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CORE CONCEPT OF

FINANCIAL ACCOUNTING

1. What is accounting? Briefly explain.
2. Point out the objective of accounting?
3. What do you understand by creditors & investors? Please explain.
4. Illustrate the advantages of accounting?
5. What are owners?
6. Point out the users of accounting.
7. What do you mean by firm?
8. Briefly illustrate the limitations of accounting?
9. Define financial accounting and point out its concept.

Accounting as Science or Art

Science is a systematized body of knowledge. It establishes a relationship of cause and effect in the various related phenomenon. It is also based on some fundamental principles. Accounting has its own principles e.g. the double entry system, which explains that every transaction has two fold aspect i.e. debit and credit. It also lays down rules of journalizing. So we can say that accounting is a science.

Art requires a perfect knowledge, interest and experience to do a work efficiently. Art also teaches us how to do a work in the best possible way by making the best use of the available resources. Accounting is an art as it also requires knowledge, interest and experience to maintain the books of accounts in a systematic manner. Everybody cannot become a good accountant. It can be concluded from the above discussion that accounting is an art as well as a science

Objective of Accounting

i) To keeping systematic record: It is very difficult to remember all the business transactions that take place. Accounting serves this purpose of record keeping by promptly recording all the business transactions in the books of account.

ii) To ascertain the results of the operation: Accounting helps in ascertaining result i.e., profit earned or loss suffered in business during a particular period. For this purpose, a business entity prepares either a Trading and Profit

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and Loss account or an Income and Expenditure account which shows the profit or loss of the business by matching the items of revenue and expenditure of the some period.

iii) To ascertain the financial position of the business: In addition to profit, a businessman must know his financial position i.e., availability of cash, position of assets and liabilities etc. This helps the businessman to know his financial strength. Financial statements are barometers of health of a business entity.

iv) To portray the liquidity position: Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital transactions, cash dividends and other distributions of resources by the enterprise to owners and about other factors that may affect an enterprise's liquidity and solvency.

v) To protect business properties: Accounting provides up to date information about the various assets that the firm possesses and the liabilities the firm owes, so that nobody can claim a payment which is not due to him.

vi) To facilitate rational decision – making: Accounting records and financial statements provide financial information which help the business in making rational decisions about the steps to be taken in respect of various aspects of business.

vii) To satisfy the requirements of law: Entities such as companies, societies, public trusts are compulsorily required to maintain accounts as per the law governing their operations such as the Companies Act, Societies Act, and Public Trust Act etc. Maintenance of accounts is also compulsory under the Sales Tax Act and Income Tax Act.

Advantages of Accounting

i) It helps in having complete record of business transactions.

ii) It gives information about the profit or loss made by the business at the close of a year and its financial conditions. The basic function of accounting is to supply meaningful information about the financial activities of the business to the owners and the managers.

iii) It provides useful information form making economic decisions.

iv) It facilitates comparative study of current year's profit, sales, expenses etc., with those of the previous years.

v) It supplies information useful in judging the management's ability to utilise enterprise resources effectively in achieving primary enterprise goals.

vi) It provides users with factual and interpretive information about transactions and other events which are useful for predicting, comparing and evaluation the enterprise's earning power.

vii) It helps in complying with certain legal formalities like filing of income-tax and sales-tax returns. If the accounts are properly maintained, the assessment of taxes is greatly facilitated.

Limitation of Accounting

i) Accounting is historical in nature: It does not reflect the current financial position or worth of a business.

ii) Transactions of non-monetary mature do not find place in accounting. Accounting is limited to monetary

iii) transactions only. It excludes qualitative elements like management, reputation, employee morale, labour strike etc.

iv) Facts recorded in financial statements are greatly influenced by accounting conventions and personal judgements of the Accountant or Management. Valuation of inventory, provision for doubtful debts and assumption about useful life of an asset may, therefore, differ from one business house to another.

v) Accounting principles are not static or unchanging-alternative accounting procedures are often equally acceptable. Therefore, accounting statements do not always present comparable data.

vi) Cost concept is found in accounting. Price changes are not considered. Money value is bound to change often from time to time. This is a strong limitation of accounting.

vii) Accounting statements do not show the impact of inflation.

viii) The accounting statements do not reflect those increase in net asset values that are not considered realized.

Users of Accounting

i) Owners: The owners provide funds or capital for the organization. A business is done with the objective of making profit. Its profitability and financial soundness are therefore, matters of prime importance to the owner who have invested their money in the business they only want to know the profit and loss and also want to expend their business

ii) Management: The management of the business is greatly interested in knowing the position of the firm. The accounts are the basis, the management can study the merits and demerits of the business activity. Thus, the management is interested in financial accounting to find whether the business carried on is profitable or not. The financial accounting is the "eyes and ears of management and facilitates in drawing future course of action, further expansion etc."

iv) Employees: Payment of bonus depends upon the size of profit earned by the firm. The more important point is that the workers expect regular income for the bread. The demand for wage rise, bonus, better working conditions etc. depend upon the profitability of the firm and in turn depends upon financial position. For these reasons, this group is interested in accounting.

iii) Creditors: Creditors are the persons who supply goods on credit, or bankers or lenders of money. It is usual that these groups are interested to know the financial soundness before granting credit. The progress and prosperity of the firm, two which credits are extended, are largely watched by creditors from the point of view of security and further credit.

v) Investors: The prospective investors, who want to invest their money in a firm, of course wish to see the progress and prosperity of the firm, before investing their amount, by going through the financial statements of the firm. This is to safeguard the investment.

vi) Government: Government keeps a close watch on the firms which yield good amount of profits. The state and central Governments are interested in the financial statements to know the earnings for the purpose of taxation.

vii) Consumers: These groups are interested in getting the goods at reduced price. Therefore, they wish to know the establishment of a proper accounting control, which in turn will reduce to cost of production, in turn less price to be paid by the consumers.

viii) Research Scholars: Accounting information, being a mirror of the financial performance of a business organization the researcher use the financial information for analysis and interpreting the financial statement of the concern