Lecture: 2

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Subject of Notes: Financial Accounting

Topic:

- Meaning and Definition of Financial Accounting,
- Nature or Features of Financial Accounting,
- Functions of Financial Accounting

FINANCIAL ACCOUNTING

Meaning and Definition of Financial Accounting

Account is a summary of relevant business transactions at one place relating to a person, asset, expense or revenue named in the heading. An account is a brief history of financial transactions of a particular person or item. An account has two sides called debit side and credit side.

Accounting includes the presentation and interpretation of the results of the financial activity so that financial performance can be assessed. Accounting provides the economic information necessary for making investment decisions.

According to American Institute of Certified Public Accountants (AJCPA), accounting is "The art of recording, classifying, and summarizing 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'.

With greater economic development, the meaning of the term 'accounting' gradually became broader.

According to American Accounting Association (AAA), accounting is, "The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information".

According to R.N. Anthony, "Accounting system is a means of collecting, summarizing, analyzing, and reporting in monetary terms the information of the business".

The above definition contains four essential characteristics of accounting:

1) Economic events,

2) Identification, measurement, recording, classification, analyzing and communication,

3) Organization, and

4) Interested usoms of information.

Nature of Financial Accounting

Following are the nature of financial accounting:

1) Monetary Transactions: In financial accountmg only transactions in monetary terms are considered Transactions not expressed in monetary terms do not find any place in financial accounting, howsoever important they may be from business pomt of view

2) Histoncal Nature: Financial accountmg considers only those transactions which are of historical nature i.e, the transaction which have already taken place. No futuristic transactions find any place in fiancial accounting, howsoever important they may be from business point of view

3) Legal Requirement: Financial accounting is a legal requirement It is necessary to maintain the financial accounting and prepare financial statements there from It is also obligatory to get these financial statements audited.

4) External Use: Financial accounting is for those people who are not part of decision making process regarding the organization like investors, customers, suppliers, financial institutions etc Thus, it is for external use

5) Disclosure of Financial Status: It discloses the financial status and financial performance of the business as a whole

6) Interim Reports: Financial statements which are based on financial accounting are interim reports and cannot be the final ones.

7) Financial Accounting Process: The process of financial accounting gets affected due to the’ different accountmg policies followed by the accountants These accounting policies differ mamly in two areas Valuation of inventory and Calculation of depreciation

Book-keeping and Accounting

Book-keeping is the art of recording the business transactions in a systematic and regular manner.

According to Northcot, “Book-keeping is the art of recording in the books of accounts the monetary aspects of commercial and financial transactions”.

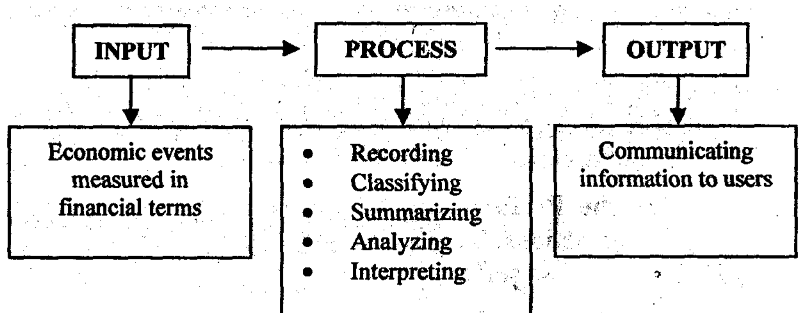
In other words, book-keeping means the art as well as the science of recording business transactions under proper accounts.

Difference between Book-Keeping and Accounting

Basis of Difference	Book-Keeping	Accounting
1) Scope	Recording and maintenance of books of accounts.	It is not only recording and maintenance of books of accounts but also includes analysis, interpreting and communicating the information.
2) Stage	Primary stage.	Secondary stage.
3) Objective	To maintain systematic records of business transactions.	To ascertain the net result of the business operation.
4) Nature	Often routine and clerical in nature.	Analytical and executive in nature.
5) Responsibility	A book-keeper is responsible for recording business transactions.	An accountant is also responsible for the work of a book-keeper.
6) Knowledge level	The book-keeper is not required to have higher level of knowledge than that of an accountant.	The accountant is required to have higher level of knowledge than that of book-keeper.
7) Supervision	The book-keeper does not supervise and check the work of an accountant.	An accountant supervises and checks the work of the book-keeper.
8) Staff involved	Work is done by the junior staff of the organization.	Senior staff performs the accounting work.
9) Principle of accountancy	In book-keeping, accounting concepts and conventions are followed.	The methods of reporting and interpretation accounting may vary from firm to firm.

Functions of Financial Accounting

The functions of financial accounting are as follows:



Accounting Functions

1) Identifying: Identifying the business transactions from the source documents.

2) Recording: Accounting records business transactions in terms of money. It is essentially concerned with ensuring that all business transactions of financial nature are properly recorded. Recording is done in journal, which is further subdivided into subsidlaty books from the point of view of convenience.

3) Classifying: Accounting also facilitates classification of all business transactions recorded in journal Items of similar nature are classified wider appropnate heads. The work of classification is done in a book called the ‘Ledger’. For example, the expenses may be classified under various heads like travelling, communication, printing and stationery, adveitisement, etc. All the entries in the Ledger shall flow based son the enthes passed in the Journal The ledger accoups will help in knowing the total expenditure under various heads for a given period

4) Summarizing: Accounting summarizes the classified information It is done in a manner, which is useful to the internal and external users Internal users interested in these inforinations are the persons who manage the business. External users of information are the investors, creditors, tax authorities, labour unions, trade associations, shareholders, etc

5) Analyzing: It establishes the relationship between the items of the profit and loss account and the balance sheet. The purpose of analyzing is to identif’ the financial strength and weakness of the business. It provides the basis for interpretation

6) Interpreting: It implies analyzing and interpreting the financial data embodied in final accounts Interpretation of the data helps the management, outsiders and shareholders in decision making

7) Communicating: It is concerned with the transmission of summarized, analyzed, and interpreted information to the users to enable them to make reasoned decisions.