

- (f) *Consumer*: Consumer is interested in information on the continued existence of the business and thus probability of the continued supply of the products, parts and after sale services. They ensure continuous existence of a business, especially in case of durable products which require after sales service and spare parts.

1.1.6 Importance and Advantages of Accounting

Appropriate and adequate accounting system plays a vital role for the successful operation of the business. It also helps in the determination of cost of production, controlling internal as well as external activities of the business, forecasting of profit, cost and sales, etc. Accounting is also useful in locating the errors, distribution of dividend and bonus to shareholders. Thus, accounting is being used as a means to achieve the objective of the business. The other advantages of the accounting are as follows:

1. **Replacement of human memory**: As the human's memory is limited and short, it is difficult to remember all the transactions of the business. Therefore, all the financial transactions of the business are recorded in the books. By this way the businessmen cannot only see the records at the required time but can also remember them for a long time. Thus, recording of the transactions is the replacement of human's memory.
2. **Helpful in the determination of financial results and presentation of financial position**: Accounting is very useful in the determination of the profit and loss of a business and showing the financial position of the business.
3. **Helpful in assessing the tax liability**: Generally, a businessman has to pay corporate tax, VAT and excise duty, etc. Therefore, it is necessary that proper accounts should be maintained to compute the tax liability of the business.
4. **Helpful in the case of insolvency**: Sometimes the businessman becomes the insolvent. If he has properly maintained the accounts, he will not face the problems in explaining few things in the court.
5. **Helpful in the valuation of business**: If the business is shut down and sold, accounting helps the businessman to determine the value of business. It would be possible only in that case when the accounts of the business are properly maintained.
6. **Helpful in the valuation of goodwill and shares**: If accounts of the business are properly maintained, it would be quite convenient to determine the value of goodwill. Goodwill is very important for the determination of the value of shares of the company.
7. **Accounting makes comparative statement possible**: Proper and adequate accounting helps in comparing the income, expenditure, purchase, sale of the current year with that of the previous years. And then future plans, policies and forecasting may be possible.
8. **Raising of funds become easy**: It helps in raising funds from investors or financial institutions by promising investors a fixed claim (interest payments) on the cash flows generated by the assets, with a limited or no role in the day-to-day running of the business.

1.1.7 Limitation of Accounting

In spite of being so many uses and advantages of accounting, it has a number of limitations which are as follows:

1. **Recording of monetary items only**: In accounting only those transactions, which have the monetary value, are recorded. And those transactions which do not have the financial value whether those are important in business, are not recorded in the accounting. For example, efficiency of the management, honesty of the workers, etc.

Notes

2. **Effect of inflation:** In accounting the transactions are recorded at the historical cost. Accordingly the assets of the business are shown at cost in the balance sheet. Thus the balance sheet prepared on the basis of historical cost ignores the price-level changes (inflation). In this way the balance sheet of the business does not present the true and fair picture of the business.
3. **Conflict between accounting principles:** In accounting, one accounting principle conflicts another. For instance, inventory should be valued on the basis of 'least of the cost and market price' as per the principle of the conservatism. If in the first year, inventory is valued on the basis of cost (being lower than market price) and in the second year at the market price (being lower than cost), this principle conflicts the accounting principle of the consistency.
4. **Financial statements are affected by personal judgment of the accountants:** Personal decisions of the accountants regarding the adoption of accounting policies, affects the results of the financial statements. As a result the financial statements lose their objectivity.
5. **Financial statements do not reflect the right picture of the business:** Sometimes the profit and loss account of the business does not show the accurate profit/loss and the balance sheet does not show the true picture of the business because the assets shown in the balance sheet are shown at the realizable (resalable) value which is wrong. Some worthless figures are also shown in the balance sheet as preliminary expenses, discount on issue of shares/debentures, etc.

Self Assessment

Fill in the blanks:

1. is the process of recording, classifying, summarizing in a significant manner of transactions which are in financial character and finally results are interpreted.
2. The users of accounting are and external.
3. Accounting records all the transactions which can be expressed either in
4. The creditors are interested to know the of the business.
5. The primary objective of the accounting is to maintain the records of all of the business.

1.2 Process of Accounting

Accounting is described as origin for the creation of information and the continuous utility of information. Now the question is how is this information created? For this, there is a step by step process, as shown in Figure 1.1.

After the creation of information, the developed information should be appropriately recorded.

Are there any scales/guides available for the recording of information? If yes, what are they?

They are as follows:

1. **What to record:** Financial Transaction is only to be recorded
2. **When to record:** Time relevance of the transaction at the moment of recording
3. **How to record:** Methodology of recording—It contains two different systems of accounting viz. cash system and accrual system.