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SUBJECT- FINANCIAL ACCOUNTING

PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements begins with analysis of transactions. are broadly defined as events that have an economic impact on the business. Examples include sale of merchandise, purchase of inventory and paying of salaries and utilities. Because a typical business will experience thousands of transactions in a year, a system is needed to track them. The system most commonly used consists of a general journal and a ledger of accounts.

The basic component of this system is the account. There is a separate account for every asset, liability, owner equity, revenue, and expense that appears on the financial statements. For example, there are cash accounts, accounts payable accounts, retained earnings accounts, cash sales accounts, credit sales accounts, rent expense accounts, and salary expense accounts. The account is simply a central place used to collect relevant information about all transactions that affect a particular item on the financial statements. For example, all transactions that affect cash would be recorded in the

Cash account. Accounts may be kept in several physical forms. Early on, they were kept as pages in a loose-leaf folder or notebook. More recently, accounts have been kept as computer files.

Accounts are kept in a ledger of accounts. They appear in the ledger in the same order that they appear on the financial statements, as follows – current assets, non-current assets, current liabilities, non-current liabilities, owner's equity, revenues and expenses.

The general journal is a chronologic listing of transactions. As transactions occur, they are journalised, or recorded in the journal. Later, they are posted to the proper accounts in the ledger.

In recording transactions, businesses need a system that ensures that assets always equal the sum of liabilities and owner's equity and that can be used to detect and minimize errors. The system used is called the system of debits and credits.