Medical Accounting

- **Fee for Service vs Value Based Care Payment Models**
  Fee for Service vs Value Based Care Payment Models How HCC Coding Affects Risk Adjustment Scores DRGs and Their Role in Hospital Reimbursement Medicare Advantage and Risk Adjustment Strategies Addressing Disparities in Reimbursement Rates Understanding ESRD Risk Adjustment Models The Impact of Chronic Conditions on Reimbursement Optimizing Documentation for Risk Adjustment Challenges in Bundled Payment Models Auditing Risk Adjustment Coding Accuracy State Variations in Medicaid Reimbursement Future of Reimbursement in Telehealth Services
- **Improving Charge Capture Processes in Healthcare**
  Improving Charge Capture Processes in Healthcare Reducing Denial Rates Through Better Documentation Automating Claim Submission for Faster Payments Strategies for Efficient Payment Posting Managing Denials Due to Prior Authorization Using Analytics to Track Revenue Cycle Performance Training Teams for Revenue Cycle Efficiency Addressing Coding Errors in Claim Denials Streamlining Patient Registration Workflows The Role of Clearinghouses in Revenue Cycle Balancing Cost Control and Revenue Growth Case Studies in Revenue Cycle Turnaround
- **About Us**

risk adjustment scores play a pivotal role in ensuring that healthcare providers receive appropriate compensation for the care of patients with varying degrees of health complexity. Medical staffing ensures balanced workloads among healthcare professionals **medical assistant staffing agency** balance sheet. At the heart of this system lies HCC coding, which is instrumental in calculating risk adjustment scores.

HCC coding is a method used to categorize patients based on their medical conditions and expected healthcare costs. Essentially, it involves assigning codes to specific diagnoses that reflect the severity and chronicity of a patient's conditions. This coding system was developed to standardize the way patient health status is reported, ultimately influencing how insurance plans predict future healthcare expenses.

The impact of HCC coding on risk adjustment scores cannot be understated. These scores are crucial because they determine reimbursement rates from Medicare Advantage plans and other insurance programs. By accurately capturing a patient's health status through HCC codes, healthcare providers can ensure they receive fair compensation for managing complex cases. This process mitigates financial risks associated with treating patients who have multiple or severe chronic illnesses.

Effective HCC coding requires meticulous accuracy and thorough documentation. Medical coders need to be well-versed in identifying relevant diagnoses from patient records and translating them into standardized codes that align with the HCC model. Each condition captured by an HCC code contributes to a cumulative risk score, which reflects the predicted cost of care for that patient over a specific period.

One significant aspect of HCC coding's influence on risk adjustment scores is its ability to promote equitable resource allocation within healthcare systems. By acknowledging the higher costs associated with treating sicker patients, this system encourages providers to focus on delivering comprehensive care without being financially penalized for taking on high-risk individuals.

Moreover, accurate HCC coding helps prevent potential fraud or abuse within healthcare reimbursement systems by ensuring that payments are aligned with actual patient needs rather than inflated or inaccurate claims. This transparency fosters trust between insurers and providers while safeguarding resources intended for those who genuinely require extensive medical intervention.

In conclusion, understanding how HCC coding affects risk adjustment scores underscores its critical importance in modern medical billing practices. By accurately representing patient health complexities through standardized codes, healthcare providers can secure appropriate reimbursement levels that reflect their efforts in managing diverse patient populations. As such, mastering this aspect of medical coding not only ensures financial sustainability but also promotes better outcomes by encouraging comprehensive care for those who need it most.

The intricate relationship between Hierarchical Condition Category (HCC) coding and risk adjustment is a pivotal element in the realm of healthcare reimbursement and management. As healthcare systems strive for efficiency and accuracy, understanding how HCC coding affects risk adjustment scores becomes crucial for providers, payers, and policymakers alike.

At its core, HCC coding is a method used to categorize patients based on their medical conditions, thereby enabling more accurate predictions of future healthcare costs. This system was developed by the Centers for Medicare & Medicaid Services (CMS) to ensure that payments to health plans reflect the expected costs associated with individual patient care needs. By identifying specific diagnoses through ICD-10 codes, HCCs help create a comprehensive picture of a patient's health status.

Risk adjustment is the process by which insurers adjust payments to healthcare plans based on the relative health status and expected costs of enrollees. The goal is to prevent adverse selection-where insurers might otherwise avoid high-risk individuals-and to promote equitable resource distribution. Accurate risk adjustment ensures that health plans have adequate funds to cover their members' anticipated medical expenses without disproportionately burdening those with complex or chronic conditions.

HCC coding plays an instrumental role in this process. Each diagnosed condition mapped through HCC contributes to an individual's overall risk score-a numerical representation of their predicted healthcare needs compared to an average beneficiary. Higher scores typically indicate higher expected healthcare utilization and thus result in increased reimbursement rates for plans managing such patients.

However, achieving precise risk scores hinges on meticulous documentation and accurate HCC coding practices. Incomplete or inaccurate coding can lead to misrepresentation of patient acuity levels, subsequently impacting risk adjustment calculations. Under-coding may result in lower-than-needed reimbursement rates, leaving providers with insufficient resources to manage care effectively. Conversely, over-coding can raise ethical concerns regarding

potential financial gain from inflated risk scores.

To optimize outcomes within this framework, it is imperative for healthcare organizations to invest in robust training programs for coders and clinicians alike. Ensuring comprehensive understanding of both clinical documentation requirements and the nuances of HCC categorization fosters precision in capturing all relevant patient conditions.

Moreover, technology plays a significant role in enhancing accuracy and efficiency in this domain. Advanced analytics tools can assist in identifying gaps or inconsistencies within medical records that may affect HCC capture rates. Additionally, implementing electronic health record (EHR) systems equipped with decision-support capabilities helps streamline the documentation process while minimizing human error.

In summary, the interplay between HCC coding and risk adjustment underscores a fundamental aspect of modern healthcare finance-one that requires vigilance, expertise, and collaboration across multiple stakeholders. By refining our approaches towards accurate diagnosis capture through effective coding practices and leveraging technological advancements, we can better align payment models with patient needs while fostering sustainable delivery systems capable of providing high-quality care for all individuals regardless of their health status complexity.

Impact of Fee for Service on Medical Coding Practices

In the intricate landscape of healthcare, accurate coding plays a pivotal role in determining risk adjustment scores, which are essential for resource allocation and financial reimbursement. Hierarchical Condition Category (HCC) coding stands as a cornerstone in this process, directly influencing how patient risk profiles are assessed and, consequently, how care is managed. The precision with which HCC coding is executed has profound implications for both health providers and patients.

HCC coding involves categorizing patients' chronic conditions into distinct groups that predict future healthcare costs. These codes encapsulate the severity and complexity of a patient's health status, providing a comprehensive picture that aids insurance companies in setting premiums and allocating funds appropriately. Accurate HCC coding ensures that all relevant conditions are captured systematically, thereby reflecting the true risk level associated with an individual patient's health.

The impact of precise HCC coding on risk adjustment scores cannot be overstated. When codes accurately reflect a patient's health status, it leads to appropriate risk scores that influence reimbursement rates under Medicare Advantage plans and other similar programs. This accuracy ensures that healthcare providers receive fair compensation for their services based on the predicted cost of care required by their patient population.

Conversely, inaccurate or incomplete HCC coding can distort these critical risk scores. Under-coding may result in lower reimbursement rates than what is necessary to cover the cost of treating complex patients, potentially leading to resource constraints within healthcare facilities. Over-coding or misrepresentation can lead to inflated payments but also increases scrutiny from regulators and auditors who aim to prevent fraud and abuse in the system.

Moreover, accurate HCC coding extends beyond financial implications; it significantly affects patient care management. By ensuring that all conditions are documented correctly, healthcare providers can better strategize treatment plans tailored to individual needs. This enables proactive management of chronic diseases, improving overall patient outcomes through targeted interventions.

To maintain accuracy in HCC coding, continuous education and training for coders are imperative. Staying updated with changes in coding guidelines and practices helps mitigate errors and enhances the reliability of data used for calculating risk scores. Moreover, leveraging advanced technologies like electronic health records (EHRs) with integrated decision-support systems can streamline the documentation process, making it more efficient while reducing human error.

In conclusion, accurate HCC coding is integral to generating valid risk adjustment scores that reflect true patient needs and ensure equitable financial distribution across healthcare settings. Its impact reverberates through every facet of healthcare delivery-affecting provider revenue streams while simultaneously shaping strategies for personalized patient care. As such, prioritizing precision in this domain not only supports fiscal sustainability but also promotes higher standards of clinical excellence and improved health outcomes for patients nationwide.

How Value Based Care Influences Medical Coding and Documentation Requirements

Hierarchical Condition Category (HCC) coding is a critical component in the healthcare industry, particularly when it comes to determining risk adjustment scores. These scores are essential for accurately predicting patient care costs and ensuring appropriate reimbursement levels under value-based payment models. However, implementing effective HCC coding practices poses several challenges that can significantly impact these risk adjustment scores.

One of the primary challenges is the complexity of HCC coding itself. The system involves a comprehensive list of diagnosis codes that map to various conditions, each with its own weight influencing the overall risk score. Coders must possess a deep understanding of both the medical conditions and the coding guidelines to ensure accuracy. This complexity requires ongoing education and training for coders to remain current with updates and changes in regulations.

Another significant challenge is documentation quality. Accurate HCC coding heavily relies on detailed and precise clinical documentation from healthcare providers. Incomplete or vague records can lead to missed diagnoses, resulting in incorrect or lower risk scores. Providers often face time constraints that hinder thorough documentation, which necessitates initiatives aimed at improving documentation practices through better workflows or technologies like electronic health records (EHRs).

Moreover, there is an inherent challenge in maintaining consistency across different healthcare settings and among individual coders. Variability in interpretation of coding guidelines can lead to discrepancies in how conditions are reported, potentially affecting risk adjustment outcomes. This inconsistency underscores the need for standardized protocols and regular auditing processes to ensure uniform application of HCC codes.

In addition, regulatory changes pose another hurdle. The Centers for Medicare & Medicaid Services (CMS) periodically updates HCC models to reflect evolving medical knowledge and policy objectives. Keeping up with these changes requires significant effort from healthcare organizations to revise their internal procedures accordingly while ensuring compliance.

Finally, there's often limited resources allocated towards technology investments that could facilitate more accurate HCC coding practices. Advanced tools such as natural language processing (NLP) software can assist coders by automating parts of the process; however, budget constraints may limit access to such technologies.

In conclusion, while HCC coding plays a vital role in shaping risk adjustment scores-thereby impacting financial sustainability within healthcare organizations-the path to implementing effective practices is fraught with challenges related to complexity, documentation quality, consistency, regulatory adherence, and technology adoption. Addressing these issues requires a multifaceted approach that includes continuous training for coders, enhanced provider engagement on documentation standards, implementation of uniform protocols across systems, staying attuned to regulatory shifts-and where possible-investing in advanced technological solutions designed specifically for optimizing health information management processes.

Challenges and Benefits of Transitioning from Fee for Service to Value Based Care in Medical Coding

Hierarchical Condition Category (HCC) coding plays a pivotal role in determining risk adjustment scores, which are crucial for healthcare providers and insurers alike. These scores influence the allocation of resources, reimbursement rates, and ultimately, patient care quality. Therefore, improving HCC coding accuracy is paramount to ensuring fair compensation and appropriate resource distribution.

To understand the significance of HCC coding accuracy, one must first appreciate its impact on risk adjustment scores. The HCC model is designed to predict future healthcare costs by categorizing patients based on their health conditions. Accurate coding ensures that all relevant conditions are accounted for, leading to a more precise reflection of a patient's health status and expected costs. Inaccuracies in coding can lead to skewed risk adjustment scores, resulting in either overpayment or underpayment for services rendered.

One effective strategy for improving HCC coding accuracy is comprehensive training programs for coders. Coders need to be well-versed in the latest guidelines and updates within the medical coding landscape. Regular workshops and certification courses can keep them updated on new codes and changes in existing ones. This continuous education helps maintain high standards of precision and consistency across different cases.

Another approach is leveraging technology through advanced software solutions that assist in identifying applicable codes based on clinical documentation. Such tools use algorithms to suggest potential codes that coders might overlook manually. However, while technology aids accuracy, human oversight remains essential to ensure context-specific application of these codes.

Collaboration between physicians and coders also enhances accuracy significantly. Encouraging open lines of communication allows coders to verify ambiguous entries directly with healthcare providers. Physicians should provide detailed documentation that clearly outlines all diagnoses, treatments, and pertinent patient history to support accurate code assignment.

Furthermore, implementing regular audits serves as both a corrective and preventive measure against inaccuracies in HCC coding. Audits can identify patterns of errors or misinterpretations among coders, enabling targeted interventions such as additional training or process adjustments.

Lastly, fostering an organizational culture that prioritizes compliance and ethical practices can sustain long-term improvements in coding accuracy. When everyone from administrators to frontline staff understands the importance of precise HCC coding and its implications for patient care funding, it encourages adherence to best practices consistently across the board.

In conclusion, enhancing HCC coding accuracy requires a multifaceted approach involving education, technology integration, collaboration between healthcare professionals, regular audits, and a strong organizational commitment to ethical standards. By refining these strategies continuously, healthcare organizations can ensure more equitable resource distribution through accurate risk adjustment scores-benefiting both providers and patients alike.

Case Studies Highlighting the Effects of Different Payment Models on Medical Coding

Efficiency

The integration of technology and data analytics in the realm of healthcare has been transformative, particularly in the area of Hierarchical Condition Category (HCC) coding. This evolution is central to understanding how HCC coding affects risk adjustment scores, which are pivotal in determining reimbursement rates for Medicare Advantage plans. As healthcare continues to transition into a more data-driven domain, the role of technology and analytics becomes increasingly significant.

HCC coding plays a vital role in providing an accurate representation of a patient's health status by capturing all relevant diagnoses. These codes are directly linked to risk adjustment scores, which are used to predict future healthcare costs for individuals enrolled in Medicare Advantage plans. The precision of these codes is crucial; inaccuracies can lead to either overestimation or underestimation of a patient's health risks, significantly impacting the financial dynamics between healthcare providers and payers.

Traditionally, HCC coding was a manual process prone to human error. Coders sifted through medical records to identify conditions that qualified for HCCs, often relying on their judgment and expertise. However, this method posed numerous challenges including missed codes due to oversight or misunderstanding complex clinical information. This is where technology and data analytics emerge as game-changers.

Advanced technologies such as machine learning algorithms and natural language processing (NLP) have revolutionized HCC coding by automating the extraction and analysis of data from electronic health records (EHRs). These tools enhance accuracy by systematically identifying potential conditions that might have been overlooked manually. Machine learning models can be trained on vast datasets to recognize patterns indicative of specific health conditions reflective in HCCs, thereby improving detection rates.

Moreover, predictive analytics play an essential part in refining risk adjustment scores through enhanced forecasting abilities. By analyzing historical patient data alongside current medical information, sophisticated analytical tools can predict future healthcare needs with greater accuracy than ever before. This capability ensures that risk scores are more reflective of

actual patient risk profiles, allowing for fairer resource allocation and reimbursement practices.

In addition to improving accuracy, technology also streamlines the workflow associated with HCC coding. Automated systems reduce the time spent on manual data entry and code selection processes, allowing healthcare professionals to focus more on patient care rather than administrative tasks. Furthermore, these technologies provide real-time feedback and insights into coding practices which help continually refine processes ensuring compliance with updated regulations.

Data analytics also contributes significantly towards enhancing transparency and accountability within HCC coding frameworks. By providing detailed reports on coding trends and discrepancies across different departments or facilities within an organization, stakeholders can identify areas needing improvement while maintaining adherence to best practices.

In conclusion, the infusion of technology and data analytics into HCC coding processes profoundly enhances how risk adjustment scores are calculated-leading to improved precision in capturing patients' health complexities accurately reflected through their respective scores. As this technological evolution continues unabatedly within healthcare settings globally-it not only promises increased efficiency but also heralds better alignment between care delivery outcomes aligned closely with financial sustainability goals-ultimately benefiting both providers & patients alike through equitable access & quality-driven care initiatives supported robustly via advanced analytic capabilities integrated seamlessly across diverse practice environments today!

About financial statement analysis

Not to be confused with Financial analysis.

- v
- t
- e

Part of a series on

Accounting

Early 19th-century German ledger

Image not found or type unknown

- Constant purchasing power
- Historical cost
- Management
- Tax

Major types

- Audit
- Budget
- Cost
- Forensic
- Financial
- Fund
- Governmental
- Management
- Social
- Tax

Key concepts

- Accounting period
- Accrual
- Constant purchasing power
- Economic entity
- Fair value
- Going concern
- Historical cost
- Matching principle
- Materiality
- Revenue recognition
- Unit of account

Selected accounts
- Assets
- Cash
- Cost of goods sold
- Depreciation / Amortization (business)
- Equity
- Expenses
- Goodwill
- Liabilities
- Profit
- Revenue

Accounting standards
- Generally-accepted principles
- Generally-accepted auditing standards
- Convergence
- International Financial Reporting Standards
- International Standards on Auditing
- Management Accounting Principles

Financial statements
- Annual report
- Balance sheet
- Cash-flow
- Equity
- Income
- Management discussion
- Notes to the financial statements

Bookkeeping
- Bank reconciliation
- Debits and credits
- Double-entry system
- FIFO and LIFO
- Journal
- Ledger / General ledger
- Trial balance

Auditing
- Financial
- Internal
- Firms
- Report
- Sarbanes–Oxley Act

People and organizations
- Accountants
- Accounting organizations
- Luca Pacioli

Development
- History
- Research
- Positive accounting
- Sarbanes–Oxley Act

Misconduct
- Creative
- Earnings management
- Error account
- Hollywood
- Off-balance-sheet
- Two sets of books

Financial statement analysis (or just **financial analysis**) is the process of reviewing and analyzing a company's financial statements to make better economic decisions to earn income in future. These statements include the income statement, balance sheet, statement of cash flows, notes to accounts and a statement of changes in equity (if applicable). Financial statement analysis is a method or process involving specific techniques for evaluating risks, performance, valuation, financial health, and future prospects of an organization.[1]

It is used by a variety of stakeholders, such as credit and equity investors, the government, the public, and decision-makers within the organization. These stakeholders have different interests and apply a variety of different techniques to meet their needs. For example, equity investors are interested in the long-term earnings power of the organization and perhaps the sustainability and growth of dividend payments. Creditors want to ensure the interest and principal is paid on the organizations debt securities (e.g., bonds) when due.

Common methods of financial statement analysis include horizontal and vertical analysis and the use of financial ratios. Historical information combined with a series of assumptions and adjustments to the financial information may be used to project future performance. The Chartered Financial Analyst designation is available for professional financial analysts.

History

[edit]

Benjamin Graham and David Dodd first published their influential book "Security Analysis" in 1934.[2] [3] A central premise of their book is that the market's pricing mechanism for financial securities such as stocks and bonds is based upon faulty and irrational analytical processes performed by many market participants. This results in the market price of a security only occasionally coinciding with the intrinsic value around which the price tends to fluctuate.[4] Investor Warren Buffett is a well-known supporter of Graham and Dodd's philosophy.

The Graham and Dodd approach is referred to as Fundamental analysis and includes: 1) Economic analysis; 2) Industry analysis; and 3) Company analysis. The latter is the primary realm of financial statement analysis. On the basis of these three analyses the intrinsic value of the security is determined.[4]

Horizontal and vertical analysis

[edit]

Horizontal analysis compares financial information over time, typically from past quarters or years. Horizontal analysis is performed by comparing financial data from a past statement, such as the income statement. When comparing this past information one will want to look for variations such as higher or lower earnings.[5]

Vertical analysis is a percentage analysis of financial statements. Each line item listed in the financial statement is listed as the percentage of another line item. For example, on an income statement each line item will be listed as a percentage of gross sales. This technique is also referred to as normalization[6] or common-sizing.[5]

Financial ratio analysis

[edit]
Main article: Financial ratio

Financial ratios are very powerful tools to perform some quick analysis of financial statements. There are four main categories of ratios: liquidity ratios, profitability ratios, activity ratios and leverage ratios. These are typically analyzed over time and across competitors in an industry.

- *Liquidity ratios* are used to determine how quickly a company can turn its assets into cash if it experiences financial difficulties or bankruptcy. It essentially is a measure of a company's ability to remain in business. A few common liquidity ratios are the current ratio and the liquidity index. The current ratio is current assets/current liabilities and measures how much liquidity is available to pay for liabilities. The liquidity index shows how quickly a company can turn assets into cash and is calculated by: (Trade receivables x Days to liquidate) + (Inventory x Days to

liquidate)/Trade Receivables + Inventory.
- *Profitability ratios* are ratios that demonstrate how profitable a company is. A few popular profitability ratios are the breakeven point and gross profit ratio. The breakeven point calculates how much cash a company must generate to break even with their start up costs. The gross profit ratio is equal to gross profit/revenue. This ratio shows a quick snapshot of expected revenue.
- *Activity ratios* are meant to show how well management is managing the company's resources. Two common activity ratios are accounts payable turnover and accounts receivable turnover. These ratios demonstrate how long it takes for a company to pay off its accounts payable and how long it takes for a company to receive payments, respectively.
- *Leverage ratios* depict how much a company relies upon its debt to fund operations. A very common leverage ratio used for financial statement analysis is the debt-to-equity ratio. This ratio shows the extent to which management is willing to use debt in order to fund operations. This ratio is calculated as: (Long-term debt + Short-term debt + Leases)/ Equity.[7]

DuPont analysis uses several financial ratios that multiplied together equal return on equity, a measure of how much income the firm earns divided by the amount of funds invested (equity).

A Dividend discount model (DDM) may also be used to value a company's stock price based on the theory that its stock is worth the sum of all of its future dividend payments, discounted back to their present value.[8] In other words, it is used to value stocks based on the net present value of the future dividends.

Financial statement analyses are typically performed in spreadsheet software — or specialized accounting software — and summarized in a variety of formats.

Recasting financial statements

[edit]

An earnings recast is the act of amending and re-releasing a previously released earnings statement, with specified intent.[9]

Investors need to understand the ability of the company to generate profit. This, together with its rate of profit growth, relative to the amount of capital deployed and various other financial ratios, forms an important part of their analysis of the value of the company. Analysts may modify ("recast") the financial statements by adjusting the underlying assumptions to aid in this computation. For example, operating leases (treated like a rental transaction) may be recast as capital leases (indicating ownership), adding assets and liabilities to the balance sheet. This affects the financial statement ratios.[10]

Recasting is also known as normalizing accounts.[11]

Certifications

[edit]

Financial analysts typically have finance and accounting education at the undergraduate or graduate level. Persons may earn the Chartered Financial Analyst (CFA) designation through a series of challenging examinations. Upon completion of the three-part exam, CFAs are considered experts in areas like fundamentals of investing, the valuation of assets, portfolio management, and wealth planning.

See also

[edit]

- Business valuation
- Financial audit
- Financial statement
- DuPont analysis
- Data analysis

References

[edit]

1. **^** *White, Gerald I.; Sondhi, Ashwinpaul; Fried, Dov (1998). The Analysis and Use of Financial Statements. John Wiley & Sons, Inc. ISBN 0-471-11186-4.*
2. **^** New York Times, August 16, 1998 Gretchen Morgenson – Market Watch MARKET WATCH; A Time To Value Words of Wisdom“ … *Security Analysis* by Benjamin Graham and David Dodd, the 1934 bible for value investors.”
3. **^** New York Times, January 2, 2000 Business Section Humbling Lessons From Parties Past By BURTON G. MALKIEL “BENJAMIN GRAHAM, co-author of "Security Analysis," the 1934 bible of value investing, long ago put his finger on the most dangerous words in an investor's vocabulary: "This time is different." Burton G. Malkiel is an economics professor at Princeton University and the author of "A Random Walk Down Wall Street" (W.W. Norton).
4. ^ ***a b*** *Dodd, David; Graham, Benjamin (1998). Security Analysis. John Wiley & Sons, Inc. ISBN 0-07-013235-6.*
5. ^ ***a b*** *"Accountingtools.com - Financial Statement Analysis". Archived from the original on 2014-08-11. Retrieved 2014-08-01.*
6. **^** Perceptual Edge-Jonathan Koomey-Best practices for understanding quantitative data-February 14, 2006
7. **^** *Investopedia Staff (2010-08-12). "Financial Statement Analysis". Investopedia. Retrieved 2018-07-14.*
8. **^** *McClure, Ben (2004-04-12). "Digging Into The Dividend Discount Model". Investopedia. Retrieved 2018-07-14.*
9. **^** *"Earnings Recast".*
10. **^** *"Recasting". Archived from the original on 2020-01-21. Retrieved 2019-03-15.*

11. ^ *Schenck, Barbara Findlay; Davies, John (3 November 2008). Selling Your Business For Dummies. ISBN 9780470381892.*

External links

[edit]

- Investopedia
- Beginner's Guide to Financial Statements by SEC.gov

Associations

[edit]

- SFAF - French Society of Financial Analysts
- ACIIA - Association of Certified International Investment Analysts
- EFFAS - European Federation of Financial Analysts Societies

Authority control databases: National Image not found or type unknown **Germany** Image not found or type unknown **Edit this at Wikidata**

About financial accounting

This article **needs additional citations for verification**. Please help **improve this article** by **adding citations to reliable sources**. Unsourced material may be challenged and removed.
Find sources: **"Financial accounting"** – **news** · **newspapers** · **books** · **scholar** · **JSTOR** *(October 2007) (**Learn how and when to remove this message**)*

- **v**
- **t**
- **e**

Part of **a series** on

Accounting

Early 19th-century German ledger

Image not found or type unknown

- **Constant purchasing power**
- **Historical cost**
- **Management**
- **Tax**

Major types

- **Audit**
- **Budget**
- **Cost**
- **Forensic**
- **Financial**
- **Fund**
- **Governmental**
- **Management**
- **Social**
- **Tax**

Key concepts

- **Accounting period**
- **Accrual**
- **Constant purchasing power**
- **Economic entity**
- **Fair value**
- **Going concern**
- **Historical cost**
- **Matching principle**
- **Materiality**
- **Revenue recognition**
- **Unit of account**

Selected accounts

- **Assets**
- **Cash**
- **Cost of goods sold**
- **Depreciation** / **Amortization (business)**
- **Equity**
- **Expenses**
- **Goodwill**
- **Liabilities**
- **Profit**
- **Revenue**

Accounting standards

- **Generally-accepted principles**
- **Generally-accepted auditing standards**
- **Convergence**
- **International Financial Reporting Standards**
- **International Standards on Auditing**
- **Management Accounting Principles**

Financial statements
- **Annual report**
- **Balance sheet**
- **Cash-flow**
- **Equity**
- **Income**
- **Management discussion**
- **Notes to the financial statements**

Bookkeeping
- **Bank reconciliation**
- **Debits and credits**
- **Double-entry system**
- **FIFO and LIFO**
- **Journal**
- **Ledger** / **General ledger**
- **Trial balance**

Auditing
- **Financial**
- **Internal**
- **Firms**
- **Report**
- **Sarbanes–Oxley Act**

People and organizations
- **Accountants**
- **Accounting organizations**
- **Luca Pacioli**

Development
- **History**
- **Research**
- **Positive accounting**
- **Sarbanes–Oxley Act**

Misconduct
- **Creative**
- **Earnings management**
- **Error account**
- **Hollywood**
- **Off-balance-sheet**
- **Two sets of books**

Financial accounting is a branch of **accounting** concerned with the summary, analysis and reporting of financial transactions related to a business.**[1]** This involves the

preparation of **financial statements** available for public use. **Stockholders**, **suppliers**, **banks**, **employees**, **government agencies**, **business owners**, and other **stakeholders** are examples of people interested in receiving such information for decision making purposes.

Financial accountancy is governed by both local and international accounting standards. **Generally Accepted Accounting Principles** (GAAP) is the standard framework of guidelines for financial accounting used in any given jurisdiction. It includes the standards, conventions and rules that accountants follow in recording and summarizing and in the preparation of financial statements.

On the other hand, **International Financial Reporting Standards** (IFRS) is a set of accounting standards stating how particular types of transactions and other events should be reported in financial statements. IFRS are issued by the **International Accounting Standards Board** (IASB).**[2]** With IFRS becoming more widespread on the international scene, *consistency* in financial reporting has become more prevalent between global organizations.

While financial accounting is used to prepare accounting information for people outside the organization or not involved in the day-to-day running of the company, **managerial accounting** provides accounting information to help managers make decisions to manage the business.

Objectives

[**edit**]

Financial accounting and financial reporting are often used as synonyms.

1. According to International Financial Reporting Standards: the objective of financial reporting is:

> To provide financial information that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the reporting entity.**[3]**

2. According to the European Accounting Association:

> Capital maintenance is a competing objective of financial reporting.**[4]**

Financial accounting is the preparation of financial statements that can be consumed by the public and the relevant stakeholders. Financial information would be useful to users if such qualitative characteristics are present. When producing financial statements, the

following must comply: **Fundamental Qualitative Characteristics:**

- **Relevance:** Relevance is the capacity of the financial information to influence the decision of its users. The ingredients of relevance are the predictive value and confirmatory value. Materiality is a sub-quality of relevance. Information is considered material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.
- **Faithful Representation:** Faithful representation means that the actual effects of the transactions shall be properly accounted for and reported in the financial statements. The words and numbers must match what really happened in the transaction. The ingredients of faithful representation are completeness, neutrality and free from error. It signifies that the accountants have acted in **good faith** during the process of representation.

Enhancing Qualitative Characteristics:

- **Verifiability:** Verifiability implies consensus between the different knowledgeable and independent users of financial information. Such information must be supported by sufficient evidence to follow the principle of objectivity.
- **Comparability:** Comparability is the uniform application of accounting methods across entities in the same industry. The principle of consistency is under comparability. Consistency is the uniform application of accounting across points in time within an entity.
- **Understandability:** Understandability means that accounting reports should be expressed as clearly as possible and should be understood by those to whom the information is relevant.
- **Timeliness:** Timeliness implies that financial information must be presented to the users before a decision is to be made.

Three components of financial statements

[**edit**]

Statement of cash flows (cash flow statement)

[**edit**]

The statement of cash flows considers the inputs and outputs in concrete cash within a stated period. The general template of a cash flow statement is as follows: *Cash Inflow - Cash Outflow + Opening Balance = Closing Balance*

Example 1: in the beginning of September, Ellen started out with $5 in her bank account. During that same month, Ellen borrowed $20 from Tom. At the end of the month, Ellen bought a pair of shoes for $7. Ellen's cash flow statement for the month of September looks like this:

- Cash inflow: $20
- Cash outflow:$7
- Opening balance: $5
- **Closing balance: $20 – $7 + $5 = $18**

Example 2: in the beginning of June, WikiTables, a company that buys and resells tables, sold 2 tables. They'd originally bought the tables for $25 each, and sold them at a price of $50 per table. The first table was paid out in cash however the second one was bought in credit terms. WikiTables' cash flow statement for the month of June looks like this:

- Cash inflow: $50 - *How much WikiTables received in cash for the first table. They didn't receive cash for the second table (sold in credit terms).*
- Cash outflow: $50 - *How much they'd originally bought the 2 tables for.*
- Opening balance: $0
- **Closing balance: $50 – 2*$25 + $0 = $50–50=$0** - *Indeed, the cash flow for the month of June for WikiTables amounts to $0 and not $50.*

Important: the cash flow statement only considers the exchange of **actual** cash, and ignores what the person in question owes or is owed.

Statement of financial performance (income statement, profit & loss (p&l) statement, or statement of operations)

[edit]

The statement of profit or income statement represents the changes in value of a company's **accounts** over a set period (most commonly one **fiscal year**), and may compare the changes to changes in the same accounts over the previous period. All changes are summarized on the "bottom line" as **net income**, often reported as "net loss" when income is less than zero.

The net profit or loss is determined by:

Sales (revenue)

– **cost of goods sold**

– selling, general, administrative expenses (SGA)

– **depreciation**/ amortization

= earnings before interest and taxes (**EBIT**)

– interest and tax expenses

= profit/loss

Statement of financial position (balance sheet)

[edit]

The balance sheet is the financial statement showing a firm's **assets**, **liabilities** and **equity** (capital) at a set point in time, usually the end of the fiscal year reported on the accompanying income statement. The total assets always equal the total combined liabilities and equity. This statement best demonstrates the basic accounting equation:

Assets = Liabilities + Equity

The statement can be used to help show the financial position of a company because liability accounts are external claims on the firm's assets while equity accounts are internal claims on the firm's assets.

Accounting standards often set out a general format that companies are expected to follow when presenting their balance sheets. **International Financial Reporting Standards** (IFRS) normally require that companies report **current** assets and liabilities separately from non-current amounts.**[5][6]** A GAAP-compliant balance sheet must list assets and liabilities based on decreasing liquidity, from most liquid to least liquid. As a result, current assets/liabilities are listed first followed by non-current assets/liabilities. However, an IFRS-compliant balance sheet must list assets/liabilities based on increasing liquidity, from least liquid to most liquid. As a result, non-current assets/liabilities are listed first followed by current assets/liabilities.**[7]**

Current assets are the most liquid assets of a firm, which are expected to be realized within a 12-month period. Current assets include:

- **cash** - physical money
- **accounts receivable** - revenues earned but not yet collected
- Merchandise inventory - consists of goods and services a firm currently owns until it ends up getting sold
- **Investee companies** - expected to be held less than one financial period
- **prepaid expenses** - expenses paid for in advance for use during that year

Non-current assets include **fixed** or long-term assets and **intangible assets**:

- *fixed (long term) assets*
  - property
  - building
  - equipment (such as factory machinery)

- *intangible assets*
  - copyrights
  - trademarks
  - patents
  - goodwill

Liabilities include:

- *current liabilities*
  - trade accounts payable
  - dividends payable
  - employee salaries payable
  - interest (e.g. on debt) payable
- *long term liabilities*
  - mortgage notes payable
  - bonds payable

Owner's equity, sometimes referred to as net assets, is represented differently depending on the type of business ownership. Business ownership can be in the form of a sole proprietorship, partnership, or a **corporation**. For a corporation, the owner's equity portion usually shows common stock, and retained earnings (earnings kept in the company). Retained earnings come from the retained earnings statement, prepared prior to the balance sheet.**[8]**

Statement of retained earnings (statement of changes in equity)

[**edit**]

This statement is additional to the three main statements described above. It shows how the distribution of income and transfer of dividends affects the wealth of shareholders in the company. The concept of retained earnings means profits of previous years that are accumulated till current period. Basic proforma for this statement is as follows:

Retained earnings at the beginning of period

+ Net Income for the period

- Dividends

= Retained earnings at the end of period.**[9]**

Basic concepts

[**edit**]

The stable measuring assumption

[edit]

One of the basic principles in accounting is "The Measuring Unit principle":

> The unit of measure in accounting shall be the base money unit of the most relevant currency. This principle also assumes the unit of measure is stable; that is, changes in its general purchasing power are not considered sufficiently important to require adjustments to the basic financial statements."[10]

Historical Cost Accounting, i.e., financial capital maintenance in nominal monetary units, is based on the stable measuring unit assumption under which accountants simply assume that money, the monetary unit of measure, is perfectly stable in real value for the purpose of measuring (1) monetary items not inflation-indexed daily in terms of the Daily CPI and (2) constant real value non-monetary items not updated daily in terms of the Daily CPI during low and high inflation and deflation.

Units of constant purchasing power

[edit]

The stable monetary unit assumption is not applied during hyperinflation. IFRS requires entities to implement capital maintenance in units of constant purchasing power in terms of IAS 29 Financial Reporting in Hyperinflationary Economies.

Financial accountants produce financial statements based on the accounting standards in a given jurisdiction. These standards may be the **Generally Accepted Accounting Principles** of a respective country, which are typically issued by a national standard setter, or **International Financial Reporting Standards** (IFRS), which are issued by the **International Accounting Standards Board** (IASB).

Financial accounting serves the following purposes:

- producing general purpose financial statements
- producing information used by the management of a business entity for decision making, planning and performance evaluation
- producing financial statements for meeting regulatory requirements.

Objectives of financial accounting

[edit]

- **Systematic recording of transactions:** basic objective of accounting is to systematically record the financial aspects of business transactions (i.e. book-

keeping). These recorded transactions are later on classified and summarized logically for the preparation of financial statements and for their analysis and interpretation.

- **Ascertainment of result of above recorded transactions:** accountant prepares profit and loss account to know the result of business operations for a particular period of time. If expenses exceed revenue then it is said that the business is running under loss. The profit and loss account helps the management and different stakeholders in taking rational decisions. For example, if business is not proved to be remunerative or profitable, the cause of such a state of affairs can be investigated by the management for taking remedial steps.
- **Ascertainment of the financial position of business:** businessman is not only interested in knowing the result of the business in terms of profits or loss for a particular period but is also anxious to know that what he owes (liability) to the outsiders and what he owns (assets) on a certain date. To know this, accountant prepares a financial position statement of assets and liabilities of the business at a particular point of time and helps in ascertaining the financial health of the business.
- **Providing information to the users for rational decision-making:** accounting as a 'language of business' communicates the financial result of an enterprise to various stakeholders by means of financial statements. Accounting aims to meet the financial information needs of the decision-makers and helps them in rational decision-making.
- **To know the solvency position:** by preparing the balance sheet, management not only reveals what is owned and owed by the enterprise, but also it gives the information regarding concern's ability to meet its liabilities in the short run (liquidity position) and also in the long-run (solvency position) as and when they fall due.

Graphic definition

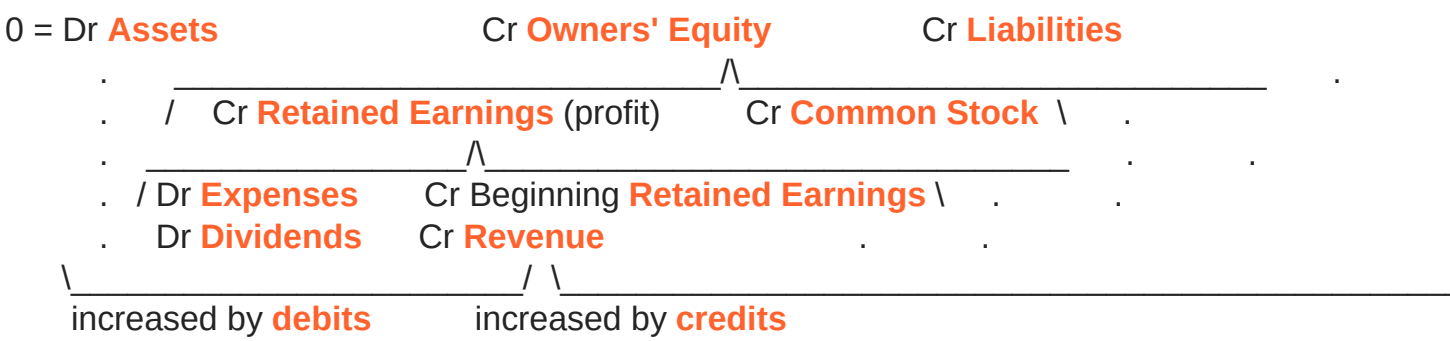
[edit]

The **accounting equation** (**Assets** = **Liabilities** + **Owners' Equity**) and financial statements are the main topics of financial accounting.

The **trial balance**, which is usually prepared using the **double-entry accounting system**, forms the basis for preparing the financial statements. All the figures in the trial balance are rearranged to prepare a **profit & loss statement** and **balance sheet**. Accounting standards determine the format for these accounts (**SSAP**, FRS, **IFRS**). Financial statements display the income and expenditure for the company and a summary of the assets, liabilities, and shareholders' or owners' equity of the company on the date to which the accounts were prepared.

Asset, **expense**, and **dividend** accounts have normal debit balances (i.e., debiting these types of accounts increases them).

Liability, **revenue**, and **equity** accounts have normal credit balances (i.e., crediting these types of accounts increases them).



Crediting a credit
Thus ----------> account increases its absolute value (balance)
Debiting a debit

Debiting a credit
Thus ----------> account decreases its absolute value (balance)
Crediting a debit

When the same thing is done to an account as its normal balance it increases; when the opposite is done, it will decrease. Much like signs in math: two positive numbers are added and two negative numbers are also added. It is only when there is one positive and one negative (opposites) that you will subtract.

However, there are instances of accounts, known as contra-accounts, which have a normal balance opposite that listed above. Examples include:

- Contra-asset accounts (such as **accumulated depreciation** and allowances for bad debt or obsolete inventory)
- Contra-revenue accounts (such as sales allowances)
- Contra-equity accounts (such as **treasury stock**)

Financial accounting versus cost accounting

[**edit**]
See also: **Cost accounting**

1. Financial accounting aims at finding out results of accounting year in the form of Profit and Loss Account and Balance Sheet. Cost Accounting aims at computing cost of production/service in a scientific manner and facilitate cost control and cost reduction.

2. Financial accounting reports the results and position of business to government, creditors, investors, and external parties.
3. Cost Accounting is an internal reporting system for an organisation's own management for decision making.
4. In financial accounting, cost classification based on type of transactions, e.g. salaries, repairs, insurance, stores etc. In cost accounting, classification is basically on the basis of functions, activities, products, process and on internal planning and control and information needs of the organization.
5. Financial accounting aims at presenting 'true and fair' view of transactions, profit and loss for a period and Statement of financial position (Balance Sheet) on a given date. It aims at computing 'true and fair' view of the cost of production/services offered by the firm.**[11]**

Related qualification

[**edit**]

Many professional accountancy qualifications cover the field of financial accountancy, including **Certified Public Accountant CPA**, **Chartered Accountant** (CA or other national designations, **American Institute of Certified Public Accountants AICPA** and **Chartered Certified Accountant** (**ACCA**).

See also

[**edit**]

- **Constant item purchasing power accounting**
- **DIRTI 5**
- **Historical cost accounting**
- **Philosophy of accounting**
- **Accounting analyst**, whose job involves evaluating public company financial statements
- **Management accounting**, the other main division of accounting
- **Bookkeeping**

References

[**edit**]

1. **^** ***"Financial Accounting - Definition from KWHS"****. The Wharton School. 28 February 2011. Retrieved 13 July 2018.*
2. **^** ***"Who We Are - January 2015"*** *(PDF). IFRS.org. IFRS Foundation. Archived from* ***the original*** *(PDF) on 1 May 2015. Retrieved 28 April 2015.*
3. **^ IFRS Conceptual Framework(2010) Par. OB2**
4. **^ European Accounting Association, Response to Question 26, Comment Letter to the Discussion Paper regarding the Review of the Conceptual Framework, on Page 2 of comment letters, dated 2014-01-24 Archived** 2014-07-29 at the **Wayback Machine**

5. ^ *"IAS 1 - Presentation of Financial Statements". Deloitte Global. Retrieved May 9, 2017.*
6. ^ Larry M. Walther, Christopher J. Skousen, "Long-Term Assets", Ventus Publishing ApS, 2009
7. ^ *Gavin, Matt (30 August 2019). "GAAP VS. IFRS: WHAT ARE THE KEY DIFFERENCES AND WHICH SHOULD YOU USE?". Harvard Business School Online. Retrieved 2 November 2020.*
8. ^ *Malhotra, DK; Poteau, Ray (2016). Financial Accounting I. Academic Publishing. ISBN 978-1627517300.*
9. ^ *Fred., Phillips (2011). Fundamentals of financial accounting. Libby, Robert., Libby, Patricia A. (3rd ed.). Boston: McGraw-Hill Irwin. ISBN 9780073527109. OCLC 457010553.*
10. ^ Paul H. Walgenbach, Norman E. Dittrich and Ernest I. Hanson, (1973), New York: Harcourt Grace Javonovich, Inc. Page 429.
11. ^ *Cost and Management Accounting. Intermediate. The Institute of Cost Accountants of India. p. 17.*

Further reading

[edit]

- David Annand, **Introduction to Financial Accounting**, Athabasca University, **ISBN 978-0-9953266-4-4**
- **Financial Accounting** (2015) **doi**:**10.24926/8668.0701 ISBN 978-1-946135-10-0**
- Johnny Jackson, **Introduction to Financial Accounting**, Thomas Edison State University.
- Alexander, D., Britton, A., Jorissen, A., "International Financial Reporting and Analysis", Second Edition, 2005, **ISBN 978-1-84480-201-2**

- **v**
- **t**
- **e**

Accounting

Type	**Financial accounting** **Cost accounting** **Management accounting** **Forensic accounting** **Fund accounting** **Governmental accounting** **Social accounting** **Tax accounting**
Statements	**Income statement** **Balance sheet** **Statement of changes in equity** **Cash flow statement**

Terms

- Debits and credits
- Revenue
- Cost of goods sold
- Operating expense
- Capital expenditure
- Depreciation
- Gross income
- Net income

Authority control databases: National Image not found or type unknown Edit this at Wikidata

- Germany
- Japan

Altrust Services

Phone : (813) 592-3807

City : Clearwater

State : FL

Zip : 33765

Address : 3000 Gulf to Bay Blvd Suite 313

Company Website : **https://altrustservices.com/**

Follow us