UNIT - 1

What Is Financial Accounting?

Financial accounting is a specific branch of accounting involving a process of recording, summarizing, and reporting the myriad of transactions resulting from business operations over a period of time.

NATURE OF FINANCIAL ACCOUNTING

- ★ Accounting Is First Step

Accounting is start when a financial transection take place. It records the financial transection after that communicates this information to its users. then the user this information for their decision making.

- ★ Accounting Is An Art And Science:

Accounting is an Art and Science as well. Accounting is an art of recording, classifying and summarizing of financial transactions. Accounting is science as well as it requires certain principles (accounting principle).

- ★ Accounting Is A Process

Accounting is a process recording of financial transaction, summarizing, analyzing, and reporting to the user of accounting information.

- ★ Accounting Deals With Financial Transactions Only

financial accounting is considering only monetary transactions. It does not take into account various non-financial aspects such as market competition, economic conditions, government rules, and regulations, etc.

- ★ Historic In Nature

Financial accounting considers only those transactions which are of historic nature. day-to-day activities transactions are recorded and the information is provided after a period of time. All financial decisions of the future are taken on the basis of this past information

- ★ Records Actual Cost

Financial accounting records the actual cost of the transaction and does not consider the price fluctuations taking place from time to time. It records the historical cost or the actual cost of the assets or liability.

SCOPE OF FINANCIAL ACCOUNTING

- ★ Records Financial Transactions

Financial accounting record each and every financial transaction taking place in the business organisation. It maintains a clear and systematic record of all information in the form of journals and various subsidiary books. It avoids any confusion or loss because if any problem arises these records can be easily checked. All transaction cannot be just memorized by humans without recording them and that makes the financial accounting important part of every business.

- ★ Classify And Summarize Information

Information collected and recorded by financial accounting is properly categorized according to their nature. Financial accounting involves classifying and summarizing all financial information recorded at the initial step. All transactions of similar nature are grouped together under one head by making accounts like Sales, Purchase, Rent, Salaries, Interest etc. Grouping of same nature transactions together adds convenience in understanding of information collected.

- ★ Prepares Financial Statements

Financial accounting prepares financial statements like cash flow statement, income statement, balance sheet etc. These financial statements depict the true financial position of business. Financial statements are the result of various information collected and analysed in overall process of financial accounting. All financial strength and weakness of business are determined by preparation of financial statements.

- ★ Interprets Financial Information

Financial accounting interprets information from several analysis conducted and financial statements prepared. It understands and explains the results of several relationships establishes by analysis to different users for easy understanding and decision making. It simplifies the accounting information so that it is well understood by persons having limited or no knowledge of accounting subject.

- ★ Communicates All Outcomes

Financial accounting serves the needs of all external stakeholders by delivering them true and accurate picture of the company's financial affairs. It communicates them all financial information by providing them with financial reports routinely. All interested parties to business are fully aware of all business financial matters and this helps them in making conclusions. It helps them in knowing profitability and future growth aspects through these reports.

- ★ Determines And Maintains Financial Position

Financial accounting determines fair and actual image of financial position of business. Finance is termed as lifeline of business activities and its management is quite important for every organisation. Mismanagement of financial resources may have adverse effects on the company's performance. Financial accounting records and analyse each financial aspect of business.

LIMITATIONS OF FINANCIAL ACCOUNTING

- Historical in Nature -

The nature of financial accounting is mostly historical. It keeps track of previously completed transactions and events. As a result, as part of the stewardship function of management, financial statements are created and presented at the closing of the accounting period. Although the data is historically significant, it does not offer management with current data for analysing operational efficiency.

- Overall Performance:

Financial accounting reveals and reflects the profit or loss of a company as a whole. It fails to offer information on expenses and profit of various sub-divisions of the organization since it does not classify accounts on the basis of departments or segments, products, processes, and sales territories.

- No Objective Classification:

Personal and impersonal accounts are the two primary types of accounts in financial accounting. Such a subjective basic classification is of limited help to management in determining costs by products, jobs, and processes.

- Distinction between Direct and Indirect Expenses:

Expenses are not divided into direct and indirect, fixed and variable, controllable and uncontrollable, and assigned to departments, jobs, or products in financial accounting. As a result, for the objectives of cost control and cost reduction, controllable and uncontrollable expenditures cannot be differentiated.

- Material Losses:

There is no protection against material losses due to wastage, pilferage, depreciation, and obsolescence of materials since there is no material management system functioning under financial accounting.

- Labour Cost Control:

Because workers are paid on the basis of hours worked, there is no way to compare the time taken with the time allowed in financial accounting. As a result, losses due to idle time, work evasion, and loitering are uncontrollable. Furthermore, no job-specific labour time is documented. As a result, there is no way to assess the effective use of labour time, and no incentive schemes based on results can be implemented.

- Idle Facilities:

Losses owing to idle plant and equipment are not recorded in financial accounting.

- ★ No Cost Comparison:

Financial accounting does not provide data that may be used to compare costs between periods, businesses, jobs, divisions, or procedures. As a result, conclusions about the profitability of various items, positions, departments, procedures, or sales areas are impossible to reach.

- ★ Distortion of Trading Results:

The value of closing inventory is calculated in financial accounting for the income statement and balance sheet. Costs and revenues cannot be effectively matched if the values are not expressed precisely. As a result, trading outcomes are skewed due to the wide range of values.

- ★ Lack of Data for Decision-Making:

One of the most essential roles of management in every organization is decision-making. Financial accounting, on the other hand, fails to provide the necessary data for decisions such as the introduction of a product line, the discontinuation of production of a product or a department, whether to produce or purchase, equipment replacement, and appropriate product mix, and so on.

ACCOUNTING CONCEPTS

(1) Entity Concept: According to this concept business is treated as a separate unit and distinct from its proprietors.

(2) Dual Aspect Concept: According to this concept every transaction has two sides at least. If one account is debited, any other account must be credited. Every business transaction involves duality of effects. (i) Yielding of that benefit (ii) The giving of that benefit.

(3) Going Concern Concept: This concept assumes that the business will continue to exist for a long period in the future. There is neither the necessity nor the intention to liquidate it.

(4) Accounting Period Concept: According to this concept the entire life of the concern is divided in time intervals for the measurement of profit at frequent intervals.

(5) Money Measurement Concept: Only those transactions and events are recorded in accounting which is capable of being expressed in terms of money.

(6) Cost Concept : According to this concept: (a) An asset is ordinarily entered in the accounting records at the price paid to acquire it. (b) This cost is the basis for all the subsequent accounting for the asset.

(7) Matching Concept: In determining the net profit from business operations all cost which is applicable to revenue of the period should be charged against that revenue.

(8) Accrual Concept: This concept helps in relating the expenses to revenue for a given accounting period.

(9) Realization Concept: According to this concept, revenue is recognized when sale is made and sale is considered to be made when a goods passes to the buyer and he becomes legally liable to pay for it.

(10) Verifiable objectivity Concept: This concept means that all accounting transactions that are recorded in the books of accounts should be evidenced and supported by business documents.

CONVENTIONS

(1) Convention of Disclosure: According to this convention accounting reports should disclose fully and fairly the information they purport to represent. The information which are of material interest to proprietors.

(2) Convention of Materiality: The accountant should attach importance to material details and ignore insignificant details.

(3) Convention of Consistency: This convention describes that accounting principles and methods should remain consistent in order to enable the management to compare the results of the two periods. These principles should not be changed year after year.

(4) Convention of Conservatism: According to this convention, in the books of accounts all anticipated losses should be recorded and all anticipated gains should be ignored

OBJECTIVES OF ACCOUNTING

★ Maintaining systematic financial records

One of the most important accounting objectives is that accounting helps the business organisation keep a systematic and accurate record of the day-to-day transactions, which helps to understand the working of the business, payments made, income received, etc.

★ To estimate and ascertain profits or losses

Recording transactions concerning revenues and expenditures helps us ascertain the profit/ loss at the end of the financial year. Ascertaining profits or losses is important to make payments, making it one of the important objectives of accounting.

★ Preparing financial reports to assess the financial position

Accounting involves the preparation of a balance sheet which is a record of the assets and liabilities of a business entity. This helps in the analysis of the financial position of the business organisation. Ascertaining profitability can help us understand the strengths and weaknesses of the business organisation and formulate various policies and strategies to correct the weaknesses and improve the organisation's strengths.

- ★ Auditing of financial reports

Accounting is that it helps in understanding the financial position of a company in the form of assets, debts, profits and losses, etc. These records are made available to the auditor, who can then analyse the reports to find any discrepancies and suggest the required corrective reforms. These reports also help the higher authorities formulate plans and make rational decisions.

- ★ To forecast future payments, expenditures and budgets

Accounting helps to predict the future profitability of a business entity. This helps plan future payments, debts, expenditures and budgets accordingly. It also helps in distributing funds among different departments of the business organisation based on past allocations and profitability.

GOLDEN RULE / ACCOUNTING RULES

- ★ Personal Account - Debit the receiver, Credit the giver
- ★ Real Account - Debit what comes in, Credit what goes out
- ★ Nominal Account - Debit all expenses and losses, Credit all incomes and gains