UNIT-2

What does an Accountant

Learning Outcomes
By the end of this unit the learner will be able to:
✓ Describe activities of an accountant; and ✓ Discuss roles of accounting personnel and the accounting function in an organization.

Unit 2

The Role of an Accountant

Moving on from discussing the scope and role of accounting, we describe who is an accountant. An accountant can be defined in a number of ways, which are listed below:

a) An accountant is responsible for account keeping;
b) An accountant is an important instrument for financial control;
c) An accountant is often described as the conscience of an organisation;
d) An accountant is involved in managing the information of an organisation and providing it internal and external users;
e) An accountant advises the company in fiscal or financial matters;
f) An accountant prepares the organisation's financial statements, such as, the income statement and balance sheet for a particular period. He/she has the responsibility of maintaining supporting evidence and classified facts related to the financial matters of the organisation; and
g) An accountant deals with the verification, authentication, and certification of the company's accounts.

The statements above describe different aspects of an accountant's job. It starts with the very basic task of bookkeeping and extends it to the complex job of preparing financial statements and keeping all financial record of the organization. The person performing such activity is referred to as a financial accountant.

The role of an accountant, as a manager and his/her contribution towards financial control, is also mentioned. Accountants can identify problems with the organization's operations and its financial position and provide solutions, as well.

An accountant is also the financial adviser of the business organization. Take taxes, for example. It is an accountant's job to manage the company's taxes in a way that there is minimum tax liability. The accountant makes sure that tax concessions and tax incentives are utilized by the business.

The responsibility of being a watchdog and performing audit is essential in the roles of an accountant listed above. The company hires a professional who is not its employee but performs certification and external verification of the company's accounts. This is to ensure that the organization's financial statements are up to date and according to the rules and regulations.

As the "conscience keeper" of the organization, an accountant must have the best interest of the business owner in mind. His/her activities should seek to maximise profits for the business in addition to making sure that ethics are being conformed to. It must be ensured that the organization or anyone affiliated with the business does not carry out unethical work, which would be harmful for the company in the long run.

An accountant carries out the task of managing information for the organization and sends it out to the internal and external users of that information. It is important to point out here that the process of managing information does not necessarily have to rely on advanced technology. Small businesses use

simpler methods to communicate with internal and external users of information. However, small enterprises fail to recognise the importance of accounting and the proper management of information.

This is one of the main reasons that many small businesses are not able to survive for a longer period and quickly go out of business. The inability of managers to control costs, predict future cash flows, and plan for the growth of the business often leads to failure. These businesses often do not have a developed accounting system due to which banks are reluctant to lend them money and investors don't invest.

Accounting Personnel

An accountant is an important part of an organisation. He plays an extensive part in all departments of a complex organisation and his role is inescapable. The duties that accountants perform are different in different organisations.

Generally, there are two categories of accountants: the ones who serve in public domain and the ones who are employed in private sector. The accountants, who serve in public sector, conduct financial and cost audits and therefore, are known as auditors. Public sector accountants also get the benefit of gaining membership of professional bodies.

Auditors scrutinise the account books and balance sheets of a company. While looking at the profits and losses of a company, they try to paint an accurate picture of the financial state of a company. Shareholders of a business usually appoint auditors who meet the requirements of the Companies Act in order to conduct financial or cost audits.

Accountants get employment opportunities in all kinds of businesses to perform several accounting functions. Internal auditors in a company or an organisation are usually designates as chief accounting officers. Financial officers can be accounting chiefs in an organisation. Nowadays, organisations have permanently placed financial regulators on their pay lists. These financial wizards who work in an organisation under different designation are discussed below.

Internal Auditor: Internal auditors perform various tasks in an organisation. They perform audit on all data of organization and in the process set up and maintain system of internal control in the company. The top internal auditor is responsible to the chief executive of the company or to Board of Directors.

While performing internal audit, the auditors verify and scrutinise entries in the account books and authenticate accounting of assets. In the process they also check if all the legal financial procedures laid down in the rulebook were observed. In essence, the internal audit in any company maintains an internal check by highlighting any mistakes committed which can affect the financial state of the company.

While the internal auditors are full-time employees of an organisation, external auditors are hired for a short season by a firm. The internal auditors focus their skills and services only on the organisation they are employed in; external auditors, on the other hand, offer their services to many clients. Shareholders appoint external auditors for the purpose of safeguarding their interestsin an organisation. External auditors achieve this by carrying out an elaborate, unbiased, and independent financial evaluation of a company's state of affairs.

External auditors report on the revenues of the organisation. Their analysis is like an expert opinion from an unbiased outsider on the financial position of the company. Other entities, such as, banks, government departments, lending institutions, etc. find these financial reports prepared by the external auditors useful while making decisions about companies.

Auditors have to comply with a certain code of conduct and clear technical competence examinations. In that sense auditors have to meet several professional regulations in order to perform their tasks.

Controller: The Chief Accountant is also known as the Controller and heads all the accounting and internal audit activities. He looks after management accounting, financial accounting, cost accounting and tax accounting among other responsibilities.

The Chief Accountant has authority on the organization's internal and external accounting functions. He provides financial reports to external parties, such as, the Tax Department and the Company Law Board to ensure that the organization is following regulations. Moreover, he controls the company's internal audit, as well.

Processing historical data and providing information about financial operations to top management are also included in the chief accountant's responsibilities. He not only fulfils the management's control and planning needs but also assists different levels of managers in areas like production and marketing.

The functions of the controller can be summarized as follows:

- **a)** Designing a functional accounting system and operating it;
- **b)** Preparation of financial statements and reports;
- **c)** Establishing and maintaining systems and procedures;
- **d)** Managing the internal and external audit of the business;
- **e)** Managing computer applications;
- **f)** Exercising cost control;
- **g)** Preparing budgets;
- **h)** Forecasting and preparing analytical reports;
- **i)** Supplying information to top management; and
- **j)** Managing the company's taxes.

Treasurer: Treasurer is the guardian and keeper of a firm's cash resources. He is responsible for developing and maintaining links with financial institutions like banks. He keeps a track on the debtors of a company and manages credit reviews. The treasurer also directs the process of collecting receivables from company's goods or services.

Finance Officer: Financial management of a company includes obtaining or accumulating financial resources and their efficient utilisation. It is a backbone of any company. In Financial Management, important decisions have to be made on investment, financing, and dividend.

Decisions on investment are critical, as they lead to distribution and apportionment of resources. It always involves risk as the future is predicted but is never certain. Good investment decisions lead to growth of

companies and an increase in their market value. Finance decisions are about coming up with the right financial and capital structure of a company. The procurement of both short-term and long-term finances and all the relating decisions fall in this category.

When an organization makes profit, part of it is retained as earnings and the other part is distributed among shareholders. The Financial Manager has to deal with the question of how much money the company needs to fund its operations and the money that can be given out as dividends to shareholders.

Finance Manager and controller usually refer to the same position. In large organizations, the Financial Director is the Financial Manager in addition to being a controller. The role of Financial Manager includes preparation of budgets for the company, implementing the financial policy of the board of directors, administering financial control through budgets (budgetary control),or managing liquidity and profitability, etc.

Methods of Accounting

There are two ways of recording a business transaction:

a) Single Entry
b) Double Entry

Single Entry: This system records incomplete or one-sided business transactions. The business usually maintains the cashbook and a record of debtors and creditors. In this system, no trial balance can be prepared.

Double Entry: Every business transaction has a two-fold effect in this system, at the giving and receiving ends. The effect of the transaction is recorded in at least two different accounts with equal amounts.

Steps involved in Double Entry System

a) **Preparation of Journal:** Journal, which is also known as the book of original entry, is the first place where a business transaction is recorded. Therefore, a journal contains a record of all business transactions that have occurred.
b) **Preparation of Ledger:** It is a collection of all of the business's accounts. Transactions recorded in journal are posted to their respective accounts in the ledger.
c) **Trial Balance Preparation:** It is a summary of all transactions that have taken place and their effects in the form of a list.
d) **Preparation of Final Account:** Final financial statements are made at the end of the accounting period to reflect the organization's financial performance and its general financial position.

Advantages of Double Entry System

The following are some of the advantages of the Double- Entry System:

a) **Scientific system:** It is a scientific system, which is needed to record transactions and their dual effects in accounts.

b) **Complete record of transactions:** This system maintains a complete record of all financial business transactions.
c) **A check on the accuracy of accounts:** The trial balance makes sure that the accuracy of recording transactions is maintained.
d) **Ascertainment of profit or loss:** The Profit and Loss Account calculates whether the business has earned a profit or suffered a loss in a particular accounting period.
e) **Knowledge of the financial position of the business:** Financial statements prepared at the end of the accounting period evaluate the business's financial performance.
f) **Information to maintain control:** This system allows for the detailed recording of accounts, which provides information that is necessary to maintain financial control.
g) **Comparative study is possible:** Financial statements of a particular year can be compared to those from another period in order to analyse growth and change.
h) **Helps management in decision-making:** It gives managers the information, which is needed for them to make important financial and managerial decisions.
i) **No scope for fraud:** Fraud, misrepresentation of facts, and misappropriations can be checked through this system as detailed accounts of the company's assets and liabilities are available.

Meaning of Debit and Credit

The terms Debit and Credit have Latin roots. The term 'Debit' comes from 'debt', which means to owe. The term 'Credit' comes from 'creditable', which means to entrust. Sometimes, the words Debit and Credit are abbreviated as 'Dr' and Credit is abbreviated as 'Cr'. It is important to understand the principles of debit and credit in order to work with financial transactions. Debit and credit can be associated with either increase or decrease in financial amounts; this is determined by the kind of account.

Nature of Accounting Function

Accounting function has characteristics of service function. The position of Chief Accounting Officer is advisory in nature. In his own apartment, he is the top boss but outside his department he holds a staff position. This role is completely different than the ones in production or marketing who carry line authority. Therefore, the account department in an organisation do not enjoy authority over line departments. An organisation, which is highly decentralized with division of several departments and units, the Chief Accounting Officer still has a functional authority over his staff, even if they are employed in different departments.

An Accountant plays two important roles in an organisation.His first role is as a watchdog for the top brass of the organisation. In this role, he reports to the top brass and keeps score of different accounting tasks of the company. In his second role, as a helper and as someone who assists, he works with the middle and lower level employees and managers of the organisation to identify and solve different problems. The relationship between accountant and managers is important for the organisation and the mutual understanding they develop goes a long way in problem solving. For this to happen, the accountant and managers have to interact frequently on matters relating to budget preparation and other budget control documents. It helps the managers in their tasks and increases their output.

Types of Accounting

Types of Accounts

Bookkeeping maintains a complete record of the business transactions of the organization. It can be categorized into the following three types:

a) Relating to persons;
b) Relating to properties and assets; and
c) Relating to incomes and expenses

The accounts relating to people are called 'personal accounts.' Those accounts, which relate to assets and properties, are also called 'real accounts.' The accounts, which are related to income and expenditure, are known as 'nominal accounts.' Accounts can be further classified as personal or impersonal. The following chart shows the various types of accounts:

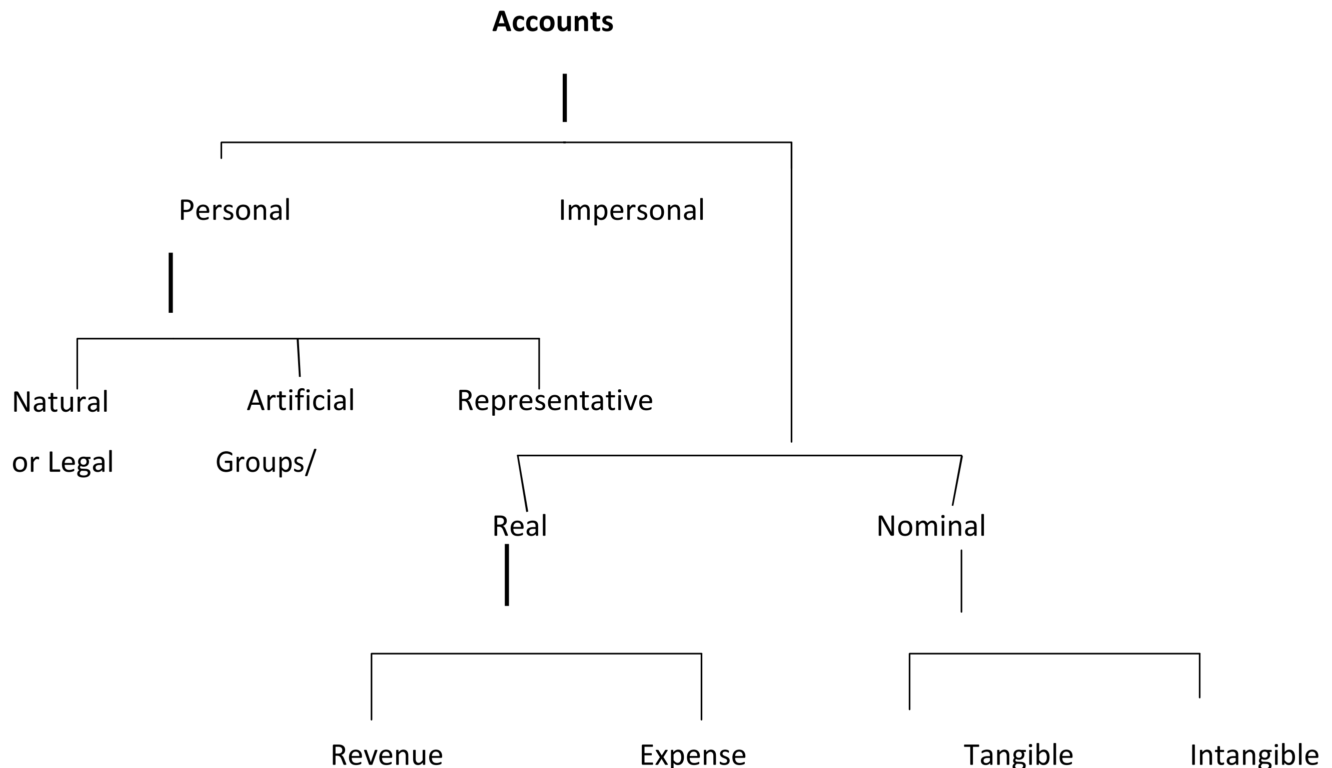

Fig. 2.1

Personal Accounts

Personal Accounts record transactions that are carried out with a person or a group of persons. These accounts are usually maintained to record credit transactions and can be classified into the following categories:

a) **Natural persons:** It records transactions with an individual person, male or female. Such accounts are titled as Henry's Account, Jane's Account, etc.
b) **Artificial or legal persons:** Such an account records financial transactions with an artificial entity or a legally created artificial person. Examples of this kind of account are accounts of firms, limited companies, educational institutions, cooperative societies, etc.
c) **Groups/Representative personal Accounts:** This account indirectly represents a person or a group of people. This is usually done when a large number of accounts, of similar nature, are grouped together under one account title. These accounts are said to be representative of a group of personal accounts. For example, outstanding salaries, rent, prepaid insurance, wages, etc.

A proprietor is a person who starts a business. He/she is represented by a **Capital Account** for the entire sum of money that is invested in the business by him/her. The **drawings** account represents whatever the proprietor withdraws from the business. Therefore, capital and drawings accounts are also classified as personal accounts.

This is the rule for personal accounts: **Debit the receiver Credit the giver**

Real Accounts

Real accounts record transactions related to property or assets. Each asset has its own separate account. For example; cash, machinery, building, land etc.

Real accounts are further classified as 'tangible' or 'intangible' accounts.

a) **Tangible Real Accounts: A** Tangible asset or property Account is that which can be touched, felt, measured, sold, or purchased such as machinery, equipment, furniture, cash, inventory, etc. The accounts related to tangible assets or properties are known as Tangible Real Accounts.
b) **Intangible Real Accounts: A** Intangible asset or property Account cannot be touched or measured in monetary terms. Goodwill, patents, copyright, trademarks, etc. are examples of such intangible assets. Accounts dealing with such assets or properties are called Intangible Real Accounts.

The basic accounting rule for Real accounts is: **Debit what comes in Credit what goes out**

Nominal Accounts

Accounts dealing with the income, expenses, revenues, profits, and losses are called Nominal Accounts. Because these accounts do not include tangible assets, they are also known as fictitious accounts. Each expense, loss, or gain is represented by a separate account, for example: wages account, commission account, rent account, interest account, etc

The transaction for Nominal Accounts is recorded as: **Debit all expenses and losses**

Credit all incomes and gains

Distinction between Book-Keeping and Accounting

Definition

Bookkeeping has numerous definitions, a couple of which are as follows:

"Book - keeping is the art of recording business transactions in a systematic manner."

A.H.Rosenkamph

"Book - keeping is the science and art of correctly recording in account books all those business transactions that result in the transfer of money or money's worth." R.N.Carter

Objectives of Book – Keeping

The following are some of the main objectives of bookkeeping:

a) A permanent record of each transaction is maintained through bookkeeping;
b) An organisation's financial position and soundness can be ascertained by analysing the records on assets and liabilities;
c) Income and expenditure figures of the firm during a particular period help in calculating the profit or loss for that period;
d) It keeps a record of all customers and suppliers, enabling the business to keep track of the money which is received or paid;
e) Business policies can be reviewed and revised in the light of past records maintained through bookkeeping; and
f) It allows the government to amend business laws, provide licenses, and assess taxation based on a business's records.

Differences between Book-Keeping and Accounting

It is important to understand the distinction between book-keeping and accounting which is summarized below:

Basis of Difference	Book-Keeping	Accounting
Transactions	To record transactions in original entry books.	To assess the recorded transactions to determine their accuracy.
Posting	Making posting in books/registers.	Scrutinising postings to determine its accuracy.
Total and Balance	To create amount totals in journal and ledger accounts. To determine balances of all accounts.	To make trial balance by using ledger accounts balances.

Income Statement and Balance Sheet	Creation of Trading, Profit, & Loss Accounts and Balance Sheet is not a part of book-keeping	Creation of Trading, Profit, & Loss Accounts and Balance Sheet is a part of accounting
Rectification oferrors	It is not a part of book -keeping	It is a part of accounting.
Special skill andknowledge	No special skills or knowledge is necessary for bookkeeping. Book-keeping is automated in first world countries	Special skills set and knowledge is required for accounting.
Liability	A bookkeeper has no responsibility or liability for the work related to accountancy.	An accountant has responsibility for the work of a bookkeeper.

Table 2.1

Organisation for Accounting and Finance

The figure below shows a typical firm's organisational chart for their accounting and financial functions. The Director of Finance, who is a member of the board of directors, is the person in charge of the organization's financial affairs. There are at least one or more general managers who report directly to the Director. Where there is one General Manager, he is also referred to as the General Manager (Finance), General Manager (Finance and Accounts), and the Controller or Financial Controller.

In large organizations, there are usually four or five deputy general managers in charge of departments like systems and data processing, accounts, finance, internal audit, etc. and they all report to the General Manager. Recently, there has been a trend in large private sector companies following the American practice of designating the General Manager (Finance) as the President (Finance/Finance and Accounts) and the Deputy General Manager as the Vice President. Numerous senior managers assist the deputy general managers in supervising different areas like financial accounting, taxation, management audit, administration, etc.

Management audit gives a comprehensive overview of different components of the organization such as goals and objectives, organizational structure, personnel policies, succession planning, technical systems, coordination and control, communication systems, etc. This kind of audit is done by a group of professionals which include internal resource persons from various departments and an external management consultant.

Organisation Chart for Accounting and Finance

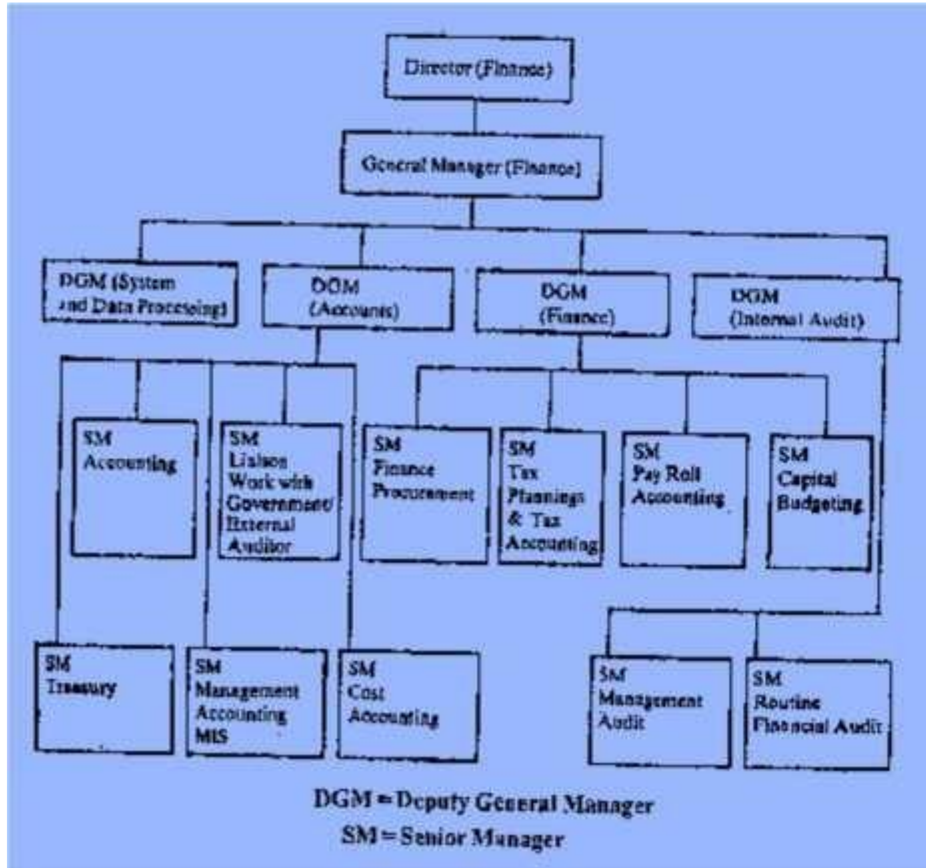

Fig. 2.2

Bases of Accounting

There are three bases upon which accounting can be done and any one of the following three can be used to finalise accounts.

(1) Cash basis;
(2) Accrual or Mercantile basis; and
(3) Mixed or Hybrid basis.

Accounting on Cash Basis

Simply put, in this type, accounting is based on cash and the entries are made only when cash payments are either made or received. When the cash payments or receipts are due, the entry is not made. Cash Basis Accounting reflects receipts surplus over payments. Government departments usually adopt this system of accounting.

Many other professionals also use cash basis accounting to record their entries. While doing entries on Cash Basis Accounting, they also consider outstanding expenses when making entries on expenditure. These financial statements are called Receipts and Expenditure Account and are created for the purpose of determining income.

Accrual Basis of Accounting or Mercantile System

In Accrual Basis of Accounting, the entries are made as soon as the payments or receipts are due and one does not wait to receive the actual cash. The amounts are credited and entries for income are made in the period in which they are incurred or earned.

The entries for all the expenses are made in the period when they are incurred without having to wait for cash payments to be made. Similarly, profits and losses are calculated. The net revenues are estimated from the difference between recorded earned incomes and incurred expenditures, without looking at the actual cash payments.

The incomes, which have been received in advance, and the outstanding expenditures are all settled during accounts finalisation. Companies are legally required to keep accounts according to Accrual basis of accounting under the Companies Act of 1956. This method of accounting is also known as Mercantile System of Accounting.

Mixed or Hybrid Basis of Accounting

In Hybrid Basis of Accounting, certain entries are made on Cash Basis Accounting and other entries are made on the Mercantile System of Accounting. Many companies practice this hybrid basis of accounting. For instance, a company practices Mercantile System of Accounting when making entries of its export business but the duties and subsidies offered by the government are recorded on cash basis accounting when the payments are received.

The Hybrid Bases of Accounting helps in reducing the uncertainty incalculating benefits and losses by making few entering only when cash payments are received. However, practicing this method of accounting can render profits and losses unrealistic. When a company or a professional wants to adopt a conservative approach, they can go for this method of accounting. They only record income when it is received and they record all incurred expenses even if the payments are not made. The inconsistent method in the Hybrid Basis of Accounting is the reason why it is not widely practiced.

Accounting Terminology

The following terms are a part of the accounting terminology and are used commonly in the business world.

Transaction

A transaction is defined as an “event that affects a change in the asset, liability, or a net -worth account. Transactions are recorded first in journal and then posted to a ledger”.

Simply put, a transaction is an exchange of money from one account to another. Purchase of goods, sale of assets, a payment to creditors or receipt from debtors, a payment for services, profit or loss in dealings, etc. are all examples of transactions. A transaction where cash is received or paid in exchange is called a cash transaction. A credit transaction does not involve a payment or receipt in cash. It gives rise to a creditor-debtor relationship in the exchange. Non-cash transactions do not involve any receipt or payment at all such as depreciation, return of sales, return of purchases, etc.

Debtor

When sales are made on credit, the person who owes money to the firm is called a debtor. Debtors agree to pay the agreed price of a good or service in the future.

Creditor

When the firm owes money to another person, that person is called a creditor. For example, a firm purchased some goods from Alex and agreed to pay the price of those good in the future. Alex is the creditor of the firm.

Capital

Money or assets having monetary value, that a proprietor invests in a firm is called capital. The proprietor can claim or withdraw this capital as well. Capital is also known as owner's equity or net worth. An owner's claim against the company's assets is called owner's equity. Capital or owner's equity is always equal to assets minus the liabilities of the company.

Capital = Assets - Liabilities.

Liability

Liability is simply defined as "amount owed to creditors." It is the sum of all debts and outstanding payments that the firm owes to outsiders.

Asset

An asset is a property or any other benefit of monetary value that a company makes expenditure to acquire.

Goods

Goods are articles that are procured keeping in mind their profit in their resale. This term is generally used for all such items.

Revenue

The increase in capital, which takes place due to operations, is called Revenue.This increase in amount in equity or capital occurs as a result of inflow of assets. Different kinds of incomes are recorded in it, which

may include: commission, interest, sales receipts, brokerage, etc. It is important to remember that revenues do not include sale of assets or additional capital, as these are all receipts related to capital.

Expense

It is the amount that one spends in operations in order to generate revenue. If the expenditures and spending is specific to one year for instance rent payment and salaries, it is included in expenses.

Expenditure

When the firm purchases goods and services or acquires an asset, it incurs expenditure. If an asset is bought during the year and used throughout a particular period, it is called an expense.

Purchases

When a trader buys goods for the purpose of selling them to the customer, those are goods are called purchases. Therefore, purchases are central to the concept of buying and selling of goods, i.e., trading.

Purchases can be categorised into cash purchases and credit purchases. Cash purchases are those where cash is paid at the time of buying the goods whereas payment of cash is postponed till a future date in credit purchases.

Sales

When goods purchased by the firm are sold to the customers and the ownership of goods is transferred to the buyer, which is known as sales. Sales are also known as "business turnover." Like purchases, sales are also categorized as cash sales and credit sales. Cash sales occur when the buyer pays for the goods in cash at the time of sale and credit sales occur when payment of cash by the buyer is postponed.

Stock

Some of the purchases of the firm remain unsold at the end of an accounting period. These unsold goods are kept as stock till the time that they are sold. Unsold goods at the end of an accounting period are also called "closing stock." Closing stock of the previous year is considered "opening stock" when a new accounting period begins.

Drawings

The amount of money or goods that a proprietor or owner withdraws for his personal use is called drawings. This amount is subtracted from capital.

Loss

When the firm spends money and receives no benefit in return, it is said to be in loss. Unlike an expense, which leads to revenue for the firm, loss does not generate anything of value for example, loss due to theft, fire, etc.

Account

An Account is a record of the firm's various dealings with the customer, supplier, debtor, etc. It contains all transactions related to the firm, its assets, liabilities, expenses, revenues, and income.

Invoice

It is a statement prepared by the seller at the time of making a sale which contains particulars such as the quantity, price per unit, deductions, and the net amount payable by the buyer.

Voucher

Vouchers are documentary proof that a transaction has taken place, specifying the kind of transaction, the amount of money exchanged and the date on which it occurred. They are necessary for auditing a firm's accounts.

Proprietor

A Proprietor is the person who makes an investment in a business and bears the risk associated with it.

Discount

Any deduction in the price of goods that customers buy is called a discount. When this deduction is based on the sales of items, it is known as a trade discount. When deduction in price is made for debtors for quick payment, it is called cash discount.

Solvent

A business is solvent when its assets with their realisable values exceed the liabilities.

Insolvent

A business becomes insolvent when its liabilities exceed the realisable value of its assets.

Accounting Equation

The accounting equation is based on the principle that a firm's sum of assets is equal to the sum of claims against those assets. In simpler words, the firm's assets equal liabilities or equity.There are two kinds equity- capital, which is an investment by owner and liability, which is the debt that the firm owes its creditors. Therefore, internal equity is the owner's share in the firm's assets and external equity is the outsider's interest in the firm. The accounting equation can state as follows:

Assets=Equities

Furthermore, keeping in mind the bifurcation of equity pointed out above, the equation can be restated as follows:

Assets= Liabilities+Capital

Or

Capital= Assets-Liabilities

Or

Liabilities= Assets-Capital

Another concept, which is central to the accounting equation, is the double aspect of every transaction. When an amount is debited, an equal amount is credited. Simply put, every business transaction has debit and credit effect. The accounting equation mentioned above lays the foundation for double entry bookkeeping. If assets are being increased as a result of a business transaction, an equal amount will be increased in the firm's capital or liabilities in order to keep the equation balanced.

Further Reading:

- ✓ ***J. Ireland, (2005), Principles of Accounting.***
- ✓ ***Roman L. Weil, Michael J. Wagner, Peter B. Frank, (1996), the Role of the Accountant as Expert.***