

Financial Accounting
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Lecture – 3
1.3 Accounting as an information system

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The slide features a red rounded rectangle on the left containing the text "Financial Accounting" and "Dr. Puran Singh". To the right is the NPTEL logo. Below this, a black bar with a white border contains the text "1.3 Accounting as an Information System". At the bottom left is the IIT Mandi logo, and at the bottom right is a video feed of Dr. Puran Singh, a man with a beard and glasses wearing a white turban and a dark blue shirt.

In this video, we are going to talk about financial accounting and how it works as an information system for the business.

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The slide is titled "Contents" in red. It lists three items: "1.3.1 Business and Information requirement", "1.3.2 Stakeholders of a business", and "1.3.3 Information: Tip of Accounting Ice-berg". The IIT Mandi and NPTEL logos are in the top right corner. At the bottom right is a video feed of Dr. Puran Singh, the same man as in the previous slide.

There are three basic sections in this video. We are going to talk about how the requirement of information in the various forms of businesses increases. We are going to talk about the stakeholders in a company form of business, and then how you know accounting works as an information system.

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The slide is titled "1.3.1 Business and Information requirement" and features the logos of the Indian Institute of Technology Mandi and NPTEL. It contains the following content:

- Handwritten note: $Org \propto f(Resources)$
- Bullet point: $O = f(R)$
- Handwritten note: D, C, C, E
- Bullet point: Suppliers of resources need information
- Bullet point: Types of business and information requirement

A diagram shows a coordinate system with a vertical axis labeled "Sale Today" and a horizontal axis labeled "Company". A red arrow points from the origin into the first quadrant, indicating a positive relationship between the two variables.

So, understand that an organization is a function of resources. What do I mean by that? I mean that in order to do a business, you need land, labor, capital: a lot of things in order to start the business. And you do not have all of those resources with you. Therefore, you are going to go out and ask different people for these resources.

For example, one of the first things that you do when you start a business is prepare the project report, go to the bank and ask for a loan, and the bank becomes a stakeholder. And I am not saying shareholder; it is a stakeholder. Somebody having an interest in your business or claim in your business is a stakeholder. So, the suppliers of all these resources, which I said, are land, labor, capital, and the fourth factor of production, as it is said in economics, is the Entrepreneur E.

So, land, you have to buy it from somebody or you may lease it; the labor you recruit people, you need manpower; capital is money, you either ask people, friends, family to invest, or you go to the bank for the capital, and entrepreneur; the person you yourself are a resource that you invest in the business.

So, as we saw in the previous video, in the continuum from sole trader to the company form of business, the resources, the complexity, and, the information requirement goes up.

Using the same analogy, if you have a sole trader at this end of the axis and a company form of business on this side of the axis. Your information requirement is going to go up very significantly, and that is primarily driven by the fact that there are more and more resources which you need. And due to these resources, you have to come in touch or you have to contract with the different parties which are called stakeholders. And therefore, these stakeholders are going to ask you questions, they want to know what you are doing with their resources, and that is where the need for accounting really comes in.

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The slide is titled "1.3.2 Stakeholders of a business" and features a list of stakeholders with handwritten notes in red ink. The list includes:

- Shareholders/Investors (Returns)
- Creditors/Lenders (Interest, Principle)
- Board/Management (Fin Results)
- Employees (Career)
- Government (Taxes, Rules)
- Public/Consumers (Products)
- Society

A red bracket groups the last three items (Society, Public/Consumers, and Employees), with the word "Information" written below it. The slide also contains logos for the Indian Institute of Technology Madras and NPTEL. A presenter wearing a white turban and glasses is visible in the bottom right corner of the slide frame.

So, for any company you have shareholders or the investors who are interested in knowing how the companies are doing financially, are they going to get their returns or not, return on investment- that is the interest of these people. You have the creditors or the lenders, the bank- it is interested in knowing if you are going to be able to pay the interest and also the principle. And the bank is going to know this through financial reporting.

You got the board and management. The board and management have the responsibility to run the business for self-assessment purposes. These people need to know the results of various transactions in the business. So, these people are also interested in the financial results of a company. The employees are very much interested in knowing whether the company is going to stay around or is the company going into insolvency. So, they would want to know whether

the company is making profit, how much salaries it can afford, what is the time horizon of the company's growth trajectory, am I going to see better career options in this company or not. So, employees are also a significant stakeholder in the business.

Then you have a government. Government wants to know whether taxes are being paid in accordance with the laws, regulation in the income tax act or not. The government also wants to know whether this company is following various rules, regulations which are required for a specific industry for financial reporting, and for many other purposes as defined from time to time. So, all these stakeholders have different kinds of interest in the business.

And finally, the public—individuals like you and me—we, and, even if we have not invested money in the business, we buy things from this business. And I said in the you know introduction video it is possible that you buy an electronic item, say for example, a washing machine or a fridge, and these things have warranty of 5 years, 10 years, 15 years in some cases. And, you want to know if this company, which is giving 10 year of warranty, will exist in 10 years in order to discharge its promise of warranty of maintenance. So, we are interested as consumers because we buy products and we are interested in the use of that product or the money that we are paying to renew our warranties by extending warranty on things. And of course, there can be other issues as well. I would add another stakeholder here which is society. Society at large is also interested, because the company makes use of various community resources, natural resources. Companies pollute rivers, air, their making use of them affect the society directly or indirectly in different ways. So, society also wants to know how the business is performing.

Now, all these stakeholders, what do they need? They need information. They want to know—whatever their area of interest is: career, taxes, returns—how the company is doing on all these parameters. And, all this is made possible by the use of accounting systems so that is where the need for accounting comes in.

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1.3.3 Information: Tip of Accounting Ice-berg

Information → For Stakeholders

Analysis Tools

Final Accounts Results

Trial Balance Summary

Ledger Classifying

Journal Recording

Accounting acts as an information system for the stakeholders

Through the process of recording, classifying, summarizing the business transaction, we get the final results of the transactions in a business which are then analyzed using various tools and techniques which are then interpreted and converted into information which can be useful for various stakeholders.

So, accounting acts as an information system. The whole back end which is required for somebody to come to this information piece which they are interested in: accounting provides all the backend data. So that is how accounting is termed as an information system for the stakeholders of a business, that is it.

I will see you in the next video.