financial accounting

troduction:-

Financial accounting is a specialized branch of accounting that keeps track of a company's financial transactions. using standardized guidelines, the transactions are recorded, summarized and presented in a financial report or financial statement such as an income statement or a balance sheet.

Definition:-

A field of accounting that treats money as a means of measuring economic performance instead of as a factor of production. It encompasses the entire system of monitoring and control of money as it flows in and out of an organization as assets and liabilities, and revenues and expenses.

Financial accounting gathers and summarizes financial data to prepare financial reports such as balance sheet income statement for the organization's management, investors, lenders, suppliers, tax authorities, and other stake holders.

Advantages:-

1) Maintanance of business records

All financial transactions are recorded in a systematic manner in the books of accounts so that there is no need to reply on memory. Human memory is limited by its very nature. Accounting helps to overcome this limitation.

2) Preparation of financial statements

systematic records enables the accountants to prepare the financial ... trading and profit and loss account to ascertain profit or lo during a particular accounting period and balance sheet to state and the final Position of the business on a particular state.

3) Comparison of result Â
Systematic maintain of business record enables the accountant to compare Profits of one year with those of earlier years to know the significant facts about the change.

4) Act as legal evidence
Proper books of accounts maintained in systematic manner act as legal evidence in case of disputes.

5) Facilitates Raising loans
Accounting facilitates raising loans from lenders by providing them required financial information.

6) Facilitates the Ascertainment of value of Business
Accounting facilitates the ascertainment of value of business in case of transfer of business to another entity.

7) Assist the Management Â
Accounting assists the management in taking managerial decisions. for example, Projected cash flow statement facilitates the management to know future receipts and payment and to take decisions regarding anticipated surplus or shortage of funds.

8) Helps in taxiation matter Â
Accounting facilitates the settlement of tax liability with the authorities by maintaining proper books of accounts in systematic manner.

9) Facilitates control over asserts Â
Accounting facilitates control over asserts by providing information regarding cash balance, Bank balance, stock debtors, fixed assets etc.

Limitations of Financial Accounting :-

1) Records only Monetary Transactions

Financial accounting records only those transactions which can be measured in monetary terms. It has no place for recording non-monetary or non-financial accounting transactions, thought these matter also have a significant role in affecting the soundness of the business for example, efficiency of the management, political situation, Government policy, market competition etc. do effect the financial result and financial position of a business, but these are not all recorded in accounting.

2) No consideration of price level changes

Accounting accepts the cost concept and hence does not consider the change in the price level from time to time. This is a very serious limitation of financial accounting.

3) No realistic information

Accounting information may not be realistic as accounting statements are Prepared by following basic concepts and conventions. For example Going concern concept give us as idea that the business will continue and assets are to be recorded at cost but the book value, which the asset is showing may not be actually realisable.

4) Personal bias of accounting affects the accounting statements

Accounting statement are influenced by the personal judgement of the accountant. He may select any method of depreciation valuation of stock and treatment of deferred revenue expenditure, such judgement is based on integrity and competence of the accountant and will affect the preparation of accounting statement.

5) Window dressing in balance sheet

When an account resorts to window dressing in the balance sheet. The The balance sheet can not exhibit the true and fair view of the state of affairs of the business.

Accounting Cycle :-

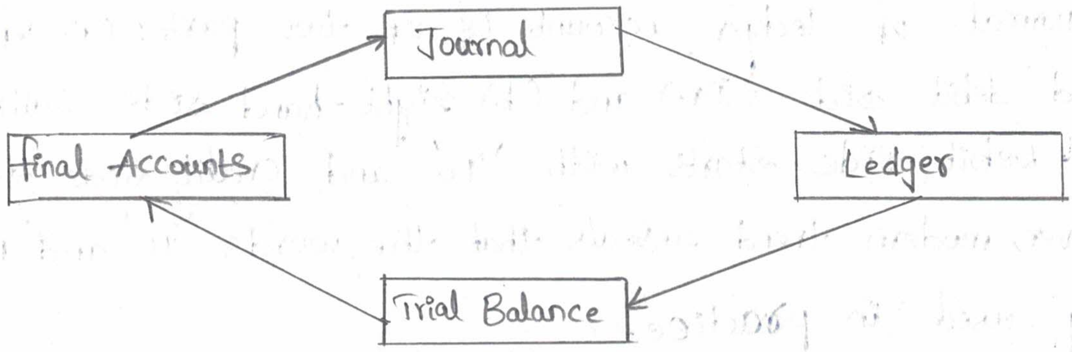

fig:- Accounting cycle.

Journal :-

Journal is the first book in which transactions are recorded in a chronological order (data wise), the moment they take place in business. It is also called 'day book'. The following is the format of a Journal.

Date	particulars	Ledger folio	Dr. amount (Rs.)	Cr. amount (RS.)

fig:- proforma of Journal

Recording entries in Journal is called Journalising. The following are the benefits of writing entries in Journal:

* To show all the necessary information about a transaction.
* To know why it is written.
* To know the date wise transactions
* To help identify and prevent errors.

Ledger :-

Ledger is a book that contains several accounts. The process of preparation of accounts from the journal into ledger is called posting in the ledger. The examples for ledger accounts include Sales account, purchases account, Sales returns account, purchase returns account, bills payable account, bills receivable account, cash account, debtors accounts, creditors accounts, and so on.

Format of Ledger Account :-

The format of ledger account is of two parts: (a) left-hand side called debit side (Dr.) and (b) right-hand side called credit side (Cr.). Debit side starts with 'To' and credit side starts with 'By'. However, modern trend reveals that the words 'To' and 'By' are not widely used in practice.

Account

Debit Side (Dr.)				Credit Side (Cr.)			
Date	Particulars	Folio	Amount	Date	Particulars	Folio	Amount

Trial Balance :-

Trial balance is a statement containing debit and credit balances of various accounts taken out from ledger books as on a particular date. A trial balance must agree as on that date.

Trial Balance
for the month ending January 31, 2014

Particulars	Debit balances Rs.	Credit balances Rs.

Preparation of Trial Balance :-

for preparing trial balance, first of all, it should be understood, which are the accounts that goes under debit and credit balances.

Accounts showing debit balances

* Debtors accounts
* Sales returns accounts
* Drawings account
* purchases accounts etc.

The following accounts show credit balances

* creditors account
* liabilities account
* Incomes account
* Loan account
* Bank overdraft account
* Gains account
* profits account etc.

Final accounts:

It gives an idea about the profitability and financial position of a business to its management, owners and other interested parties. The Preparation of a final accounting is last stage of the accounting cycle. The team " final accounts include

(i) Trading account;

(ii) Profit and loss Account

(iii) Balance sheet

Trading account:

After the preparation of trail balance, the next step is to prepare Trading Account. Trading Account is one of of the financial statements which shows the result of buying and selling of goods and/or service during an accounting period. The main objective of preparing the Trading Account is to ascertain gross profit or gross loss during the accounting period.

TRADING ACCOUNT

For the year ended 31st March, 2006

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening stock		By sales	
To Purchases		Less Sales Returns	
Less Purchases Return		By Closing stock	
To Direct Expenses:		By Gross loss transfered to P&L A/c	
Carriage Inward			
Freight and Insurance			
wages			
Fuel, Power and Lighting expenses			
Manufacturing expenses			
Coal, water and Gas			
Motive Power			
Octroi			
Import Duty			
Custom Duty			
Consumable Stores			
Royalty on manufact-ured Goods			
Packing charges			
To Gross Profit transferd to P&L A/c			

PROFIT AND LOSS ACCOUNT

Trading account results in the Gross profit / loss made by a businessman on purchasing and selling of goods. It does not take into consideration the other operating expenses incurred by him during the cource of running the business. Besides this, a businessman may have other cources of income. In order to ascertain the true profit or loss which the business has made during a particular period, it is necessary that all such expenses and income should be considered. Profit and Loss Account considers all such expenses and incomes and gives the net profit made or net loss suffered by a business during a particular period.

PROFIT AND LOSS ACCOUNT

For the year ended....

Particulars	Rs.	Particulars	Rs.
To Gross loss b/d		By Gross Profit b/d	
To Management Expenses:		By other Income:	
Rent, Rates and Taxes		Discount received	
Heating and Lighting		Commission received	
Office Salaries		By Non-trading Interest:	
Printing & stationary		Bank Interest	
Postage & Telegrams		Rent of property lay out	
Telephone charges		Dividend from shares	
Legal charges		By Abnormal Gains.	
Audit Fees			

Insurance		Profit on Sale of investment	
General Expenses		Profit on Sale of machinary	
To Selling and Distribution Expenses:		By Net loss transferred to Capital Account .	
Advertisement			
Tavellers' Salaries			
Expenses & Commision			
Godown Rent			
Export Expenses			
Carriage outwards			
Bank charges			
Agent's Commision			
upkeep of Motor lorries			
To Depreciation and Maintenance:			
Depreciation			
Repairs & Maintenance			
To Financial Expenses:			
Discount Allowed			
Interest on loans			
Discount on Bills			
To Abnormal losses:			
Loss by fire (not covered by Insurence)			
Loss on Sale of Fixed Assets			
Loss on Sale of Investments			
To Net profit transferred to Capital A/c			

BALANCE SHEET

A Balance sheet is a statement of financial position of a bussiness concern at a given date. It is called a Balance Sheet because it is a sheet of balances of those ledger accounts which have not been closed till the preparation of Trading and Profit and loss Account. After the Preparation of Trading and Profit and loss Account the balances left in the trail balance represent either Personal or real accounts.

Blance sheet:

Liabilities	Rs.	Assets	Rs.
Current Liabilities:		Liquid Assets:	
Bills payable		Cash in Hand	
Sundry Creditors		Cash at Bank	
Bank overdraft		Floating Assets	
Long Term Liabilities:		Sundry Debtors	
Loan from Bank		Investments	
Debentures		Bill Receivable	
Fixed Liabilities:		Stock in Trade	
Capital		Prepaid Expences	
		Fixed Assets:	
		Machinary, Building	
		Furniture & Fixtures	
		Motor Cars	
		Fictitious Assets:	
		Advertaisement	
		Misc. Expenses	
		Profit & loss A/c	
		Intangible Assets	
		Good will	
		Patents	
		Copy right	

Ratio Analysis:

Ratio is an expression of one number in relation to another. It is one of the methods of analyzing financial statements. Ratio analysis facilities the Presentation of the information of financial statements. Ratio analysis is the Process of determining and interpreting numerical relationships based on financial statements.

USES OF Ratio Analysis:

1. Helps in decision making:

Financial statements are prepared primarily for decision making. Ratio analysis helps in making decision from the information provided in these financial statements.

2. Helps in Financial Forecasting and planning:

Ratio Analysis is of much help in financial forecasting and planning. Ratio's Calculated for a number of years work as a guide for future.

3. Helps in Communication:

The financial strength and weakness of a firm are Communicating in a more Easy and understandable manner by the use of ratio's.

4. Helps in Co-ordination:

Ratio's help in Coordination which is of almost importance in effective business management. Better Communication of the efficiency and weakness of an Enterprise results in better co-ordination in the enterprise.

5. Helps in Control:

Ratio analysis also helps in making effective control of business. Standard ratio's can be based upon Performa financial statements and variances or deviation if any can be found by Comparing the actuals with standards. so as to take Corrective action at the right time.

6. Other uses:

It is an essential part of the budgetary control and standard costing.

Limitations of Ratio Analysis:

1. Limited use of a single Ratio:

A single ratio, usually does not convey much of

Statements.

5. Personal Bias:

Ratio have to be interpreted and different People may interpret the same ratio in different ways.

6. Uncomparable:

The firms of the similar business widely differ in their size and accounting procedures Etc. It makes comparision of ratio's difficult & misleading.

7. Price level changes:

while making ratio analysis, no consideration is made to the changes in price levels and this makes the interpretation of ratio invalid.

sense. To make a better interpretation, a number of ratios have to be calculated which is likely to confuse the analyst.

2. Lack of adequate standards:

There are no well accepted standards or rule of thumb for all ratios which can be accepted as norms. It renders interpretation of the ratio's difficult.

3. Change in Accounting Procedure:

Change in accounting procedure by a firm often makes ratio analysis misleading

Example: A change in the valuation of methods of inventories from FIFO to LIFO increases the cost of sales and reduces considerably the value of closing stocks.

4 Window dressing:

Financial statement can easily be window-dressed to present a better picture of its financial and profitability position to outsiders. Hence, one has to be very careful in making a decision from ratio's calculated from such financial