For the students of

B.C.A, Sem: IInd

Name of Paper- ACCOUNTING AND FINANCIAL MANAGEMENT (Unit I and 2)

Prepared by: Mr. SAKSHAM KUMAR SRIVASTAVA

FINANCIAL ACCOUNTING AND ANALYSIS

INTRODUCTION:

Accounting is the language of business. Companies communicate their performance tooutsiders and evaluate the performance of their employees using information generated bytheaccountingsystem. Learning the language of accounting is essential for anyone that must make decisions based on financial information. Accounting is not an end in itself; it is a means to an end. It performs the service activity by providing quantitative financial information that helps the users in making better businessdecisions. Accounting also describes and analyses the mass of data of an enterprise through measurement, classification, and summarization, and reduces that data into reports and statements, which show the financial condition and results of operations of that enterprise. Accounting as an information system collects processes and communicates information about an enterprise to a wide variety of interested parties.

Definitions:

The American Accounting Association defines accounting as follows: "The process of identifying, measuring and communicating economic information to permit informed judgementsand decisions by users of theinformation."

American Institute of certified public Accountant defines accounting as "Accounting is an art of recording, classifying and summarizing in a significant manner and in terms of money, transaction and events which are, in part at least, of a financial character and interpreting the results thereof "

The purpose of financial accounting statements is mainly to show the financial position of a business at a particular point in time and to show how that business has performed over a specificperiod.

The three main financial accounting statements that help achieve this aim are:

(1) The profit and loss account (or income statement) for the reportingperiod
(2) Abalancesheetforthebusinessattheendofthereportingperiod

(3) A cash flow statement for the reportingperiod

A balance sheet shows at a particular point in time what resources are owned by a business (“assets”) and what it owes to other parties (“liabilities”). It also showshow much has been invested in the business and what the sources of that investment financewere.

Differences between Accounting and Book-Keeping:

Book keeping usually involves only the recording of businesstransactions (transactions) and is therefore, just one part of the accounting process. Accounting on the other hand, involvesthe entire accounting process, i.e. identification, measurement, recording, and communication. Now-a-days, much of the book keeping function is performed by the computer and othermachines.

Objectives of Accounting

The basic objective of accounting is to provide information to the interested users to enable them to make business decisions. The necessary information, particularly in the case of external users, is provided in the basic financial statements: Profit and loss statement and Balancesheet.

Besides the above sources of information, the internal users, officers and staff of the enterprise, can obtain additional information from the records of business. Thus the primaryobjectives of accounting can be statedas:

- Maintenance of Records of Businesstransactions.
- Calculation of Profit orLoss
- Depiction of FinancialPosition.
- Provide Information to theUsers

Maintenance of Records of Business:

First record, then pay; if there is an error, trace it fromthe records. Human memory is short. Even the most brilliant executive or manager cannot accuratelyrememberwhat hemighthaveobserved regarding the daily operations. He need not strain his memory unnecessarily, if proper and complete records of all business transactions are kept regularly. More-over, records can be used by different officials for different decision-makingpurposes.

Calculation of Profit or Loss:

Earning profit is the main purpose for which a business is carried on. This information is available from theprofit and loss statement. Profit is calculated by deducting expenses from the associated revenues. Profit is a measure of the performance of theenterprise.

Depiction of Financial Position

A balance sheet depicts the financial position of an enterprise. It is a statement of assets and liabilities. It shows the resources (assets) owned by an enterprise and depicts the claims (liabilities) against the resources. The balance of assets minus the external liabilities shows the capital (owner’sequity).

Provide Information to the Users

Generation of information is not an end initself.Itisameanstofacilitatethedisseminationofinformation among different user groups. Therefore, communicationof informationis the essential function ofaccounting.

Users of the Financial Statements

The most basic objective of financial accounting is preparation of generalpurpose financial statements, which are financial statements meant for use by stakeholders external to the entity, who do not have any other means of getting such information, i.e. people otherthan the management. These stakeholdersinclude

Investors and Financial Analysts:

Investors need the information to estimate the intrinsic value of the entity and to decide whether to buy, hold or sell the entity's shares. Equity researchanalysts use financial statements to conduct their research on earnings expectations and pricetargets.

Employee groups:

Employees and their representative groups are interestedin information about the solvency and profitability of their employers to decide about their careers, assess their bargaining power and set a target wage forthemselves.

Lenders:

Lenders are interested in information that enables them to determine whether their loans and the interest earned on them will be paid when due.

Suppliers and other trade creditors:

Suppliers and other creditors are interested in informationthatenablesthemtodeterminewhether amounts owing to them will be paid when due and whether the demand from the company is going to increase, decrease or stayconstant.

Customers:

Customers want to know whether their supplier is going to continue as an entity, especially when they have a long-term involvement with that supplier. For example, Apple is interested in long-term viability of Intel because Apple uses Intel processors in its computers and if Intel ceases operations at once, Apple will suffer difficulties in meeting its own demand and will loserevenue.

Governments and their agencies:

Governments and their agencies are interested in financial accounting information for a range of purposes. For example, the tax collecting authorities are interested in calculating taxable income of the tax-paying entities and finding their tax payable. The governments themselves are interested in efficient allocation of resources and they need financial accounting information of different sectors and industries to decide on federal and state budget allocation, etc. The bureaus of statistics are interested in calculating national income, employment and othermeasures.

Public:

The public is interested in an entity’s contribution towards the communitiesin which itoperates, its corporate socialresponsibilityupdates,itsenvironmentaltrackrecord,etc.

The AccountingCycle:

There are ten basic steps to the accounting cycle.

1. Collect SourceDocuments:

The very first step in the accounting cycle is to gather all the documents that are related tofinancial transactionsof the organization. These documents, called source documents, are things like receipts, bank statements, checks and purchase orders. They arethe items that describe what a transaction wasfor.

2. AnalyzeTransactions:

The second step in the accounting cycle is to analyze sourcedocuments. The purposeof this is to look them over and then decide what effect they have had on companyaccounts.

3. JournalizeTransactions:

The third step in the accounting cycle is to post entries into the journal for the analyzed transactions. A journal is the book or electronic record that documents all the financial transactions of a company and the accounts that are affected by each transaction. When a journal entry is made, the 'double-entry' rule is used. This means that for every one transaction, at least two accounts are affected. There must be adebit and a credit for each transaction, and the total of debits and credits must equal the amount of the transaction. Journal entries are entered in chronological order, and debits are entered beforecredits.

4. **PostTransactions:**

The fourth stepin the accounting cycle is to transfer information from the journal to the ledger. A ledger is a book or an electronic record of all the accounts that a company has. These accounts are brokendown by account number and class. When the information from the journal is transferred to the ledger, it is transferred to each account that was affected by a transaction.

5. **Prepare an Unadjusted TrialBalance:**

A trial balance is a list of all the company's accounts and their balance at the time that the trial balance is prepared. An unadjusted trial balance is a trial balance that is prepared before adjusting entries are made into accounts. This information comes directly from the ledger. The total debit balance and totalcredit balance must beequal.

6. **Prepare AdjustingEntries:**

Adjusting entries are entries that are made in the journal and posted in the ledger. The purpose ofthese entries is to bring account balances to the proper amounts. Not all accounts will have an adjusting entry. Adjusting entries are made at the end of the accounting period, but not the end of the accountingcycle.

7. **Prepare TrialBalance:**

Remember, the trial balance is a list of all accounts and their balances after adjustments havebeen made. This trial balance is prepared to check and make sure that the debitsand credits equal after adjusting entries are made. It is used to prepare the financialstatements.

8. **Prepare FinancialStatements:**

These are prepared in a specific order because information from one financial statement is often used in preparing another financial statement. The order that the financial statements need to be prepared is:

a) **Income Statement -** This statement measures how well a company is performing financially during a specific time period. If the company made money, then ithad a net profit. If itlost money, then it had a netloss.

b) **Balance Sheet-** A balance sheet also known as thestatement of financial position tells about the assets, liabilities and equity of a business at a specific point of time. It isa snapshot of a business. A balance sheet is an extended formof the accounting equation. An accounting equationis:

Assets = Liabilities + Equity

Assets are the resources controlled by a business, equity is the obligation of the companyto its owners and liabilities are the obligations of parties other thanowners.

c) **Statement of Cash Flows -** A statement of cash flows is a financial statement which summarizes cash transactions of a business during a given accounting period and classifies them under three heads, namely, cash flows from operating, investing and financing activities. It shows how cash moved during the period by indicating whether a particular line item is a cash in-flow or cashout-flow.

9. **ClosingEntries:**

Closing entries are journal entries made at the end of an accounting period which transfer the balances of temporary accounts to permanent accounts. Closing entries are based on the account balancesin an adjusted trialbalance.

Temporary accounts include:

Revenue, Income and Gain Accounts

Expense and Loss Accounts

Dividend, Drawings or Withdrawals Accounts

Income Summary Account

The permanent account to which balances are transferred depend upon the type of business. In case of a company, retained earnings account, and in case of a firm or a sole proprietorship, owner's capital account receives the balances of temporary accounts.

10. Post-Closing TrialBalance:

A post-closing trial balance is a list of balances ofledger accounts prepared after closing entries have been passed and posted to the ledger accounts. Since the closing entries transfer the balances of temporary accounts (i.e. expense, revenue, gain, dividend and withdrawal accounts) to the retained earnings account, the new balances of temporary accounts are zero and therefore they are not listed on a post-closing trial balance. However, all the other accounts having non-negative balances are listed including the retained earningsaccount.

The preparation of post-closing trial balance is the last step of the accounting cycle and its purpose is to be sure that sum of debits equal the sum of credits before the start of new accounting period. It provides the openings balancesfor the ledger accounts of the new accountingperiod.