

Introduction to Financial Accounting

Tremendous growth in business has increased the volume of business transactions many fold. So it has become necessary to maintain complete record of transactions as human memory is limited. Accounting records are required for obtaining information about:

- Total revenue
- Profit earned or losses suffered
- Assets of the business
- Liabilities of the business
- Debtors and creditors etc.

Meaning of Book Keeping

It is that branch of knowledge which tells how to keep a record of financial transactions.

“Book keeping is an art of recording business dealings in a set of books”

J.R.Batliboi

Characteristics

- Systematic record of business transactions
- Transactions which can be expressed into monetary terms
- Recording in Journal, subsidiary books or ledger
- Records may relate to person, firm, company, non profit organisation etc.

There is need for recording transactions due to various reasons like:

- Human memory is limited
- The control of business rest with different persons
- Records are required in future for various internal and external matters

Process of Book Keeping

Identification of transaction



Recording at first stage



Posting in ledger



Balancing of ledger accounts



Preparation of trial balance

Accounting

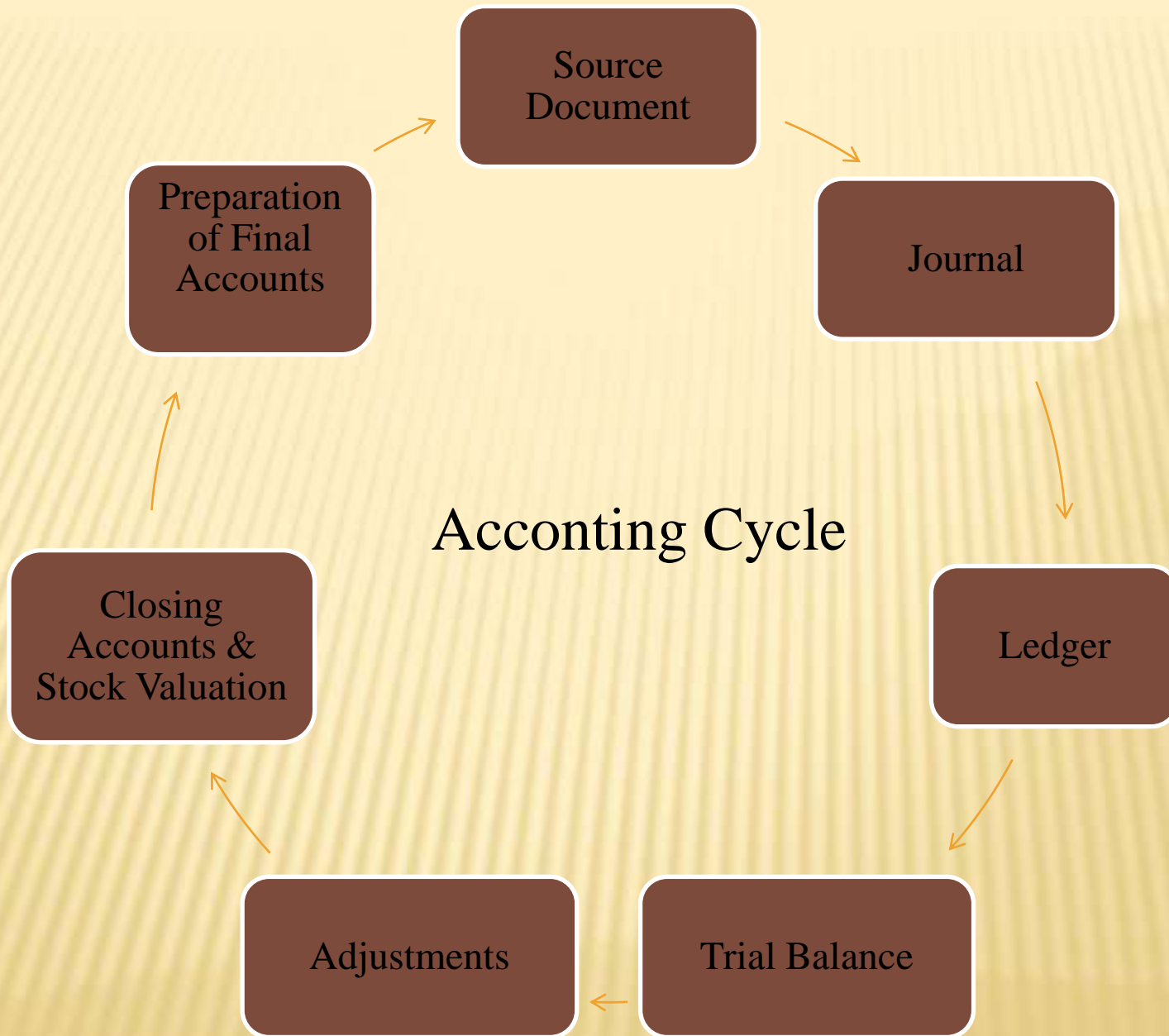
“Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events, which are, in part, at least of a financial character and interpreting the results thereof”

American Institute of Certified Public Accountants

Features of Financial Accounting

- Recording
- Classifying
- Summarising
- Interpreting
- Communicating

Accounting Cycle



Need & Objectives of Financial Accounting

Primary Objectives

- To keep systematic records
- To ascertain profit or loss
- To judge the financial position

Secondary Objectives

- To depict liquidity position
- To protect business properties
- To facilitate decision making
- To file tax returns
- To communicate information to stakeholders
- To provide information for internal reporting

Advantages of Financial Accounting

- **Ascertainment of profit or loss:** It helps in computing the profit earned or loss incurred by business. So owners can judge about success or failure of business and helps them to take steps for further improvement.
- **Ascertainment of financial position:** Financial accounting records help us in preparing the balance sheet to judge the financial position of business.
- **Replacement of human memory:** Accounting helps in maintaining a systemic record of business transactions, as human memory is limited and we cannot memorise each and every transaction.
- **Helpful in tax assessment:** The business is required to pay various taxes, so in absence proper accounting records it would difficult to correctly assess the tax liabilities.

- **Helps in debt collection:** Proper records of debtors help in timely collection of debts.
- **Evidence in court:** Accounting records can be used as an evidence in the court, as each transaction is recorded with documentary proof.
- **Helpful in raising funds:** Financial accounting information is used by banks and financial institutions to assess the liquidity and solvency position of the business. In this the accounting information helps to raise loans.
- **Helpful in comparative study:** Proper financial accounting records are required to evaluate the performance of business with its competitors and with his own performance in the past.
- **Helpful in rational decision making:** Financial accounting records help a businessman to take decisions like choosing the most profitable product mix, closing the product or department, make or buy decision, accepting or rejecting the order, fixation of sale price etc.

Limitations of Financial Accounting

- ❑ **Historical in nature:** Financial accounting reports the net effect of transactions of a business during an accounting year on financial results and position of the business but does not provide any information about future.
- ❑ **Permits alternative treatments:** In financial accounting the alternative methods are available for the treatment of items like there are different methods for stock valuation, for calculating depreciation. So these records are affected by personal biasness.
- ❑ **Influenced by personal judgement:** To record certain events estimates have to be made which require personal judgement.
- ❑ **Ignores the importance of non-monetary information:** Financial accounting does not consider the transactions which are qualitative in nature like loyalty of customers, hardworking employees, efficient management etc.

- ❑ **Deals with overall profitability:** Financial accounting information is recorded and reported for the entire business, without considering various divisions, products and functions involved. So it does not provide information to take rational decisions with regard to different divisions and departments.
- ❑ **No focus on cost control:** Here costs are recorded as they are incurred. Hence no yardstick is provided against which the actual costs can be compared.
- ❑ **Does not disclose the present value of the business:** Financial accounting the assets are shown at their acquisition cost. Any change in their value is not recognised in books of accounts.
- ❑ **Absence of evaluation of business policies:** Financial accounting is primarily historical in nature. It does not generate information which can be used for preparation of plans and policies and their evaluation.

Users of Accounting Information

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graph TD; A[Users of Accounting Information] --- B[ ]; B --- C[Owners]; B --- D[Management]; B --- E[Employees]; B --- F[Suppliers]; B --- G[Government]; B --- H[Consumers]; B --- I[Student & Researchers]; B --- J[Potential Investors]; B --- K[Media]; B --- L[Stock markets]; B --- M[Market Regulator];
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- Owners
- Management
- Employees

- Suppliers
- Government
- Consumers
- Student & Researchers
- Potential Investors
- Media
- Stock markets
- Market Regulator

Internal Users

- **Owners:** Accounting records provide information regarding earnings, expenses, capital, assets, liabilities and other related information. This information is used by the owners in assessing the past performance of the company and to take decisions for future.
- **Management:** In company form of organisation there is separation between ownership and management. The management is responsible for carrying on the business in efficient and profitable manner. The accounting information helps them to take right decision at right time.
- **Employees:** They are interested in good working conditions, wages, perquisites, bonus etc. So they are also interested in accounting information with which they can forecast about their bonus.

External Users

- **Suppliers:** Suppliers and lenders use accounting information to evaluate liquidity and solvency position of the business to ensure the safety of their investments
- **Government:** Government is interested to get information regarding sales, production and income of the business to know whether the business abides all rules and regulations, pays taxes in time or not.
- **Consumers:** Consumers expect good quality products at reasonable price. Accounting information will enlighten them in this respect.
- **Students and Researchers:** Annual reports of business prepared from accounting information helps researchers in their projects and they can enhance their practical knowledge in accounting.

- **Potential Investors:** They are interested in the profits and financial position of the business. They can get the required information to take their decision to invest or not in that business.
- **Media:** Financial newspapers, journals, business channels need information about performance, achievements and problems faced by the business firms. Accounting through published annual reports and various web disclosures provide necessary information for further analysis by media.
- **Stock Markets:** Accounting provides information about the performance and financial health of the business as well as the information related to vital decisions taken or to be taken by concerns to stock markets where the shares of these companies are listed.
- **Market Regulator:** SEBI keeps a watch on the financial dealings of the companies to protect the interest of investors. Accounting is the vehicle to provide information to market regulator from time to time.

Bibliography

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Thank You