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SUBJECT- FINANCIAL ACCOUNTING

TYPES OF ACCOUNTING

The Financial literature classifies accounting into two broad categories, viz, Financial Accounting and Management Accounting. Financial accounting is primarily concerned with the preparation of financial statements where as management accounting covers areas such as interpretation of financial statements, cost accounting etc. Both these types of accounting are examined in the following paragraphs.

* ## Financial Accounting:

As mentioned earlier, financial accounting deals with the preparation of financial statements for the basic purpose of providing information to various interested groups like creditors, banks, shareholders, financial institutions, government, consumers etc. Financial statements, i.e. the income statement and the balance sheet indicate the way in which the activities of the business have been conducted during a given period of time.

Financial accounting is charged with the primary responsibility of external reporting. The users of information generated by financial

accounting like bankers, financial institutions, regulatory authorities, government, investors, etc. want the accounting information to be consistent so as to facilitate comparison. Therefore financial accounting is based on certain concepts and conventions which include separate business entity, going concern concept, money measurement concept, cost concept, dual aspect concept and conventions of conservatism, disclosure, consistency, etc.

The significance of Financial accounting lies in the fact that it aids the management in directing and controlling the activities of the firm and to frame relevant managerial policies related to areas like production, sales, financing, etc. However it suffers from certain drawbacks which are discussed in the following paragraphs.

- The information provided by financial accounting is consolidated in nature. It does not indicate a break-up for different departments, processes, products and jobs. As such, it becomes difficult to evaluate the performance of different sub-units of the organisation.

- Financial accounting does not help in knowing the cost behaviour as it does not distinguish between fixed and variable costs.

- The information provided by financial accounting is historical in nature and as such the predictability of such information is limited.

The management of a company has to solve certain ticklish questions like expansion of business, making or buying a component, adding or deleting a product line, deciding on alternative methods of production, etc. The financial accounting information is of little help in answering these questions.

The limitation of financial accounting, however should not lead one to believe that it is of no use. It is the basic foundation on which other branches and tools of accounting analysis are based. It is the source of information, which can be further analysed and interpreted according to the tailor-made requirements of decision-makers.

* Management Accounting :

Management accounting is 'tailor-made' accounting. It facilitates the management by providing accounting information in such a way so that it is conducive for policy making and running the day to day operations of the business. Its basic purpose is to communicate the facts according to the specific needs of decision-makers by presenting the information in a systematic and meaningful manner. Management accounting, therefore, specifically helps in planning and control. It helps in setting standards and in case of variances between planned and actual performance. It helps in deciding the corrective action.

An important characteristic of management accounting is that it is forward looking. Its basic focus is one future activity to be performed and not what has already happened in the past.

Since management accounting caters to the specific decision needs, it doesnot rest upon any well-defined and set principles. The reports generated by a management accountant can be of any duration - short or long, depending upon purpose. Further, the reports can be prepared for the organisation as a whole as well as its segments.

* Cost Accounting:

One important variant of management accounting is the cost analysis. Cost accounting makes elaborate cost records regarding various products, operations and functions. It is the process of determining and accumulating the cost of a particular product or activity. Any product, function, job or process for which cost are determined and accumulated, are called cost centres.

The basic purpose of cost accounting is to provide a detailed break-up of cost of different departments, process, jobs, products, sales, territories etc. so that effective cost control can be exercised.

Cost accounting also helps in making revenue decisions such as those related to pricing, product-mix, profit volume

- decisions, expansion of business, replacement decisions, etc.

The objective of cost accounting, therefore can be summarized in the form of three important statements, viz, to determine costs, to facilitate planning and control of business activities and to supply information for short-and long term decision. Cost accounting has contain distinct advantages over financial accounting. Some of them have been discussed succeedingly. The cost accounting system provides data about profitable and non-profitable products and activities, thus prompting corrective measures. It is easier to segregate and analyse individual cost items and to minimize losses and wastages arising from the manufacturing process. Production methods can be varied so as to minimize cost and increase profits. Cost accounting helps in making realistic pricing decisions in times of low demand, competitive conditions, technology changes, etc.

Various alternative courses of action can be properly evaluated with the help of data generated by cost accounting. It would not be an exaggeration if it is said that a cost accounting system ensures maximum utilization of physical and human resources.

It checks frauds and manipulations and directs the employer and employees towards achieving the organisational goals.