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Financial Accounting

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Introduction

Financial Accounting is a type of accounting which deals with preparing, classifying, summarising, analysing and explaining the financial operations of a business. The main purpose of these accounting principles is to provide information to creditors, investors, shareholders, bankers, and tax authorities accordingly. It deals with preparing financial data related to equity, capital, asset, liability, income and expense accounts. Financial Accounting is followed by the principles of GAAP (Generally Accepted Accounting Principles) which is declared by ICAI (Institute of Chartered Accountants of India) and under the Indian Companies Act, 1956. GAAP is used by an accountant to prepare financial statements according to the rules, standards and guidelines.

Golden Rules of Accounting

Financial Accounting relates to a double entry system in which every financial transaction has both debit and credit. For the purpose of identifying the debit and credit accounts, three golden rules of accounting exist. Their rules are based on three different accounts, namely Personal A/C, Real A/C and Nominal A/C which are briefly explained below.

***Personal Account**: It relates to real or artificial persons like any individual, supplier, customer, company, bank, firm etc. The rule of Personal Account is **Debit the Receiver, Credit the Giver.**

***Real Account**: It relates to tangible and intangible assets like cash, land, building, plant and machinery, furniture, trademarks, goodwill, brand, copyright etc. The rule of Real Account is **Debit What Comes In, Credit What Goes Out.**

***Nominal Account**: It relates to income, expense, profit and loss transactions like salary, rent, bank charges, discount, interest, insurance, dividend etc. The rule of Nominal Account is **Debit All Expenses and Losses, Credit All Incomes and Gains.**

Types of Financial Statements

In financial accounting, different types of financial statements are prepared to know the financial position of a business, which is detailed as follows.

****Balance Sheet:*** A balance sheet is a financial statement used to assess the financial condition of a business for a particular period of time. It comprises assets, liabilities and equity for every financial year and its calculation is based on Total assets = Total Liabilities + Total Equity. The purpose of the balance sheet is to ascertain the financial ability, liquidity and profitability of a business.

****Income Statements:*** This financial statement supports generating the details of revenue, expenses, gains or losses of an organization. It has a detailed list of overall income and expenses for every financial year. Income statements generally deal with income from sales, profit and loss accounts, statutory payments, operating and other expenses.

****Cash Flow Statements:*** As the name of the statement tells you, this financial statement deals with cash inflow and cash outflow. Cash flow happens from business transactions which deal with operating, financing and investing activities. A simple formula to understand and access net cash flow in a business is Net Cash Flow = Total Cash Inflows - Total Cash Outflows.

****Equity Statements:*** Equity refers to the owners or shareholders investment in a business, including retained earnings. A statement of equity is generally prepared at the end of a financial year along with the overall financial documents. This is to show the changes in the company's financial condition for a regular period of time.

Thank you and best wishes for your future endeavors.

Reference

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