11 Financial Accounting: A Dynamic Approach

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Abstract

Financial accounting is one of the most significant sections of the accounting which is responsible for recording, classification, summarisation, analysis and reporting about financial transactions of a business organisation in a systematic manner. It offers a clear and consistent system for gathering and displaying finance data in a significant way. The main objective of Financial Accounting is to measure the financial results and the financial status of an organisation in a specific accounting period. It helps the owners, managers, investors, creditors, government bodies and other interested parties to grasp the activities and finances of an enterprise.

Keywords: Financial Accounting, Business Organisation, Investors, Creditors, Government Bodies.

Introduction

In financial accounting, the first step is to identify financial transactions. The books of accounts record all transactions that affect the business in terms of monetary value. The transactions are first entered in the double entry bookkeeping system where every transaction affects two or more accounts. Once posted in a Journal, they are transferred and entered in the appropriate ledger accounts. The balances of these accounts are then used to prepare the trial balance. Lastly, financial statements, like the Trading Account, Profit and Loss Account, and the Balance Sheet are created to provide an insight into the outcomes of business activities and the financial state of the organisation.

One of the important features of financial accounting is that it is based on the generally accepted accounting principles, concepts, conventions and standards. The principles bring uniformity and consistency in the preparation of financial statements. They assist in the reliability, comparability, understandability and relevance of financial information to users. Additionally, IFRS based financial reporting is affected by applicable Accounting Standards and the Indian Accounting Standards (Ind AS) depending on the nature and size of the reporting entity in India.

Financial accounting primarily deals with the information regarding the past. It documents past transactions and shows their financial outcomes. For instance, the machinery, salaries paid, goods sold, cash collected from customers and cash paid for supplies are recorded systematically. This information is useful for stakeholders to assess the performance of an organisation and to help them make an economic choice.

Financial accounting has a wide scope. This involves journalizing transactions, keeping ledger accounts, drawing up trial balances, calculating depreciation, valuing inventories, drawing up bank reconciliation statements, correcting accounting errors and preparing final accounts. It also may include any specialties like branch accounting, partnership accounting, consignment accounting and corporate accounting.

Accounting Concepts and Principles

Financial accounting is based on accounting concepts and principles. They offer principles for identifying, documenting, categorizing, measuring and reporting financial transactions. If there were no generally accepted concepts and principles, financial statements of different organisations would not be consistent and comparable. The concepts thus contribute to the reliability, system and usefulness of information in accounting for decision making.

- The Business Entity Concept assumes that the business is distinct from its owner(s). This idea involves keeping business records separate from personal records of the owner. For instance, when the owner invests money in the business, the investment is considered capital of the business instead of his or her income.
- The Going Concern Concept implies that an organisation will stay in operation for the foreseeable future. This assumption has traditionally resulted in the valuation of assets and their depreciation over their service lives rather than their immediate closing.
- According to the Money Measurement Concept, only the transactions and events which can be quantified in monetary value are recorded in the accounting books. Motivation of employees, quality of management, and customer satisfaction are some factors that can be important to a business, but are not normally written down directly since they are not subject to an accurate monetary measurement.
- The Accounting Period Concept breaks the business' life into segments or periods, typically a year, to measure the financial performance of each segment. This enables organisations to prepare periodic financial statements and evaluate their performance regularly.

- The Double Entry System is based on the Dual Aspect Concept. It states that every financial transaction has two aspects. This relationship is reflected in the basic accounting equation: Assets = Liabilities + Capital.
- The Accrual Concept calls for income and expenses to be recorded at the time they are earned or incurred instead of when cash is received or paid. This gives a more valid indication of the financial performance of an accounting period.
- The Matching Principle calls for the expenses of a specific period to be the expenses of that period. It is useful in calculating the actual profit or loss of the business enterprise.
- From one accounting period to the next, an organisation must use the same accounting methods as outlined in the Consistency Principle. Financial statements are used to compare the performance of one period with another, so consistency facilitates comparability.
- According to the Prudence or Conservatism Principle, accountants must be cautious when dealing with uncertainty. Gains where there is uncertainty are not recognised until the loss has been reasonably foreseen.Gains where there is uncertainty are not recognised until losses are reasonably foreseen.
- According to the Materiality Concept, the accounting information should emphasize those items that might make a difference to financial statement users. Where appropriate, the treatment of insignificant items may be treated in a simpler manner.
- Hence, accounting concepts and principles serve as a common ground rule for financial reporting. They provide uniformity, reliability, transparency and comparability and aid in the interpretation of financial statements.

Journal, Ledger and Trial Balance

Trial Balance, Journal & Ledger are the basic elements of accounting. They assist an organization in systematically recording, categorizing and confirming its financial transactions. Typically, the accounting process starts in the journal, then the ledger and then the trial balance.

The Journal is called the book of original entry because business transactions are entered chronologically first in the Journal. The nature of each transaction is considered in terms of double entry bookkeeping. Typically, the journal entry is made up of the date, the particulars, the ledger reference, the debit and the credit. A narration of explanation may be included if needed. The system and accuracy of financial transactions is ensured in proper journalisation of the same.

The journal is used to record transactions and the principal book of accounts is the Ledger. For instance, all the transactions which involve cash are posted in the

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Cash Account while the transaction involving purchase, sales, debtors, creditors, and expenses are posted to the relevant accounts. The ledger is used to calculate the amount of money in each account at the end of an accounting period. These balances are used to make financial statements.

Subsidiary Books and Cash Book

Subsidiary books are special books used to keep track of transactions of the same business. If there are many transactions, it is inconvenient and time consuming to have them all in one journal. Subsidiary books in turn, facilitate the division of the work of accounting in various categories and enhance the efficiency, accuracy, and internal control.

Some subsidiary books are Purchases Book, Sales Book, Purchases Returns Book, Sales Returns Book, Bills Receivable Book, Bills Payable Book and Journal Proper. Credit purchases of goods are recorded in the Purchases Book and credit sales of goods in the Sales Book. Returns are booked in the ‘returns books'. These books help to be more specific when identifying and summarising certain types of transactions.

The Cash Book is one of the significant accounting books that is used for recording cash/bank transactions. It performs the functions of both a journal and a ledger. The cash receipts are debited and cash payments are credited. A cash book can be kept in a single column, double column or triple column, according to the needs of the business.

A single column cash book only records cash transactions. Usually a double column cash book is used to record cash and bank transactions or cash and discount transactions. A triple column cash book can contain cash, bank and discount columns. The cash book is a continuous account of cash and bank balances and helps in monitoring the liquidity of the business.

Bank Reconciliation Statement

Bank Reconciliation Statement (BRS) is a statement that is prepared for reconciling the balance of cash book with the balance of bank statement/pass book for a particular date. These balances are supposed to be equal in normal times as the same banking transactions are entered into both balances. But often discrepancies will occur because transactions are logged at different times or some entries might be in one log before the other.

There are several reasons why there may be a discrepancy, one being cheques issued but not presented for payment. The business would record the cheque payment in its Cash Book as soon as it is paid but the bank would record only when it is presented. The Cash Book will also show cheques collected but not yet cashed, which might not be reflected in the bank statement at the same time.

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The concept of depreciation and inventory valuation.

Depreciation is the decrease in the value of a fixed asset as a result of its use, passage of time, obsolescence or any other cause. It is applied over the useful life of an asset in a systematic way. Typically, these methods are the Straight-Line Method or the Written-Down Value Method. Depreciation accounting provides the correct profit or loss of a business and the carrying value of its assets.

The process of assigning a dollar amount to the value of unsold inventory at the end of an accounting period is called inventory valuation. The inventory is usually valued under the accounting concept as per accounting standards which usually take cost and net realisable value into consideration. Inventory valuation is significant as it is a direct impact on the financial position of the organisation and also on the Gross profit calculation, hence it is important to have proper valuation of inventory.

Rectification of Errors

Errors Correction are the correction of errors committed during the process of recording, classification and posting accounting transactions. Journalisation, posting of ledgers, balancing and preparation of financial statements can all be subject to errors. There are generally four types of errors, such as omission, commission, principle and compensating. Some errors impact the agreement of the trial balance; others have no impact.

The rectification can be made by using proper Journal Entry. If an error is found prior to preparing a trial balance, it can be corrected directly in the proper accounts in most cases. Errors after the trial balance, if they are found and it is a difference, can be temporarily put into Suspense Account. Correcting imbalances leads to accurate accounts and financial statements.

Final Accounts

Final Accounts are made at the end of an accounting period to find out the actual performance and position of a business. They usually have the Trading Account, Profit and Loss Account and Balance Sheet. The Trading Account is used to calculate gross profit or gross loss as it involves sales and cost of goods sold. The Profit and Loss Account is used to calculate the net profit or net loss once the operating and other expenses and incomes are taken into account.

The Balance Sheet displays the financial position of the business by listing the assets, liabilities and capital at a specific point in time. Final accounts are an essential source of information for owners, managers, investors and creditors, and other stakeholders to assess business performance and make economic decisions.

Bill of Exchange and Consignment

A Bill of Exchange is a financial document that includes an unconditional order from one party to another to pay a certain amount of money to a certain person

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either now or at a fixed time in the future. In a credit transaction, bills of exchange can be useful and are a form of documentary evidence of an obligation.

Consignment accounting is used in the context of consignment in which the goods are sent by one person (consignor) and are sold by another person (consignee) on the consignor's behalf. The consignee is usually commissioned on sales. The cost expenses, the sales, commission and unsold stock are recorded by the consignor to find out the profits or losses on consignment. These accounting procedures ensure proper documentation of sales made via a third party.

Branch and Partnership Accounting.

The accounting for various branches or operating units of an organisation is called branch accounting. This helps the business identify the performance of each branch and gives them control over branch transactions. The maintenance of branch accounts is allowed to be kept based on the nature and requirements of the organization.

Partnership accounting is related to the accounting transactions of a partnership firm which is established by two or more persons and they agree to share the profits and losses of the partnership firm. Some important topics are partners capital accounts, current accounts, profit sharing, interest on capital and drawings, admission/retirement of partners, dissolution of the firm. In the case of partnerships, proper accounting procedures help in determining and distributing the profits accurately and keep the partners' transactions transparent.

Corporate Accounting

Corporate accounting deals with the accounting procedures and financial reporting requirements of companies. It includes articles of transactions on share capital, debentures, reserves, dividends and the preparation of the company's financial statements. The value of corporate accounting is that companies are legally distinct from their investors and follow their own legal and regulatory rules.

Key issues are issue and forfeiture of shares, redemption of preference shares, issue and redemption of debentures, financial statements and accounting for corporate restructuring. Good corporate accounting ensures transparency and accountability in company operations. It also offers helpful financial details to shareholders, investors, creditors, administration, regulatory authorities, and other stakeholders, to assess the company's financial performance and position.

Financial Accounting (Current Issues)

The field of financial accounting is constantly changing as technological, regulatory, economic and business environment changes. The digital revolution in accounting is one of the biggest challenges of the time. The use of cloud accounting, artificial intelligence, automation, blockchain, and data analytics is growing in the field

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of financial reporting, enhancing both the speed, accuracy, and efficiency of reporting. New challenges associated with cyber security, data privacy and skills for professional life are also introduced by these technologies. In addition, transparency, sustainability, and non-financial reporting are becoming more and more a focus. Organisations are supposed to supply data on environmental, social and governance (ESG) issues and also conventional financial information. Financial reporting needs to be consistent and comparable with changes in accounting standards and the growing globalisation. Financial accountants are thus required to keep themselves abreast of new technologies, accounting principles, regulatory rules, and business practice. Modern financial accounting is therefore becoming more integrated, recollective, transparent and decision oriented.

Conclusion

Financial accounting is a key system that records, classifies, summarises and communicates the financial activities of an organisation. It offers a framework for analyzing business performance and financial position. There are concepts and principles that keep consistency and reliability. Journal, ledger, Trial balance, subsidiary books and cash book are instrumental in systematic recording and classification of transactions.

Financial Accounting is further extended by areas like depreciation, inventory valuation, rectification of errors, final accounts, bills of exchange, consignment, branch accounting, partnership accounting and corporate accounting. These are used to ensure that organisations have accurate financial records and can create meaningful financial statements. Financial accounting is also on the verge of transformation in the current business landscape, thanks to digital technologies, automation, artificial intelligence, cloud computing, and evolving reporting needs. Thus, financial accounting is far from being a mere bookkeeping procedure. Important information system to support transparency and accountability, financial control and informed decision-making. It is crucial for the business to continue developing if it is to have a good business management.

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