
UNIT 1 ACCOUNTING AND ITS FUNCTIONS

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1.0 INTRODUCTION

Accounting is often called the language of business. The basic function of any language is to serve as a means of communication. In this context, the purpose of accounting is to communicate, or report the results of business operations and its various aspects. Though accounting has been defined in various ways. According to one commonly accepted definition, “Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of financial character and interpreting the results thereof”. Another definition which is less restrictive interprets accounting as “the process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by the users of information”.

1.1 OBJECTIVES

After studying the unit, you should be able to:

- the nature and role of accounting,
- the activities of an accountant, and
- the roles of accounting personnel and the accounting function in an organisation.

1.2 THE SCOPE OF ACCOUNTING

The scope of accounting can be presented in a diagrammatic form as shown in *Figure 1.1*.

Data creation and collection is the area which provides the necessary inputs for accounting system. The data collected is related to economic and financial transactions and ‘historic’ in the sense that it refers to transactions which have already taken place. Earlier, accounting was largely concerned with what had happened, rather than making any attempt to predict, and prepare for future.

After the historic data has been collected and related to various transactions, it is recorded in accordance with generally accepted accounting theory. All transactions or

events have to be entered in the books of original entry (journals) and ledgers in accordance with the classification scheme already decided upon. The recording and processing of information usually accounts for a substantial part of total accounting work. This type of activity in accounting may be called **recordative**. The methods employed for recording may be manual, mechanical or electronic. Computers are also used widely in modern business for doing job.

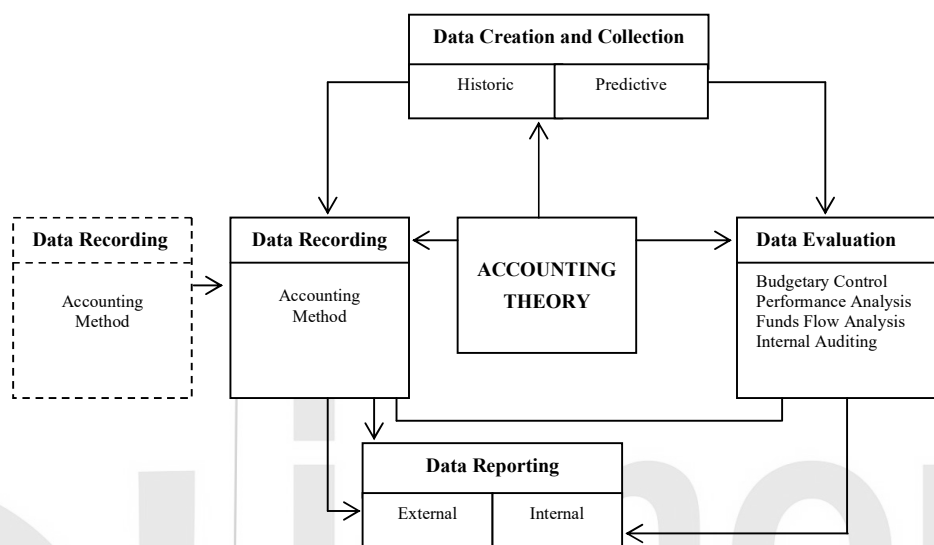


Figure 1.1: Scope of Accounting

Data evaluation is regarded as the most important activity in accounting these days. Evaluation of data includes controlling the activities of business with the help of budgets and standard costs (budgetary control), evaluating the performance of business, analysing the flow of funds, and analysing the accounting information for decision-making purposes by choosing among alternative courses of action.

The **analytical and interpretative** work of accounting may be for internal or external uses and may range from snap answers to elaborate reports produced by extensive research. Capital project analysis, financial forecasts, budgetary projections and analysis for reorganization, takeover or merger often lead to research-based reports.

Data evaluation has another dimension and this can be known as the **auditive** work which focuses on verification of transactions as entered in the books of account and authentication of financial statements. This work is done by public professional accountants. However, it has become common these days for even medium-sized organisations to engage internal auditors to keep a continuous watch over financial flows and review the operation of the financial system.

Data reporting consists of two parts-external and internal. External reporting refers to the communication of financial information (viz., earnings, financial and funds position) about the business to outside parties, e.g., shareholders, government agencies and regulatory bodies of the government. Internal reporting is concerned with the communication of results of financial analysis and evaluation to management for decision-making purposes.

You will note that **accounting theory** has been shown in the center of the diagram. We will turn to the role of accounting theory in the next unit.

The central purpose of accounting is to make possible the periodic matching of costs (efforts) and revenues (accomplishments). This concept is the nucleus of accounting theory. However, accounting is moving away from its traditional procedure-based record-keeping function to the adoption of a role which emphasises its importance for various managerial decisions.

List the various accounting activities that your organisation is undertaking. Can you describe any particular reason as to why your organisation is undertaking these accounting activities?

Accounting Activity	Reason
1	1
2	2
3	3
4	4
5	5
6	6
7	7
8	8

1.3 THE EMERGING ROLE OF ACCOUNTING

The history of accounting indicates the evolutionary pattern which reflects changing socio-economic conditions, and the enlarged purposes to which accounting is applied. In the present context, four phases in the evolution of accounting can be distinguished.

Forensic Accounting

Forensic Accounting is an art of investigation over accounting records, financial statements, and other related financial records. The result of the investigation is mostly used for legal support and resolving conflict. This job requires technical skills in accounting, investigation, and legal. These are what drive forensic accounting to become more attractive and highly paid. The investigation covers certain areas, including Fraud, crime, insurance claims, and disputes among shareholders. Forensic Accounting involves the following steps:

- i) Investigation:** Forensic accountants typically begin an investigation and collect evidence when fraud suspicions already exist. Because of this, the data they look for when conducting an investigation include red flags and discrepancies that might indicate fraud has taken place. They may interview staff at an organization to gain more information and attempt to find the individual behind the fraud. Using the gathered information they begin to form a hypothesis as to what happened and create follow-up plans to continue to assess the business. Once this step reaches completion, the forensic accountant determines the next necessary action and relays this information to the company.
- ii) Reporting:** Once forensic accounting professionals gather information/data and develop a case, they present a summary of their findings to necessary personnel. Using this information, these workers determine how the fraud occurred and who played a role. Then, the accountant determines how to handle the case and suggests steps the company should take next. In addition, they may recommend ways to prevent these incidents in the future by increasing/strengthening internal security and pointing out red flags. After

submitting their report, the forensic accountant prepares for their role in court proceedings related to the case.

- iii) **Litigation:** The final step of a forensic accountant's process involves participation as an expert witness in the incident's court case. The professional presents their findings as evidence in court and testifies against the offenders. They explain any evidence and interpret financial documents in understandable terms, presenting how they identified the subject. This means that the accountant must not only find evidence but also use rhetoric that makes sense to the court. Once this step reaches completion, the court determines the final decision for the situation. The forensic accountant plays an important role throughout this process.

Carbon Accounting

Carbon accounting is the practice of making scientifically robust and verifiable measurements of GHG emissions. Forests play an important role in the global carbon balance. Accounting for the carbon within forest ecosystems and changes in carbon stocks resulting from human activities is a necessary step towards the better representation of forests in climate change policy at regional, national and global scales. The main objective of carbon accounting is to identify the carbon-density of areas, providing information for low carbon impact land use planning. It prepares territories for accounting and reporting of emissions from the forestry sector. It allows comparison of the climate change impact of the forestry sector relative to other sectors, as well as allowing comparison between territories. Finally, it enables trade of project emission reductions on carbon markets and for emission reductions to be included in policy targets.

Stewardship Accounting

In earlier times in history, wealthy people employed 'stewards' to manage their property. These stewards rendered an account of their stewardship to their owners periodically. This notion lies at the root of financial reporting even today which essentially involves the orderly recording of business transactions, commonly known as 'book-keeping'. Indeed, the accounting concepts and procedures in use today for systematic recording of business transactions have their origin in the practices employed by merchants in Italy during the 15th century. The Italian method which specifically began to be known as 'double entry book-keeping' was adopted by other European countries during the 19th century. Stewardship accounting, in a sense, is associated with the need of business owners to keep records of their transactions, the property and tools they owned, as well as the debts they owed, and the debts others owed them.

Financial Accounting

Financial accounting dates from the development of large-scale business and the advent of the Joint Stock Company. This form of business which enables the public to participate in providing capital in return for shares in the assets and the profits of the company. This form of business organisation permits a limit to the liability of their members to the nominal values of their shares. This means that the liability of a shareholder for the financial debts of the company is limited to the amount he had agreed to pay on the shares he bought. He is not liable to make any further contribution in the event of company's failure or liquidation. As a matter of fact, the law governing the operations (or functioning) of a company in any country (for instance, the Companies Act in India) gives a legal form to the doctrine of stewardship which requires that information be disclosed to the shareholders in the form of annual income statement and balance sheet such statements are generally known as annual financial statements.

Briefly speaking, the income statement is a statement of profit and loss made during the year of the report; and the balance sheet indicates balances of the assets held by the firm and the monetary claims against the firm as on a particular date. The general unwillingness of the company directors to disclose more than the minimum information required by the law, and the growing public awareness have forced the governments in various countries of the world to extend the disclosure (of information) requirements.

The importance attached to financial accounting statements can be traced to the need of the society to mobilise savings, and channel them with profitable investments. Investors, whether they are large or small, must be provided with reliable and sufficient information in order to be able to make sound investment decisions. This is the most significant social purpose of financial accounting.

Cost Accounting

The industrial revolution in England presented a challenge to the development of accounting as a tool of industrial management. Costing techniques were developed as guides to management actions. The increasing awareness on the part of entrepreneurs and industrial managers of the benefits of using scientific principles of management in the wake of scientific management movement led to the development of cost accounting. Cost accounting is concerned with the application of costing principles, methods and techniques to ascertain the costs with a view to controlling them, and assessing the profitability and efficiency of the enterprise.

Management Accounting

The advent of management accounting was the next logical step in the developmental process. The practice of using accounting information as a direct aid to management is a phenomenon of the 20th century, particularly the last 30-40 years. The genesis of modern management, with its emphasis on detailed information on decision-making, provided a tremendous impetus to the development of management accounting.

Management accounting is concerned with the preparation and presentation of accounting and controlling information in a form which assists management in the formulation of policies, and in decision-making on various matters connected with routine and/or non-routine operations of business enterprise. It is through the techniques of management accounting that managers are supplied with information that they need for achieving objectives for which they are accountable. Management accounting has, thus, shifted the focus of accounting from recording and analysing financial transactions, to using information for decisions affecting the future. In this sense, management accounting has a vital role to play in extending the horizons of modern business. While the reports emanating from financial accounting, specially for outsiders, are subject to the conceptual and legal framework of accounting, internal reports—routine or non-routine—are free from such constraints.

Social Responsibility Accounting

Social responsibility accounting is a new phase in the development of accounting and owes its birth to increasing social awareness which has been particularly noticeable over the last two decades or so. Social responsibility accounting widens the scope of accounting by considering the social effects of business decisions, in addition to the economic effects. Several social scientists, statesmen, and social workers all over the world have been drawing the attention of their governments and the people in their countries to the danger posed to environment and ecology by unbridled industrial growth. The role of business in society is increasingly coming under greater scrutiny. The management is being held responsible not only for efficient conduct of business as expressed in profitability, but also for what it contributes to social well being and progress. There is a growing feeling that the concepts of growth and profit as

measured in traditional balance sheets and income statements are too narrow to reflect the social responsibility aspects of a business.

Human Resource Accounting

Way back in 1964, the first attempt to include figures on human capital in the balance sheet was made by Hermansson which later came to be known as Human Resource Accounting (HRA). However there has been a great socio-economic shift in the 1990s with the emergence of the knowledge economy, a distinctive shift towards recognition of human and intellectual capital in contrast to physical capital. Human Resource Accounting is a branch of accounting which seeks to report and emphasise the importance of human resources (knowledgeable, trained, loyal and committed employees) in a company's earning process and total assets. It is concerned with "the process of identifying and measuring data about human resources and communicating this information to interested parties". In simple words, it involves accounting for investment in people and their replacement costs, as well as accounting for the economic values of people to an organisation. Generally, the methods used for the valuing and accounting of human resources are either based on costs, or on economic value of human resources. However, providing adequate and valid information on human assets (capital), which are outside the concept of ownership, in figures is very difficult. Nevertheless HRA is a managerial tool providing valuable information to the top management to take decisions regarding adequacy of human resources, and thus, encouraging managers to consider investment in manpower in a more positive way.

Inflation Accounting

Inflation Accounting is concerned with the adjustment in the value of assets (current and fixed) and of profit in the light of changes in the price level. In a way, it is concerned with the overcoming of limitations that arise in financial statements on account of the cost assumption (that is, recording of the assets at their historical, or original cost) and the assumption of stable monetary unit (these are discussed in detail in the next unit). It thus aims at correcting the distortions in the reported results caused by price level changes. Generally, rising prices during inflation have the distorting influence of overstating the profit. Various approaches have been suggested to deal with this problem in inflation accounting.

If this little introduction of HRA and Inflation accounting provokes you to know more about them, we suggest that you listen to the audio programme "**Emerging Horizons in Accounting and Finance-Part II and III**" which deal with these two topics. You may also read "Money Measurement Concept" and "Cost Concept" explained in the next unit which has a bearing on inflation accounting.



Check Your Progress 2

In the context of your organisation, describe some of the cost and management accounting related activities. Please also identify any particular accounting practice in the area of social responsibility.

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1.4 ACCOUNTING AS AN INFORMATION SYSTEM

While discussing the scope of accounting, you must have observed that accounting involves a series of activities linked with each other, beginning with collecting, recording, analysing and evaluating the data, and finally communicating information to its users. Information has no meaning unless it is linked to a certain purpose. It seems that accounting looks like a system that undertakes processing of collected data to generate necessary information for certain purpose.

Accounting as a social science can be viewed as an information system since it has all the features of a system. It has its inputs (raw data), processes (men and equipment), and outputs (reports and information). If we consider accounting as an information system, then we are in a position to make some important observations. First, the goal of the system is to provide information which meets the needs of its users. If we can correctly identify the needs of the users, we are then able to specify the nature and character of the outputs of the system. Second, it is the output requirements that determine the type of data that would be selected as inputs for processing into information output.

There are several groups of people who have a stake in a business organisation—managers, shareholders, creditors, employees, customers, etc. Additionally, the community at large has economic and social interests in the activities of such organisations. Such interests are expressed at the national level by the concerns of Government in various aspects of the firms' activities, such as their economic well-being, their contribution to welfare, their part in the growth of the national product, to mention only a few examples.

We shall now briefly discuss what the information needs of various users of accounting are.

Shareholders and Investors: Since shareholders and other investors have invested their wealth in a business enterprise, they are interested in knowing periodically about the profitability of the enterprise, the soundness of their investment and the growth prospects of the enterprise. Historically, business accounting was developed to supply information to those who had invested their funds in business enterprises.

Creditors: Creditors may be short-term or long-term lenders. Short-term creditors include suppliers of materials, goods or services. They are normally known as trade creditors. Long-term creditors are those who have lent money for a long period, usually in the form of secured loans. The main concern of the creditors is focused on the credit worthiness of the firms and its ability to meet its financial obligations. They are, therefore, concerned with the liquidity of the firms, its profitability and financial soundness. In other words, it can also be stated that creditors are interested mainly in information which deals with solvency, liquidity, and profitability so that they can assess the financial standing of the firm.

Employees: The view that business organisations exist to maximise the return to shareholders has been undergoing change as a result of social changes. A broader view is taken today of the economic and social role of management. The importance of harmonious industrial relations between management and employees cannot be overemphasised. The fact that the employees have a stake in the outcomes of several managerial decisions is recognised. Greater emphasis is on industrial democracy through employee participation in management decisions has important implications

for the supply of information to employees. Matters like the settlement of wages, bonus, and profit sharing rest on adequate disclosure of relevant facts.

Government: In a mixed economy it is considered to be the responsibility of the Government to direct the operations of the economic system in such a manner that it subserves the common good. Controls and regulations on the operations of private sector enterprises are the hallmark of a mixed economy. Several Government agencies collect information about various aspects of the activities of business organisations. Much of this information is a direct output of the accounting system, for example, levels of outputs, profits, investments, costs, and taxes. All this information is very important in evolving policies for managing the economy. The task of the Government in managing the industrial economy of the country is facilitated if accounting information is presented, as far as possible, in a uniform manner. It is clear that if accounting information is distorted due to manipulations and window-dressing in the presentation of annual accounts, it will have ill-effects on the measures the Government intends to take, and the policies it wishes to adopt.

Management: Organisations may or may not exist for the sole purpose of profit. However, the information needs of the managers of both kinds of organisations are almost the same, because the managerial processes, i.e., planning, organising, and controlling are the same. All these functions have one thing in common, and it is that they are all concerned with making decisions which have their own specific information requirements. The emphasis on efficient and effective management of organisations has considerably extended the demand for accounting information. The role of accounting, as far as management is concerned, was highlighted earlier when we discussed about management accounting.

Consumers and others: Consumers' organisations, media, welfare organisations, and the public at large are also interested in accounting information in order to appraise the efficiency and social role of the enterprises in different sectors of the economy, that is, what levels of profits and outputs are being achieved, in what way the social responsibility is being discharged, and in what manner growth is being planned by the enterprises, in accordance with the national priorities.

The above discussion, perhaps, has indicated to you that the information needs of various users may not necessarily be the same. Sometimes, they may even conflict and compete with each other. In any case, the objective of accounting information is to enable information users to make optimum decisions.

1.5 THE ROLE AND ACTIVITIES OF AN ACCOUNTANT

Having discussed the scope of accounting and its emerging role, we are now in a position to describe who is an accountant. In an attempt to answer this question, we reproduce below some statements in this regard:

- a) An accountant is one who is engaged in accounts keeping.
- b) An accountant is a functionary who aids control.
- c) An accountant keeps the conscience of an organisation.
- d) An accountant is a professional whose primary duties are concerned with information management for internal and external use.
- e) An accountant is a fiscal adviser.
- f) An accountant produces an income statement and a balance sheet for an accounting period, and maintains all supporting evidence and classified facts that lead to the final accounting statements.
- g) An accountant verifies, authenticates, and certifies the accounts of an entity.
- h) An accountant provides necessary information for various managerial decisions.

Tell us your reactions about the above statements. Perhaps you do have your own ideas, but our thinking is that each of the foregoing statements contains some truth in it as it highlights some aspects of the functions of an accountant. Except for one statement which presents a somewhat competitive view, can you identify this statement? We will help you in doing this.

Statement (a) defines a person who maintains accounts. Statement (f) echoes almost a similar motion, but extends his role to the production of financial statements. The work implied in these statements is that of score-keeping and the person performing such activity is known as a financial accountant (or maintenance accountant).

Statements (b) and (h) are about the role which an accountant can play in the decision-making and the management control process. It is concerned with attention-directing and problem-solving. The functionary may be designated as management accountant (or controller, as in the United States).

Statement (e) underlines a narrow, specific role of an accountant, though of critical significance. In view of the high incidence of taxes on business in India, tax planning assumes a vital role in fiscal management. By planning the operations of the enterprise in a particular manner, the tax adviser attempts to minimise the liability of the firm by availing the concessions and incentives provided for in the applicable tax laws.

Statement (g) stresses the 'audit', 'watchdog', or 'certification role' of the accountant who is not an employee of a business but who performs an external verification of accounts. Such a functionary is a trained and qualified professional who, like any other professional, has an educational status and prescribed code of conduct. Chartered Accountants in India, England-Wales, and Certified Public Accountants in USA belong to this category of accountants.

Statement (c) presents the accountant as a conscience-keeper. He is seen as a person whose mission is to protect and promote the interest of the employer in a positive manner. He is there to see to it that none of the staff of the organisation carries on this work in an unethical way, or in a manner prejudicial to the long-term legitimate interests of the firm.

We are now left with statement (d) which defines an accountant as a professional and underlines his pre-occupation with management of information for internal use (management accounting function) and for external use (financial accounting function). We are sure our discussion of accounting as an information system has made it easier for you to comprehend this role of the accountant. We may clarify that information management is not necessarily associated with the sophisticated (or hi-tech) area of computers. Small firms may 'manage' information without a substantial degree of mechanisation, or automation. Often, the role of accounting in small business is not properly recognised. It is widely known that a large number of small businesses fail and do not survive beyond a few years. One of the main reasons for the failure is that they do not have adequate information system, to help their managers to control costs, to forecast cash needs, and to plan growth. Organisations which have poor accounting systems often find it considerably difficult to obtain finance from banks and other outside investors.

1.6 ACCOUNTING PERSONNEL

There is hardly any organisation which does not have an accountant. His role is all pervasive, and he is involved in a wide range of activities, particularly in a large and complex organisation. The exact duties of an accountant might differ in different organisations. However, a broad spectrum of responsibilities can be identified.

The accountants can be broadly divided into two categories, those who are in public practice, and those who are in private employment. The accountants in public practice offer their services for conducting financial and/or cost audit. As such, they are known as auditors. The auditor examines the books of account and reports on the balance sheet and profit and loss account of the company as to whether they give a true and fair view of the state of affairs of the company and its profit respectively. The auditor in a company is appointed by the shareholders to whom s/he reports. Public accountants are generally members of professional bodies like the Institute of Chartered Accountants of India. In addition to conducting a financial or cost audit (in accordance with the requirements of, say, the Companies Act), as the case may be, they may also provide advisory services for designing, or improving accounting and management control systems.

Accountants in employment may be in various business, or non-business organisations to perform a variety of accounting and management control functions. Accountants at higher levels generally belong to professional accounting bodies, but those who are at lower levels need not be so. Accounting chiefs in different organisations, depending upon their nature of work, are variously designated as finance officers, or internal auditors, or chiefs accounts officers, etc. The term 'controller' as the head of the accounting and finance function is not very popular in India, but of late, it is catching on. Several large organisations, both in the public and private sectors, have controllers. Let us get an idea of who these people are, and what they do.

Internal Auditor: An Internal Auditor is an employee of an organisation in contrast to an external auditor who is paid a fee for his services. An external auditor is not an employee of a company, and he is appointed to conduct what is known as statutory audit. The internal auditor is responsible for performing monitoring activities, and other services, including designing and operating the system of internal control, auditing the data reported to the directors of the company, and assisting external auditors. The head of the internal audit function reports directly either to the chief executive or to the audit committee of the Board of Directors.

Internal audit includes continuous verification of entries appearing in the books of account with the original vouchers and proper accounting assets. Further, it attempts to ensure that the policies and procedures regarding financial matters are being complied with. Internal auditing is also concerned with administering the system of **internal checks** so that mistakes, innocent or intentional, are prevented from taking place.

We should distinguish an internal auditor from an external auditor. While an internal auditor devotes his entire time and energy to the needs of one company (i.e., his employer), an external auditor serves many clients. The primary function of the external auditor, as pointed out earlier, is to safeguard the interests of the shareholders (by whom he is appointed) by an independent and impartial appraisal of the financial transactions of the company so that he could report on the net profit earned by the company and its financial position. His role is that of an objective outsider, expressing expert opinions to the financial condition and operating results of the client's business. Apart from shareholders, other parties such as banks, lending institutions, Government agencies, etc. rely on the fairness of such financial reports in making certain decisions about a given company. An auditor is bound by a set of professional regulations which include an examination on technical competence and adherence to a code of ethical conduct.

Controller: This is the other name for Chief Accountant and s/he is usually the head of the whole area of accounting, including internal audit. S/he is overall in-charge of all activities comprising financial accounting, cost accounting, management

accounting, tax accounting, etc. S/he exercises authority both for accounting within the organisation and for external reporting. The external reports include reports to Government revenue collecting and regulatory bodies, such as the Company Law Board and the Income Tax Department. S/he may also supervise the company's internal audit and control systems. In addition to processing historical data, s/he is expected to supply a good deal of accounting information to top management concerning future operations, in line with the management's planning and control needs. Besides, s/he is also expected to supply detailed information to managers in different functional areas (like production, marketing, etc.) and at different levels of the organisation, so as to assist them in decision-making.

We may enumerate the functions of the controller as follows:

- a) Designing and operating the accounting system
- b) Preparing financial statements and reports
- c) Establishing and maintaining systems and procedures
- d) Supervising internal auditing and arranging for external audit
- e) Supervising computer applications
- f) Overseeing cost control
- g) Preparing budgets
- h) Making forecasts and analytical reports
- i) Reporting financial information to top management
- j) Handling tax matters and ensure other legal compliances.

Treasurer: S/he is the custodian and manager of all the cash and near-cash resources of the firm. The treasurer handles credit reviews and sets policy for collecting receivables (debtors of the firm, to whom the firm has sold goods or services on credit). S/he also handles relationships with banks, and other lending or financial institutions.

The Financial Executive Institute (USA) makes the following distinction between controllership and treasurership functions:

Controllership

Planning and Control
Reporting and Interpreting
Evaluating and Consulting
Tax Administration
Government Reporting
Protection of Assets
Economic Appraisal

Treasurership

Provision of Capital
Investor relations
Short-term Financing
Banking and Custody
Credit and Collections
Investment
Insurance

Finance Officer: Finance is the lifeblood of business. Procuring financial resources and ensuring their judicious utilisation are the two important activities of financial management. Financial management includes four major decisions: investment decision, financing decision, dividend decision, and working capital decision. Investment decision is perhaps the most important decision, because it involves allocation of resources. It is concerned with the future which, being uncertain, involves risk. How the firm is allocating its scarce resources and is planning growth will largely determine its value in the market place. Financing decision is concerned with determining the optimum financing mix, or capital structure. It examines the various methods by which a firm obtains short-term and long-term finances through various alternative sources. The dividend decision is concerned with questions such as, how much of the profit is to be retained, and how much is to be distributed as dividends. For the smooth running of a firm, we need some amount of working capital, and working capital decisions are concerned with ensuring the optimum

amount and mix of working capital. The finance manager has to strike a balance between the current needs of the enterprise for cash, and the needs of the shareholders for adequate return. The financial management of a large company is usually the responsibility of the finance director who may be in place of, or in addition to the controller. Often the finance manager and controller are inter-changeable terms, and only one of these two positions may be found in a company. The finance manager, when there is a controller also in the organisation, is concerned with implementing the financial policy of the board of directors, managing liquidity, preparation of budgets and administration of budgetary control system, managing profitability, etc.

Though financial management is regarded as a separate area, this function is performed in several countries, including in India, by the accountant (or the financial controller). Several large organisations, however, have a financial executive besides the chief accountant. Often, finance and accounting functions are clubbed together in one person, in small organisations.



Check Your Progress 3

Please meet one, or more, of the following personnel in any organisation, and talk to them about their respective roles within the organisation.

Accountant

- 1
- 2
- 3
- 4
- 5

Chief Accountant

- 1
- 2
- 3
- 4
- 5

Controller

- 1
- 2
- 3
- 4
- 5

Finance Manager

- 1
- 2

3	
4	
5	

Internal Auditor

1	
2	
3	
4	
5	

1.7 THE NATURE OF THE ACCOUNTING FUNCTION

Accounting is a **service function**. The chief accounting executive (by whatever name he is called) holds a staff position except within his own department where he exerts authority. This is in contradiction to the roles played by production or marketing executives who hold line authority. The role of the accountant is advisory in character. S/he works through the authority of the chief executive. The accounts and or finance department(s) do not exercise direct authority over line departments. In decentralized structure with a number of units and divisions, the accounting executive, however, exercises what is known as the functional authority over all the accounting staff deployed in different segments.

There are two facets to the role of the accountant. For top managers, s/he works as a watchdog, and for middle and lower level managers s/he acts as 'helper'. The watchdog role is usually performed through the 'score-keeping' task of accounting and reporting to all levels of management. The 'helper' role is usually performed through the task of directing managers' attention to problems, and assisting them in solving problems. Mutual understanding and rapport between the accountant and the manager, in the tasks of attention-directing and problem-solving, can be enhanced if the accountant and his staff frequently interact with the line managers and guide them in matters concerned with preparation of budgets and control documents with which they might not be conversant. This will instill confidence among line managers regarding the reliability of reports.

1.8 THE ORGANISATION FOR ACCOUNTING AND FINANCE

A typical organisation chart for accounting and finance is presented in *Figure 2*. You will note that the person at the helm of affairs is the Director (Finance) who is a member of the Board of Directors. Reporting to him may be one or more General Managers. If there is only one General Manager, s/he may be designated as General Manager (Finance), or General Manager (Finance and Accounts), or Controller or Financial Controller. In a large company, four or five (as shown in *Figure 2*) the Deputy General Managers incharge of different areas like systems and data processing, accounts, finance, internal auditing may report to him/her. Following the American pattern, a tendency has recently been observed among large companies, especially in the private sector, to designate General Manager (Finance) as President (Finance, or Finance and Accounts), and a Deputy General Manager as Vice-President. Each of these Deputy General Managers is assisted by a number of senior

managers who look after different components of similar activities, e.g., financial accounting, tax planning and administration, management auditing, etc. Management audit is a comprehensive review of the various sub-systems of the organisation such as objectives and goals, structure, technical system, personnel policies, (including succession planning), control and coordination policies and procedures, adequacy and effectiveness of communication system, etc. This type of audit is usually done by a team of people comprising the internal resource persons drawn from various functional areas and an external management consultant.

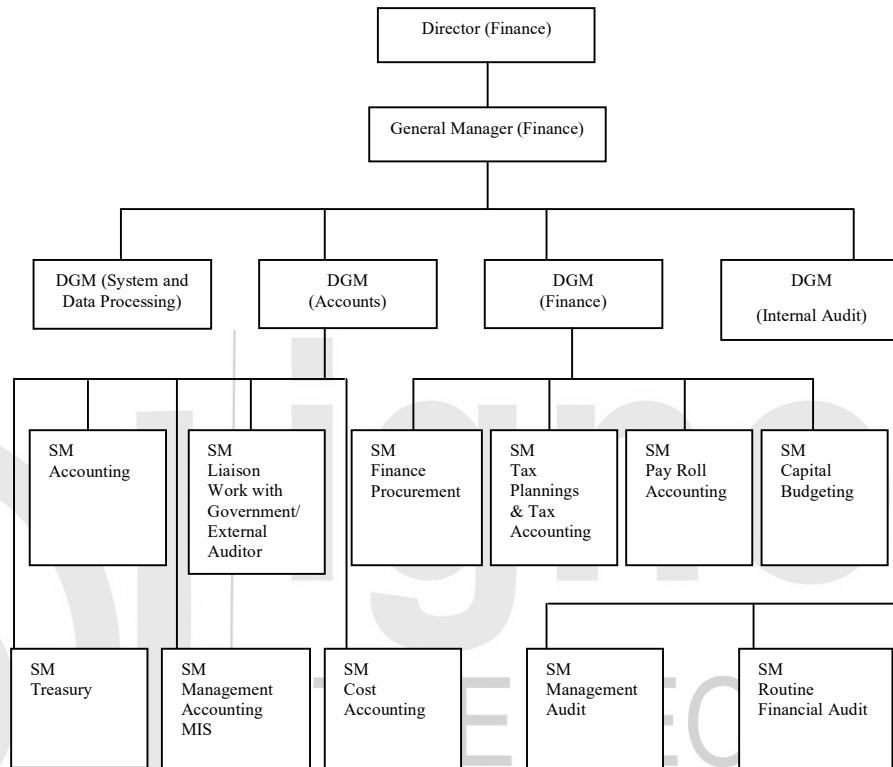


Figure 1.2: Organisation Chart for Accounting and Finance

We hope you now have a reasonably good idea of what accounting is, what its scope is, and what the different types of activities which are generally included in accounting. While basic functions of accounting and finance are performed in all types of organisations, their relative emphases or relevance might differ in different types of organisations. Keeping this in view, we have prepared an audio programme “**Accounting and Finance in Different Types of Organisations**”, and we suggest that you listen to this tape. This will not only augment your familiarity with the basic aspects and functions of accounting, but will develop your appreciation for relative divergencies.

1.9 SUMMARY

Accounting is an important service activity in business and is concerned with collecting, recording, evaluating and communicating the results of past events. The history of accounting development reflects its changing role in response to the changing business and social needs. With the emergence of management accounting, the focus of accounting has been shifting from the mere recording of transactions to that of aiding management in decisions.

Accounting can be perceived as an information system which has its input, processing methods, and outputs. The usefulness of accounting lies in its capacity to provide information to various stakeholders in business so that they can arrive at sound decisions.

The top accounting personnel are designated by various nomenclature. The practice in this regard differs in different companies. The organisational setting for the accounting and finance function may also vary in different organisations, depending upon their peculiarities, nature and size of business, technology, and structural form. At the helm of affairs is usually the Director of Accounts and Finance who is a member of the Board of Directors. He is assisted by a General Manager who, in turn, is helped by Deputy General Managers in charge of various sub-functions, like accounts, finance, internal audit, and data processing, etc. Each of the sub-functions is further sub-divided into activities which are the responsibility of a subordinate manager.

1.10 KEY WORDS

Accountant is a professional who is responsible for the processing of financial data for score-keeping, attention-directing, and problem solving purposes. Accounting is perceived as an Information System whose inputs are collected from various financial transactions entered into by a firm; it processes these inputs by proper classification and recording, and finally, generates output in the form of financial statements like Profit and Loss Account and Balance Sheet.

Attention-directing role of accounting consists of directing managerial attention to situations where corrective action is needed in the case of unfavourable (or even favourable) differences in operations, outputs or inputs.

Forensic Accounting is an art of investigation over accounting records, financial statements, and other related financial records. The result of the investigation is mostly used for legal support and resolving conflict.

Carbon accounting is the practice of making scientifically robust and verifiable measurements of GHG emissions. The main objective of carbon accounting is to identify the carbon-density of areas, providing information for low carbon impact land use planning.

Audit work of an accountant comprises authentication of accounting statements.

Control is the action that implements the planning decision, and evaluates performance.

Controller of the management accountant is a staff-functionary who uses accounting information for management planning and control.

External reporting is the production of financial statements for use by external interest groups like shareholders and Government.

Feedback comprises the performance reports which managers can use for improving their decision-making.

Information system is a system, sometimes formal and sometimes informal, for collecting, processing, and communicating data at the most relevant time to all levels of management. The data flowing through the system is helpful to managers for

decision-making in the areas of planning and control, or is otherwise needed for financial reporting required under the laws. An essential requirement of the information system is feedback for needed modifications.

Planning is the identification and decision-making.

Recordative work extends to routine recording and classified posting of financial transactions and events.

Staff function is performed in an advisory capacity, and without line or decision making authority.

Store-keeping is the process of data accumulation or record-keeping which enables interested parties (internal and external) to ascertain how the organisation is performing.

1.11 SELF ASSESSMENT QUESTIONS/EXERCISES

1. “Financial Accounting is an extension of Stewardship Accounting”. Comment.
2. What new developments in Accounting have taken place over the past 20-25 years? Examine the main factors which have affected such developments.
3. Pick a group of persons having interest in a business organisation, and examine the nature of their information needs.
4. Discuss the role of accountants in modern business organisation.
5. Differentiate between recordative, interpretative, and auditive functions of accounting.
6. How can accounting reports, prepared on a historical basis after the close of a period, be useful to managers in directing the activities of a business?
7. Distinguish management accounting from financial accounting.
8. How does the accountant help in the planning and control process of a large commercial organisation?
9. Write short notes on the following:
 - i) Forensic Accounting
 - ii) Carbon Accounting
10. State whether the following statements are true or false:
 - a) To have an accountant is the privilege of a joint stock company only. True ☐ False ☐
 - b) A controller is entrusted with the responsibilities of raising funds. True ☐ False ☐
 - c) Management control differs from engineering control since the latter is fully automatic and the former is highly complex. True ☐ False ☐

- d) An accountant is the custodian of the properties and financial interests of a business enterprise. True ☐ False ☐

Answers to Self-assessment Questions/Exercises

10. (a) False, (b) False, (c) True, (d) True,

1.12 FURTHER READINGS

Accounting Principles, Anthony, Robert N, and James S. Reece, 1987. All India Traveller Book Seller: New Delhi (Chapter I).

Accounting for Management: Text and Cases, Bhattacharya S.K. and John Dearden, 1987. Vikas Publishing House: New Delhi. (Chapter I).

Accounting for Managers: Interpreting Accounting Information for Decision Making, Paul Collier, May 09.2003, Wiley Publishers: Canada. (Chapter I).



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