretical concepts of each chapter have been vividly discussed using unique bulleted format.

Topics updated with Indian Accounting Standards

The topics of the syllabus (both theory and numerical illustrations) have been updated with the provisions of the relevant Indian Accounting Standards (Ind AS).

6.3.4 Present Status of Accounting Standards in India

- Until recently, India employed an antiquated set of generally accepted accounting proved difficult for foreign entities to adhere to. For the purpose of ensuring that thes more closely with International Financial Reporting Standards (IFRS), the Ins Accountants in India (ICAI) set out to introduce a new system, called the Indian A (Ind AS).
- The first phase of Ind AS was implemented in April 2011 and introduced a total o standards. Subsequent phases were implemented in April 2013 and April 2014.
- On February 16, 2015, the Ministry of Corporate Affairs (MCA) released a roadma of implementation, to be active from April 1, 2016. The map is intended to bring foreign companies with a minimum net worth of ₹500 crore into full complianc therefore, into effective compliance with IFRS. This was thereafter extended to co worth of ₹250 crore by April 1, 2017.

Balance Sheet as on Dec. 31, 2014 (includes)

Liabilities	₹	₹	Assets	₹	₹
			Stock on Sale or Return		24,000
			Sundry Debtors	17,35,000	
			Less: Sales or Return Suspense	30,000	17,05,000

WORKINGS

1. **Goods awaiting approval on Mar. 31, 2014**

	₹	₹
Invoice Price (I.P.) of goods sent		1,50,000
Less: I.P of Goods Returned within Dec. 31, 2014	40,000	
I.P of Goods accepted within Dec. 31, 2014	80,000	1,20,000
∴ I.P of Goods awaiting approval		30,000

∴Cost of goods awaiting approval = ₹30,000 × 100/ 125 = ₹24,000

Solved Numerical Examples with detailed Working Notes

Each chapter contains worked-out illustrations along with detailed Working Notes to elucidate the concepts.

Graded Illustrations

The worked-out problems of each chapter have been arranged in the graded structure (i.e., from easy numerical problems to advanced numerical problems).

GRADED ILLUSTRATIONS

Illustration 1: ***Basic problem – Concept building problem with indep***

The premises of A & Co. were damaged by fire on 31.3.15 and its st firm closed its books on Dec. 31 every year. From the following partic to be lodged with the insurance company for loss of stock in each of (Fig in ₹):

Stock on 1.1.14 10,000 Stock on 31.12.1

the Book

Student Note **Difference between cost and expense** Th
the term 'Cost' is a wider concept, while
provides benefits only in the current acc
Amount incurred on acquiring a fixed asset

Concept Note It is to be noted that even though accounting st
accounting, presently they are not issued only i
in other disciplines viz. cost accounting and taxation. Thus, th
- Financial Accounting Standards;
- Cost Accounting Standards; and
- Tax Accounting Standards.

NB: In this title, the term 'Accounting Standard' refers only to

Student Notes & Concept Notes

Each chapter contains relevant Student Notes & Concept Notes for enhancing the conceptual clarity of the readers.

EXERCISES

1. From the following particulars of Shri Mukesh, ascertain the Net Profit for the year ended Mar. 31, 2
'Cash Basis' (ii) under 'Accrual Basis' (Figs in ₹):

Sales: Cash	20,000	Outstanding Repairing Charges	
Credit	15,000	Rent paid in cash	
Purchases (including Cash Purchases ₹2,500)	18,000	Prepaid Rent for 2015–16	
Salaries paid (including Outstanding Salaries of 2013–14: ₹200)	800		

[*Ans.* Net Profit: (i) Cash Basis ₹15,500, (ii) Accrual Basis ₹15,190]

2. M/s X, a stationery merchant, determines his profit at ₹5,20,000 under 'Cash Basis'. He provides further information for 2014–15:
Credit sales ₹20,500; Credit purchases ₹12,000; Outstanding expenses ₹5,000; Rental income receiv
₹4,200;
Determine the profit earned by Mr X under 'Mercantile Basis'. [*An*

Chapter-end Exercises

Each chapter contains questions for students to practise.

READY ACCESS TO EXAMINATION PROBLEMS

CU B Com	Illustration No.	CU B Com	Illustration No.
2011	2	2015 (Hons)	10
2013 (Gen.)	8	2016 (Hons)	11
2014 (Hons)	9		

Ready Access to Examination Problems

This unique table presents the questions set in the past examinations (CU B Com and Professional Courses) in a chronological order for easy access.

CU Question Papers of last 5 Years

Numerical problems set as per the CU B Com examinations for the last 5 years (2012 to 2016) have been solved and appears separately at the end of the 'Graded Illustrations'.

CU SOLVED QUESTIONS 2012-2016

Illustration 43: *The following balances are extracted from the books of Mr. S for the year ended 31.*

	01.01.2011 (₹)	31.12.2011 (₹)
Stock	**15,000**	**?**
Debtors	**40,000**	**60,000**
Creditors	**20,000**	**40,000**

(i) During the year, he paid his creditors ₹60,000 and received from debtors ₹90,000. (ii) B written off ₹5,000. (iii) Discount received from creditors ₹1,000. (iv) Cash Sales are 20% sales.
(v) Credit purchases arc 75% of total purchases. (vi) Rate of Gross profit 20% of sales.
Calculate:
(a) Total sales, (b) Total Purchases and (c) Value of slock on 31.12.2011.

[*CU B Com (Hons & Gen*

Preface

The responsibility of recording the financial events entered by any kind of organization lies with the discipline of accountancy. It is the 'language' using which the happenings of an organization are communicated to its stakeholders. Financial accounting happens to be one of the core subjects of any commerce and business faculty.

Accountancy is an age-old subject which is regularly evolving in this ever changing world. In this era of globalization, accountancy, as a discipline, is undergoing significant transformation. In the modern times it is getting transformed from 'principle-based' to 'rule-based'.

ABOUT THE BOOK

We are pleased to present before the academic community a book on the subject Financial Accounting. This book is primarily intended to cater to the needs of the students undergoing B Com course (Hons and Gen.) in different universities, specifically University of Calcutta (CU).

The aim of this book is to help the students solidify their conceptual base of the subject and bring clarity in understanding the principles of accountancy. Moreover, the title has been developed keeping in mind the knowledge requirement of those students who are willing to join the Bachelor of Commerce curriculum coming from non-commerce background at the plus-two level.

This title has been developed as per the CBCS based new and revised syllabus (2017) of CU. Moreover, it also guides the students undergoing different professional courses namely CA, CS, and CMA.

PEDAGOGICAL FEATURES

Some of the distinguishing features of the book are:

- The first **self-study textbook** of Financial Accounting for the students of CU.
- **Student-friendly approach** in theory and worked-out problems.
- Theoretical discussion in **lucid language** and in innovative **bulleted form**.
- Key conceptual issues in various chapters under **Student Notes** and **Concept Notes**.
- **More than 450 worked-out illustrations** in **self-explanatory approach** with **Problem Notes** and detailed **Working Notes**.
- **Model Objective Questions and Answers** provided in line with CU's new question paper format.
- Relevant **problems set as per CU B Com [Hons** and **Gen.]** examination and **professional examinations [CA, CS, CMA]** of about last 20 years.
- Chapter-end **Exercises** for practising the contents discussed in the chapter.
- **Ready Access Tables** to past examination problems.

CONTENT AND STRUCTURE

This book covers the entire syllabus of Financial Accounting I of CU over 23 chapters. These chapters may be divided into the following broad areas:

- **Introduction (Chapter 1 to Chapter 6)**: This section introduces the subject of accountancy by discussing the basic accounting rules, techniques, accounting theory, basis and principles (concepts and conventions) along with the accounting standards.
- **Concepts for Determination of Operating Income (Chapter 7 to Chapter 14)**: This is a core conceptual area that discusses the topics that are relevant for determination of operating income of any entity. The

principles of recognition of revenue, valuation of inventories, accounting for depreciation, creation of reserves and provisions, segregation between capital and revenue transactions, and the developments of adjustment and rectification entries are discussed and explained in this section.

- **Finalisation of Accounts (Chapter 15 to Chapter 18)**: This section of the book discusses the principles for finalization of accounts for different types of entities viz. profit-oriented organizations (both Manufacturing as well as Trading) and non-profit oriented organizations.
- **Accounting for Special Transactions (Chapter 19 to Chapter 23)**: Certain transactions of special nature are sometimes entered into by the organizations viz. special sale transactions, insurance claim, self and sectional balancing of multiple ledgers. Chapters 17 and 18 deal with two of the most common special sales transactions namely 'consignment sales' and 'sale on approval basis'. Chapter 19 discusses the principles and accounting for organizations maintaining books under multiple-ledger system (both Self and Sectional-balancing), and Chapters 20 and 21 deal with calculation of insurance claim to be lodged for loss of stock and consequential loss of profit.

Soumya Mukherjee
Abhik Kr. Mukherjee

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A number of problems, illustrations, and exercises have been drawn from questions based on the examinations of universities and also public examinations of the professional bodies viz. the Institute of Chartered Accountants of India, the Institute of Cost Accountants of India, and the Institute of Company Secretaries of India. Every effort has been made to give due credit to the sources from where the materials have been drawn.

We express our deepest respect and love to our family members for bearing with us during this long journey of developing the title.

Last but not the least, we are thankful to the entire team of Oxford University Press for their untiring support in this project.

Soumya Mukherjee
Abhik Kr. Mukherjee

Contents

Road Map to the University of Calcutta Syllabus

UNIT	TOPIC	DETAILS	CHAPTER
1	Introduction	• Nature of accounting; Users of accounting information; Qualitative characteristics of accounting information.	1
		• Double entry book keeping system – Basic accounting equation, meaning of assets, liabilities, equity, revenue and expenses. Accounting Cycle - Recording of transaction: Journal, Ledger and preparation of Trial Balance.	2
		• Bases of accounting; cash basis and accrual basis.	3
		• Basic concepts and conventions: entity, money measurement, going concern, cost, realization, accruals, periodicity, consistency, prudence (conservatism), materiality, matching and full disclosures.	4
2	Concepts for determination of business income	• Revenue recognition: Meaning of revenue; objective; timing of recognition. Recognition of expenses.	7
		• Inventories: meaning. Significance of inventory valuation. Lower of cost or market rule; Inventory ascertainment and reconciliation.	8
		• The nature of depreciation. The accounting concept of depreciation. Factors in the measurement of depreciation. Methods of computing depreciation: straight line method and diminishing balance method; Disposal of depreciable assets; change in estimate and method of charging depreciation. Accounting for depreciation: Asset-depreciation, Asset-provision.	9
		• Reserves and provisions: Meaning; Objective; Types & Accounting.	10,11
		• Capital and revenue expenditures and receipts: general introduction only.	12
		• Adjustment and rectification.	13, 14

3	Introduction to Accounting Theory	Concept of accounting theory; relation with practice; GAAP; Capital – capital maintenance concepts; Limitations of Historic Cost accounting; Introduction to Fair Value accounting	5
	Introduction to Accounting Standard	Financial accounting standards: concept, benefits, procedure for issuing accounting standards in India, Need for a global standard, IFRS (concept only).	6
4	Final accounts of Trading Concern	Preparation of financial statements: of sole proprietorship business entities from a trial balance – Manufacturing, Trading, P/L A/c and Balance Sheet.	15, 16
5	Financial statements from Incomplete records and of NPO	Preparation of financial statements: a) from incomplete records b) of non-profit organization	17 18
6	Accounting for special sales transaction	• Consignment: Basic features; difference with sales. Recording in the books of Consignor – at cost & at invoice price, Valuation of unsold stock; Ordinary commission. Treatment and valuation of abnormal & normal loss. Special commission; Del credere commission (with and without bad debt) - use of Consignment Debtors A/C, Recording in the books of Consignee.	19
		• Accounting for sale on approval.	20
	Sectional and Self balancing Ledger	• Concept of sectional balancing, preparation of control accounts. Self balancing Ledger: advantages; Recording process; preparation of Adjustment accounts.	21
	Insurance claim for loss of stock and for loss of profit	• Loss of stock: Physical & ownership concept; concept of under-insurance and average clause; computation of claim – with price change; consideration of unusual selling line; price reduction etc.	22
		• Loss of profit: Concept – insured & uninsured standing charges, GP rate, short sales and increased cost of working, average clause and computation of claim (simple type).	23

1

Introduction to Accounting

1.1 MEANING OF ACCOUNTING

- **Accounting** may be defined as the process of recording, classifying, summarizing, analysing, and interpreting financial transactions and communicating the results thereof to the users interested in such communication. In other words, accounting can be defined as an information system that provides information to users about the economic activities and condition of an entity for the purpose of decision-making.
- A very comprehensive definition was put forward by the **American Institute of Certified Public Accountants (AICPA)**, according to which '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 at least, of a financial character, and interpreting the results thereof.'
- **American Accounting Association (AAA)** defines accounting as 'the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the user of accounts.'

From the aforementioned definitions, the following attributes of accounting can be observed:

- **Identification** of monetary transactions and events
- **Measurement** of the identified transactions and events
- **Recording** of such transactions
- **Classifying** and **summarizing** of the recorded transactions
- Obtaining the results of operations
- **Analysing** and **interpreting** the results to help in decision-making
- **Communicating** such information to the users (both internal and external)

To conclude, accounting is regarded as the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of information. It is a service activity to provide qualitative financial information and it is useful in making economic decision.

Student Note

- Luca Pacioli (1447–1517), an Italian mathematician, in his book *Summa de Arithmetica, Geometrica, Proportioni et Proportionalite* discussed in detail about the accounting and recording system.
- He is considered to be the 'Father of Accounting'.

1.2 RELATIONSHIP OF ACCOUNTING WITH BOOK-KEEPING AND ACCOUNTANCY

Book-keeping is a part of accounting that is concerned with the recording of transactions and maintenance of books of accounts. Its primary objective is to maintain systematic recording of transactions on a regular basis. It is a concept narrower than accounting.

Accountancy is a discipline that incorporates certain principles or rules of accounting. It refers to the entire body of the theory and practice of accounting. It is a concept wider than accounting.

Relationship: Thus, Book-keeping is a subset of accounting, whereas Accounting, in turn, is a part of Accountancy (see Fig. 1.1).

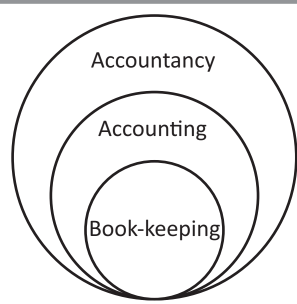

Figure 1.1 Relation between Book-keeping, Accounting, and Accountancy

1.3 NATURE OF ACCOUNTING

- ○ **It is a process** as it performs the task of collecting, recording, classifying, summarizing, and analysing financial information in a sequential order.
- ○ **It is considered as an art** because it has certain definite techniques of performing the various functions.
- ○ **It is an information system** as it receives transactions as inputs, processes them applying necessary principles and techniques, and generates needful information required by different users.
- ○ **It is a 'means to an end' and not an 'end in itself'**. Accounting generates and communicates the financial information to the users for the purpose of taking decisions. It does not end with merely reporting the results of an entity to the users but also paves the way for their decision-making.
- ○ **It deals with only monetary events**,' that is, only those transactions which can be measured and expressed objectively in terms of money.

1.4 ACCOUNTING—'THE LANGUAGE OF AN ENTITY'

Languages are used to communicate certain facts and feelings by one person to another. Every organization has to communicate its developments and happenings to its stakeholders. Accounting prepares different statements and reports to communicate the financial results and position of the organization to its users. Hence, accounting is considered to be the language of an entity.

1.5 FUNCTIONS OF ACCOUNTING

The primary functions of accounting are as follows:

1. **Keeping systematic records:** By maintaining proper books of accounts and regular recording of transactions therein in a chronological and systematic manner.
2. **Ascertaining the operating results:** By preparing the Income Statement through matching of expenses against revenues.
3. **Ascertaining the financial position of the business:** By drafting the Balance Sheet at the end of each accounting period.
4. **Facilitating rational decision-making by the users:** By providing necessary information in an organized and systematic manner.

1.6 BRANCHES OF ACCOUNTING

The primary function of the discipline of accounting is to record the happenings of different events for the purpose of meeting different objectives of the various users or stakeholders. Depending upon the type of information dealt with, the time of usage of information, and the target audience, different branches of accounting have evolved over the time period.

Classification

- Traditionally, the important branches of accounting are as follows:
  - ○ Financial Accounting,
  - ○ Cost Accounting, and
  - ○ Management Accounting
- However, in recent years the scope of accounting has expanded to include the following:
  - ○ Human Resource Accounting
  - ○ Environmental Accounting
  - ○ Social Accounting
  - ○ Forensic Accounting, etc

Financial Accounting: Financial Accounting is that branch of accounting that is concerned with the recording of transactions in the books of accounts. The primary objective of this is to determine the operating results (i.e., profit or loss) of an organization during each accounting period and to disclose its financial position as at the end of such accounting period. It records the transactions that have already occurred. For this reason, financial accounting is also called historical accounting or post-mortem accounting.

Cost Accounting: Cost Accounting is that branch of accounting that is concerned with the collection, classification, recording, summarization, and presentation of costing information that is used for cost ascertainment, cost control and cost reduction. Cost Accounting deals with the determination of costs of manufacturing a product or rendering a service. The objectives of cost accounting are ascertainment of cost, cost control, and cost reduction.

Management Accounting: It is the branch of accounting that deals with the presentation of accounting information in such a way so as to assist the management in day-to-day operations of the concern, in planning, in policy formulation, in controlling, and in decision-making. Management accounting utilizes data and information from both financial accounting and cost accounting.

Comparison between Financial and Cost Accounting

The following is the comparison between Financial Accounting and Cost Accounting:

Points of Difference	Financial Accounting	Cost Accounting
1. Applicability	It is applicable to all types of entities (namely, trading, manufacturing, service-rendering, etc.)	It is applicable only for manufacturing and service-rendering entities and not for trading concerns.
2. Concern	It is concerned with classifying, recording, and analysing the transactions of an entity.	It is concerned with classifying, recording, allocation, reporting, and control of costs.
3. Objective	Its objective is to determine the true financial performance of the organization and disclose its financial position.	Its objective is ascertainment of cost, cost control, and cost reduction.
4. Function	Its function is to classify, record, analyse, and interpret the financial transactions of an entity.	Its function is to classify, record, analyse, and interpret the cost-related transactions of an entity.
5. Cost focus	It is concerned only with historical costs.	It is concerned with both historical costs as well as future or estimated costs.
6. Nature of data	It uses only actual financial data.	It uses actual data as well as abstract data such as, opportunity costs, relevant costs, etc.
7. Focus	It focuses on the entire organization.	It focuses on specific parts of the organization, namely, individual products, services, departments, etc.

Comparison between Financial and Management Accounting

The following is the comparison between Financial Accounting and Management Accounting:

Points of Difference	Financial Accounting	Management Accounting
1. Concern	It is concerned with classifying, recording, summarizing, and analysing the transactions of an entity.	It is concerned with assisting the management in day-to-day operations, planning, policy formulation, controlling, and decision-making.

Points of Difference	Financial Accounting	Management Accounting
2. Objective	Its objective is to determine the true financial performance of the organization and disclose its financial position.	Its objective is to help management in decision-making.
3. Function	Its function is to classify, record, analyse, and interpret the financial transactions of an entity.	Its function is to ensure optimum use and accountability of the resources of an entity.
4. Data	It deals with only financial data.	It deals with both financial as well as non-financial data.
5. Periodicity	Financial Accounting is done for a specific accounting period.	In case of Management Accounting, there is no such specific period of accounting.
6. Interdependency	Financial accounting is not dependent on Management Accounting.	Management accounting depends on financial accounting and cost accounting data and information.

1.7 ACCOUNTING INFORMATION

Accounting Information refers to the information generated by the accounting system of an entity relating to a particular accounting period. They disclose the operating results and financial position of the entity. It acts as a mirror of the financial performance of a concern.

Users of Accounting Information

Users of accounting information refer to those people or organizations who refer to the information generated by the accounting system of an entity for their respective purposes. The users of accounting information can be broadly classified into two categories—External and Internal, which are discussed as follows.

A) *External Users*

a) **Investors:** Investors may include 'existing investors' as well as 'prospective investors'. Accounting information is accessed by both these parties for different purposes.
Existing investors are interested to know the performance of the organization for measuring their return from the investments already made.
Prospective investors require information about the past performance of the concern in which they would like to park their funds so as ensure that their investments are rationally made.

b) **Loan providers:** These entities conduct detailed study of the past accounting information of its prospective borrowers. It is done for ascertaining the financial credibility and credit worthiness of the borrower to get a measure of its repaying capacity.

c) **Stock Exchange:** They require accounting information of the entities whose securities are traded in the stock exchange for protecting the interest of the parties associated with the exchange.

d) **Suppliers or Creditors:** They supply goods and services on credit basis to an entity. The financial information is studied by the creditors for deciding upon the extent of credit to be granted and also the party's capability of meeting the commitment, that is, their credit worthiness.

e) **Customers:** They are dependent on an organization for the goods or services. As such, to have some interest about the long-term existence and continuation of the entity, they study the relevant accounting information of such entity.

f) **Government:** The government needs accounting information for ensuring proper allocation of resources, price control, and regulating the activities of the enterprise. Moreover, they gather financial information for preparing the statistics for national income computation.

g) **Regulatory Agencies:** Certain governmental or quasi-governmental organizations are responsible for overall regulation of specific sectors of the economy. They need to study the accounts prepared by the different concerns operating in the respective sector for the purpose of regulation and control.

Examples of Regulatory Agencies in India	
Name of Regulatory Body	**Regulated Sector**
Reserve Bank of India (RBI)	Banking
Securities and Exchange Board of India (SEBI)	Capital Markets
Telecom Regulatory Authority of India (TRAI)	Telecom
Insurance Regulatory and Development Authority (IRDA)	Insurance
Directorate General of Civil Aviation (DGCA)	Aviation

h) **Tax Authorities:** The taxation authorities are interested to study the financial information of different entities for the purpose of levy, collection, and regulation of different types of taxes and duties (both for Direct taxes and Indirect taxes).

i) **Security Analysts:** They are interested to study and analyse the accounting information of different organizations so as to enable them to advise their clients about the buying, selling, or holding decisions.

j) **Academicians and Research Scholars:** This user group is interested in the information provided by the accounting systems of various organizations and agencies for their research work and analysis. The accounting information acts as 'secondary data' for testing of hypothesis and model development.

k) **General public:** Public is generally interested in an organization as every organization (whether profit-oriented or not) is a 'social entity'. It exists in the society and for the society. It adds value to the society in a variety of ways such as creating employment opportunities, producing goods, or rendering services for the public but at the same time may pollute the surrounding environment. As such, for communicating its overall performance and social responsibilities discharged to the public at large, the organization presents the 'Annual Reports' and other social commentaries.

B) *Internal Users*

a) **Owners** or **Promoters:** These are the people who invest their hard-earned money to start and promote an organization. So, they make regular and detailed study of the accounting information to know the results of operation of the entity and its financial position.

b) **Management:** The management is responsible for regular running and operations of the organization. As such, to measure the results of their operations, they prepare financial statements and analyse them for making proper decisions to ensure further improvements and overcoming deficiencies, if any.

c) **Employees:** Employees and their representative groups (i.e., trade unions, associations, etc.) refer to the accounting information for studying the stability and profitability of the employer organization, primarily for ensuring their job security. It also helps them to assess their performance-related remuneration, retirement benefits, and other employment opportunities.

Qualitative Characteristics of Accounting Information

IASC Framework[1] has identified four qualitative characteristics of accounting information:

1. **Reliability:** Reliability is the quality of accounting information that allows the users to depend on it with confidence. Reliable accounting information acts as the foundation on which the users can build up

[1]IASC refers to 'International Accounting Standards Committee'.

their sound and rational decisions. To make accounting information reliable, it should have the following secondary qualities:

- Verifiability,
- Representational Faithfulness, and
- Neutrality or Unambiguity

2. **Relevance:** Relevance refers to that quality that ensures that the information is meaningful and useful to the user of accounting information for the purpose of decision-making. In order to be relevant, accounting information must be capable of making a difference in the decision-making process of the user. To make accounting information relevant, it should have the following secondary qualities:
   - Timeliness
   - Predictive Value
   - Feedback Value
3. **Understandability:** Understandability refers to that quality that makes the information comprehensible to the users of accounting information. For this purpose, information should be presented in a lucid and systematic way to the users. However, at the same time, the users are expected to have reasonable knowledge of business and accounting.
4. **Comparability:** Comparability is a quality of the relationship between two or more pieces of information. It refers to that quality of the accounting information that enables users to identify similarities in and differences between two sets of financial information.

   Comparability with regard to accounting information may be of two types, which are as follows:
   - **Horizontal Comparability**, i.e., comparison of the financial information of two or more entities pertaining to the same accounting period.
   - **Vertical Comparability**, i.e, comparison of the financial information of a single entity over different accounting periods.

Presently, with the objectives of financial reporting focused on decision-making, comparability is one of the most essential and desirable qualities of accounting information.

EXERCISES

1. What do you mean by accounting?
2. Explain, in brief, the relationship between book-keeping, accounting, and accountancy.
3. Why is accounting considered to be an accounting system?
4. 'Both monetary and non-monetary events are considered in accounts.' Comment.
5. State the primary functions of accounting.
6. What are the traditional branches of accounting?
7. State two points of difference between financial accounting and cost accounting.
8. What do you mean by accounting information?
9. Who are the users of accounting information?
10. Mention two internal and two external users of accounting information.
11. State the qualitative characteristics of accounting information.
12. Explain, in brief, the reliability characteristic of accounting information.