What is accounting?

Definition of Accounting:

Accounting is the systemic process of identifying, recording, classifying, summarizing, interpreting and communicating of economic transaction to users for their improved decision making.

Recording

Accounting is the art of recording of transactions. Only business relative transactions are recorded in which money is mentioned. All transactions are recorded in detail. Both journal and subsidiary books are used for this.

Classifying

Accounting's main feature is also classifying all business transactions. Accounting makes group of all similar accounting entries in one place. For example, all receipt and payment will be shown in cash book. So, all transactions are collected under one common head. This system is also called classification of transaction. This process is completed by opening accounts in books. These books are called ledger.

Summarizing

Summarizing is the art of showing business results in summarize form. After this, it can use for all the interested parties. This feature tells about to financial statement. One is Trading and profit and loss account and other is Balance Sheet.

Interpreting

By interpreting, we can know whether the position of profitability is good or bad. By knowing this, we can estimate business's performance.

Event:

An event is an incident or occurrence that concerns the business or impacts the business dealings. An event that has measurable monetary impact qualifies as a transaction which has been elaborated on in the subsequent paragraph. Events that do not qualify as transactions are those that although impact the business do not have immediate monetary impact on its accounts. Events (other than transactions) are thus not recorded in the books of accounts of the company.

An example of an event can be death of a senior key management personnel or a large scale employee strike. These events do not have immediate monetary impact and thus do find any place in the books of accounts. However, they have more long lasting impact on the business – employee strike may negatively impact production and sales.

Transaction:

A transaction is a business event that has impact, direct or indirect on finances of the business. An event becomes a transaction if it involves exchange of values or resources and can be measured in monetary terms. It is thus recorded in its books of accounts. A transaction is recorded by a journal entry in the books of accounts.

A transaction need not involve actual exchange of cash but must have monetary impact to qualify as a transaction. For example, credit sales of goods and services do not involve cash exchange however they result in recognition of income and creation of assets i.e., accounts receivable or debtors, thus it has monetary impact and qualifies as a transaction. Similarly, credit purchases of goods and services do not involve cash payments but result in recognition of liabilities i.e., accounts payable or creditors.

Difference between Event and Transaction

Event	Transaction
(1) All events are not transactions.	(1) All transactions are events.
(2) An event may or may not bring change in the financial position of a person, family, or organization.	(2) An event must bring financial change.
(3) Financial changes caused by events may or may not be measurable in terms of money. For example, the death of a skilled employee may bring heavy loss to a business, but this loss is not measurable in terms of money.	(3) The financial changes caused by transactions must be measurable in terms of money.
(4) Events are used in a wider sense. It may or may not require two parties for the occurrence of an event.	(4) Transactions are used comparatively in a narrow sense. In the case of transaction two parties are must.
(5) Transfer of goods or services may or may not occur for an event.	(5) As a consequence of transactions transfer of goods or service is a must. Of course, in some cases, there is an exception. For example, burning of goods, fixed asset depreciation etc.
(6) It is not necessary that every event will be recorded in the books of accounts. It is needless to record any event in the books of accounts if it is not measurable in terms of money.	(6) Every transaction must be recorded in the books of accounts; otherwise accurate results cannot be ascertained from the books of accounts.
(7) Transaction relating event is settled for cash.	(7) Financial transactions may be settled in Cash or are made on credit.
(8) As per accounting principle of events— (a) Cash statement. (b) Separate statements for receipts and payments head wise and, (c) Final statement of receipts and payments are made.	(8) In the accounting process of the transaction in the first phase journalizing, in the second phase posting in the ledger and in the third phase financial statement is prepared.
(9) The scope of the event is very wide.	(9) The scope of the transaction is limited.
(10) Transactions related to events are not always supported by evidence.	(10) Business transactions must be supported by evidence.

What is Accounting information?

Accounting information is the information that arises from business transactions. Once identified, the information is then classified and recorded, and it eventually finds its way into various reports. For cash-basis accounting, this is relatively simple. Revenue is recorded in the books when cash is received, and expenses are recorded when cash is paid out. This method may be simpler, but it is only suited to smaller businesses with only a few owners or partners. However, businesses with more investors and businesses that have inventory find the accrual basis of accounting necessary. Additionally, publicly traded businesses are required by law to use accrual-basis accounting.

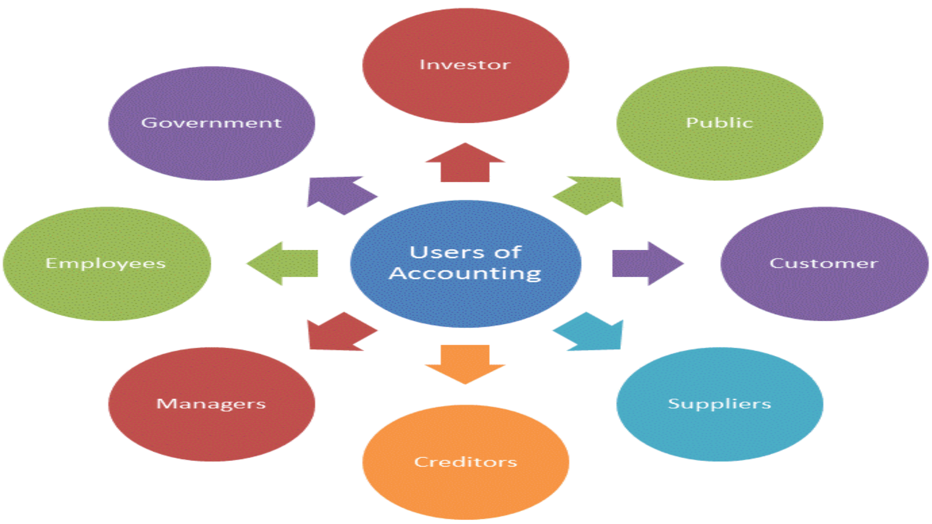
Transactions in accrual accounting are recorded with respect to the accounting equation, where every transaction has a debit side and a credit side.

Who are the users of accounting information?

Users of Accounting Information

1. External users:
   i. Investors.
   ii. Creditors.
   iii. Customers.
   iv. Suppliers.
   v. Government.
   vi. Organizations.

2. Internal users:
   i. Management.
   ii. Managers of operations.
   iii. Employees.



The users of accounting information include the present and potentials investor, creditors, managements, suppliers, tax authorities, government and public as well as.

Investors: Both present and potentials investor need the information to judge the prospect of present and potentials investment in the business. Present investor need the information in order to decide whether they should continue in the presents or not. Future investors may require the information to determine whether they should buy the shares of company or make investment somewhere else.

Creditors: Creditors are the person who owes money to the business. Both short term and long term creditors need the information. Long term creditors are interested in both the solvency and liquidity of the business. On the other hand short term creditors are interested to determine whether the amount owing to them will be paid when due.

Employees: The interest of the employees in accounting information is related to that they want more salary and other monetary incentives like bonus, overtime payments, etc. They are interested in financial statements on account of various profit and bonus schemes negotiation with the management.

Managers: Managers or management are the main internal users of accounting information. Managers need the information for making various decisions. Managers need the information to protect the property of business from fraud, mismanagement, to make specific decision, to plan for future, to measure the performance.

Customers: Customers are interested to judge the profitability and solvency of the business for knowing the ability of the company to survive so that they are supplied with to goods on regular basis. Strong financial background also implies quality products and more money on innovation of products.

Governments: Government needs the information for various regulatory purposes. They are interested in the accounting information on account of taxation, labor and corporate laws. Different agencies like Registrar of Company, Company Law Board, and Ministry of Finance use the information for framing policies for the betterment of the economy.

General Public: General public may be interested in the accounts of the business for social obligation of business. The public is interested in pollution abatement, community welfare program, ecological benefits or hazards out of operation of the business. Public is interested to know how the national resource are being utilized by the organization and their contribution in the economy.

Analysts: Investment analysts are an important user group - specifically for companies quoted on a stock exchange. They require very detailed financial and other information in order to analyze the competitive performance of a business and its sector. Much of this is provided by the detailed accounting disclosures that are required by the London Stock Exchange. However, additional accounting information is usually provided to analysts via formal company briefings and interviews.

Lenders: Banks and other financial institutions who lend money to a business require information that helps them determined whether loans and interest will be paid when due.

Qualities of Good Accounting Information

Accounting involves the process of transforming data about an organization's operations into information that various stakeholders can use for myriad reasons. However, accounting requires the production of good information according to specific standards. Good information possesses a significant number of ten characteristics.

1) **Completeness**

Good accounting information is complete. This means that it provides intended users with all the information that is necessary to fulfill their information needs and requirements. Completeness also suggests that all necessary information is included in any report that the organization produces. The assumption is that there would be no error of omission in the information.

2) **Relevance**

There is always an objective to be fulfilled when accounting information is required. For accounting information to be valuable, it should be relevant to the objective and the intended user. An analysis of the prime cost of a project should not include information on indirect costs, for example. It is important that any figures or reports should stick to the point and not provide more information than is necessary. Irrelevant information wastes time and can increase the cost of information production.

3) **Accuracy**

It is almost self-evident that accounting information should be accurate. This does not suggest that you must always state figures and facts down to the last penny or detail. What it means is that information should be accurate enough for its intended purpose (or user), without being unnecessarily detailed. Inaccurate information cannot provide a valid representation of reality and can limit the effectiveness or worth of decisions based on it.

4) **Clarity**

It is useless to have accurate, timely and complete information if it is not clear to the user of the information. The ability of the user to understand and properly comprehend the information is critical. This is another reason why accounting standards are created and enforced.

5) **Properly communicated**

It is necessary for organizations to monitor activities and accounting information is useful in so doing. However, good information is properly communicated to those who need it. Accounting departments should not merely create required reports but communicate them to information users in manner that increases the value of the information.

6) Timely

Since information has an objective, there are usually periods within which these objectives operate. Good information neither is produced too frequently nor is it compiled after it is needed most. For instance, information that reaches a decision-maker after the decision is of limited use in the context of the decision-making process.

7**) Confidence**

A major reason why independent auditors audit some accounting information is to inspire confidence in the validity and worth of the information. This is a vital aspect of good accounting information, especially where critical decisions are taken based on such information. There must be confidence in the competence and integrity of those who produce accounting information.

8) **Volume**

Information overload can be a problem - particularly with the inherently limitations of the human mind. Accounting information needs to be distilled in a manner that makes it clear and concise and does not overwhelm the user. An unnecessarily high volume of information (although accurate and relevant) can do just that.

9) Cost-efficient

Valuable information should not cost more to produce than it is worth. This is the reason why information that is produced more regularly than required is less useful/ valuable than information that is produced to satisfy a specific need or requirement.

10) Communicated through the right channel

You can present and communicate accounting information in a number of ways. The most important factor is whether you communicate and distribute it through the appropriate channels. Since accounting information is created for certain users, you can judge the appropriateness of the communication channel by the effect on intended users. You can communicate some accounting information informally, while others require a very formal approach that strictly adheres to standards.

At any point in time, some characteristics may be more important than others are. Generally, good accounting information possesses all or most of the ten aforementioned qualities.

What are the limitations of accounting information?

- **Dependence on historical costs**. Transactions are initially recorded at their cost. This is a concern when reviewing the balance sheet, where the values of assets and liabilities may change over time. Some items, such as marketable securities, are altered to match changes in their market values, but other items, such as fixed assets, do not change. Thus, the balance sheet could be misleading if a large part of the amount presented is based on historical costs.

- **Inflationary effects.** If the inflation rate is relatively high, the amounts associated with assets and liabilities in the balance sheet will appear inordinately low, since they are not being adjusted for inflation. This mostly applies to long-term assets.
- **Intangible assets not recorded.** Many intangible assets are not recorded as assets. Instead, any expenditures made to create an intangible asset are immediately charged to expense. This policy can drastically underestimate the value of a business, especially one that has spent a large amount to build up a brand image or to develop new products. It is a particular problem for startup companies that have created intellectual property, but which have so far generated minimal sales.
- **Based on specific time period.** A user of financial statements can gain an incorrect view of the financial results or cash flows of a business by only looking at one reporting period. Any one period may vary from the normal operating results of a business, perhaps due to a sudden spike in sales or seasonality effects. It is better to view a large number of consecutive financial statements to gain a better view of ongoing results.
- **Not always comparable across companies.** If a user wants to compare the results of different companies, their financial statements are not always comparable, because the entities use different accounting practices. These issues can be located by examining the disclosures that accompany the financial statements.
- **Subject to fraud.** The management team of a company may deliberately skew the results presented. This situation can arise when there is undue pressure to report excellent results, such as when a bonus plan calls for payouts only if the reported sales level increases. One might suspect the presence of this issue when the reported results spike to a level exceeding the industry norm.
- **No discussion of non-financial issues.** The financial statements do not address non-financial issues, such as the environmental attentiveness of a company's operations, or how well it works with the local community. A business reporting excellent financial results might be a failure in these other areas.
- **Not verified**. If the financial statements have not been audited, this means that no one has examined the accounting policies, practices, and controls of the issuer to ensure that it has created accurate financial statements. An audit opinion that accompanies the financial statements is evidence of such a review.
- **No predictive value.** The information in a set of financial statements provides information about either historical results or the financial status of a business as of a specific date. The statements do not necessarily provide any value in predicting what will happen in the future. For example, a business could report excellent results in one month, and no sales at all in the next month, because a contract on which it was relying has ended.

Basic Accounting Equation

ASSETS = LIABILITIES+ Owners EQUITY
A = L + OE
Asset: Any resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.
Liability: A present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.
Owner’s equity: the residual interest in the assets of the enterprise after deducting all its liabilities.

Definition Financial Statements

Financial Statements represent a formal record of the financial activities of an entity. These are written reports that quantify the financial strength, performance and liquidity of a company. Financial Statements reflect the financial effects of business transactions and events on the entity.

Types of Financial Statements: The four main types of financial statements are:
Statement of Financial Position
Statement of Financial Position, also known as the Balance Sheet, presents the financial position of an entity at a given date. It is comprised of the following three elements:

- Assets: Something a business owns or controls (e.g. cash, inventory, plant and machinery, etc)
- Liabilities: Something a business owes to someone (e.g. creditors, bank loans, etc)
- Equity: What the business owes to its owners. This represents the amount of capital that remains in the business after its assets are used to pay off its outstanding liabilities. Equity therefore represents the difference between the assets and liabilities.

Income Statement
Income Statement, also known as the Profit and Loss Statement, reports the company's financial performance in terms of net profit or loss over a specified period. Income Statement is composed of the following two elements:

- Income: What the business has earned over a period (e.g. sales revenue, dividend income, etc)
- Expense: The cost incurred by the business over a period (e.g. salaries and wages, depreciation, rental charges, etc)

Net profit or loss is arrived by deducting expenses from income.

Cash Flow Statement
Cash Flow Statement, presents the movement in cash and bank balances over a period. The movement in cash flows is classified into the following segments:

- Operating Activities: Represents the cash flow from primary activities of a business.
- Investing Activities: Represents cash flow from the purchase and sale of assets other than inventories (e.g. purchase of a factory plant)
- Financing Activities: Represents cash flow generated or spent on raising and repaying share capital and debt together with the payments of interest and dividends.

Statement of Changes in Equity
Statement of Changes in Equity, also known as the Statement of Retained Earnings, details the movement in owners' equity over a period. The movement in owners' equity is derived from the following components:

- Net Profit or loss during the period as reported in the income statement
- Share capital issued or repaid during the period
- Dividend payments

- Gains or losses recognized directly in equity (e.g. revaluation surpluses)
- Effects of a change in accounting policy or correction of accounting error

Elements of Financial Statements

1. Assets:
2. Liabilities:
3. Equity:
4. Income:
5. Expense:

Detailed Comparison between Financial Accounting and Managerial accounting

Unbeknownst to many people, managerial accounting vs financial accounting mean there's so much variance between the two as well as areas where they seem the same. Here's a look at financial vs managerial accounting areas of difference.

	Financial Accounting	Managerial Accounting
1	Financial accounting reports are consumed by public stakeholders.	Managerial accounting information is for internal purposes.
2	Focuses mostly on offering information on those outside the organization.	Heavily focused on providing information to persons inside the organization.
3	Financial accounting heavily used by public regulators, creditors and shareholders.	Managerial accounting information is confidential and used largely by managers only inside the company.
4	Financial accountancy data, information and analyses reports are historical in nature.	Managerial accounting information is heavily forward-looking.
5	Financial accounting reports and other material are case based.	Information for managerial accounting is based on model and abstract to some level in support of decision making.
6	Information in financial accounting computation follows the general accepted financial accounting norms and standards.	Information for managerial accounting computation is guided by the managerial needs identified within a specific company.
7	Financial accounting is encompassing, focusing on the entire organization.	Managerial accounting is specific offering detailed and divided information on diverse things such as tasks, department, operations, specific activities, sales, products.
8	Financial accountancy is legally required and expected by law.	Managerial accounting is not required by any law or norm.
9	Financial accounting reports are derived after a set period of time such as a fiscal year or quarter for those outside the company.	On the other hand managerial accounting reports could be provided to cover any specific period such as a day, month, week or month.
10	Financial accounting reports are predictively valuable and historically factual to help those wishing to invest or get involved with the organization to make better financial decisions.	Managerial accounting specifically deals with confidential material and exclusively for a company's top management to make critical decision.
11	Reports in financial accounting are of the entire results of the business.	Managerial accounting reports are usually detailed and poignant and can be for geographic area, customer, product, service among others.
12	Financial accounting largely looks at reports particularly to show company's profitability and efficiency.	Managerial accounting offers reports on areas of weaknesses and problems and how they should be fixed to the concerned management.

	Financial Accounting	Managerial Accounting
13	Financial accounting requires reports to be maintained with acute precision so that their accuracy is not in question.	Managerial accounting works with estimations and hardly on precise, verifiable or proven details or facts.
14	Financial accounting mostly ends with financial statements preparation and distributed externally and internally.	Managerial accounting usually concerns itself with creating operational based reports and distributed to the management inside the company.
15	Financial accounting largely concerned on the results or outcome and not the overall company system of operations.	Managerial accounting definitely interested on the bottlenecks and where they manifest in operations and fixing them to enhance profits.