

SECTION

5

FINANCIAL ACCOUNTING



FINANCIAL ACCOUNTING

Conceptual Framework

Introduction

In this section, we will focus on the conceptual framework of accounting. We will delve into the fundamental aspects of accounting by showing its importance in both personal life and business contexts. The central objective is to equip you with the ability to use personal financial activities as a lens to understand the essence, purpose and application of accounting. Consequently, by the end of this section, you will gain a holistic understanding of financial aspects in diverse fields and the capacity to articulate the conceptual framework of accounting so that you can apply it to personal financial scenarios and exhibit proficiency in discussing the various facets of accounting, including standards and financial statement components.

At the end of this section, you will be able to

- Explain accounting as a system and its purpose in daily life.
- Examine the major steps in processing accounting information and its characteristics.
- Examine the informational needs of users of accounting information.
- Discuss the need for Accounting Standards.

Key Ideas

- **Accounting** is the systematic process of recording, summarising, analysing, and reporting financial transactions of a business or organisation.
- **Accounting System** is a structured set of processes and tools used to manage and record an organisation's financial transactions.
- **Accounting Process** refers to the systematic series of steps followed to collect, process, and communicate financial information about an organisation.
- **Accounting information** refers to the financial statements or records generated through the process of book-keeping and accounting.
- **Users of accounting information** are those persons or businesses who use the financial statements to make decisions.
- **Accounting standards** are set of principles, rules, guidelines and procedures that define the basis of financial accounting policies and practices.

ACCOUNTING AS A SYSTEM

Definition /Introduction of Accounting

Accounting is the art of recording, classifying, summarising, analysing and interpreting financial data to aid users in decision making.

Accounting as a system

It is a system that a business uses to collect, store, manage, process, retrieve and report its financial data.

Purpose of accounting

The purpose of accounting in a business is to gather and report on financial information about the business's performance, financial position and cash flow. This information is then used to make decisions about how to manage or invest in a business. Also, to record financial transaction in the books of accounts, to identify, measure and communicate economic information.

As an individual, the principles of accounting serve as a useful tool for you to organise or record your own finances and improve your financial literacy.

Careers in accounting

Accounting provides varied career opportunities. These include;

1. Teaching/ Lecturing
2. Auditors – in public and private practice
3. Tax consultants/ Advisors
4. Financial Analyst/ Consultants
5. Accountants in both public and private organisations
6. Insurance brokers

The importance of accounting

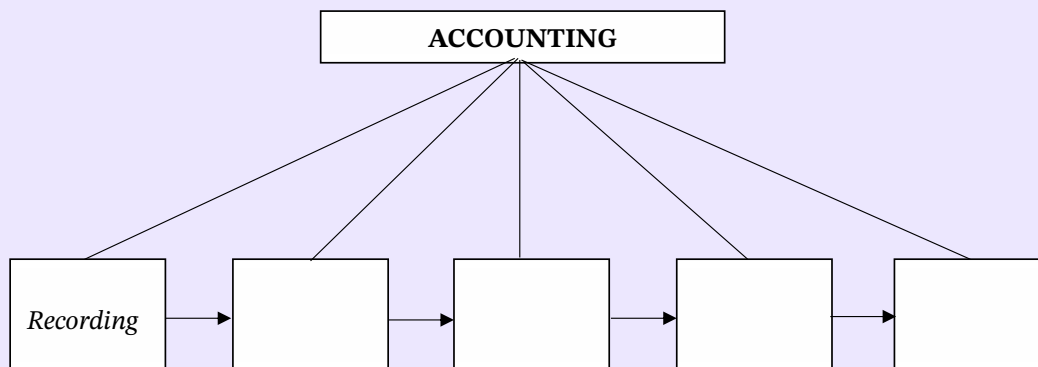
1. It serves as a tool for planning by managers and provides management with the right information for decision- making.
2. It helps companies and the government in calculating the tax of organisations.
3. It helps to evaluate the performance of managers of a business.
4. It is used to compare the performance of a company over a number of years.
5. It helps in comparing the performance of two or more organisations.

Activity 5.1

1. Write a list of items you buy and the cost or price of these items on sticky-pads or pieces of paper.
2. Exchange your list with a colleague for observation and discussion.
3. Ask your colleague whether they keep records of items they purchase.
4. Discuss with your colleague whether they would be able to account for the money they spend on items they purchased within a month without keeping records

Activity 5.2

1. Copy the diagram below into your book.
 - a. Fill in the empty boxes with the sequence of activities that define accounting.
 - b. Share and discuss your answer with a colleague for feedback.



2. In groups, discuss and make a PowerPoint presentation on the purpose of the study of accounting and its related career pathways.

THE ACCOUNTING PROCESS

The accounting process is the series of steps followed by a business entity to record the business's financial transactions. This process includes steps for collecting, identifying, classifying, summarising and recording business transactions in the account books of a company so that the financial statements can be prepared. These are explained in more detail below.

Major steps in processing accounting information

1. Identify and analyse transactions

The first step in the accounting cycle, is to identify and analyse all transactions made during the accounting period. These include expenses, debt payments, sales revenue and cash received from customers.

2. Record transactions in a journal

The next step is to record the details of all financial transactions in chronological order as journal entries (whether in an actual book or in an accounting programme). With double entry system, each transaction is recorded as a debit and a corresponding credit in two ledger accounts.

3. Post transactions to a general ledger

Once a transaction is recorded as a journal entry, using double entry system, it should post to an account in the general ledger. The general ledger provides a breakdown of all accounting activities by accounts.

4. Determine the trial balance

The closing balances of all the accounts in the general ledger at the end of an accounting period are reflected in a trial balance. The trial balance is used to check for errors and ensure that all transactions are recorded in the general ledger.

5. Analyse the workbooks

The fifth step is to identify errors and anomalies that may have occurred in the books of accounts. This involves analysing the books of accounts to identify entries that need to be adjusted. Any error corrected and non-cash transaction can be recorded as an adjusting journal entry. As every transaction is recorded as a credit or debit, it ensures that the total credit balance and debit balance are equal.

6. Prepare financial statements

Once account balances have been corrected and adjustments made, financial statements can be prepared. Financial statements are accounting reports that summarise a business' activities and performance for a defined period of time, such as monthly, quarterly or annually. The three key financial statements that businesses prepare are the income statement, the balance sheet and the cash flow statement.

7. Close the books

Finally, a business ends the accounting cycle by closing its books at the end of a financial year. The closing statements provide a report for analysis of performance over the period. The accounting cycle starts over again from the beginning of a new reporting period.

Below is a diagram showing the major steps in accounting:

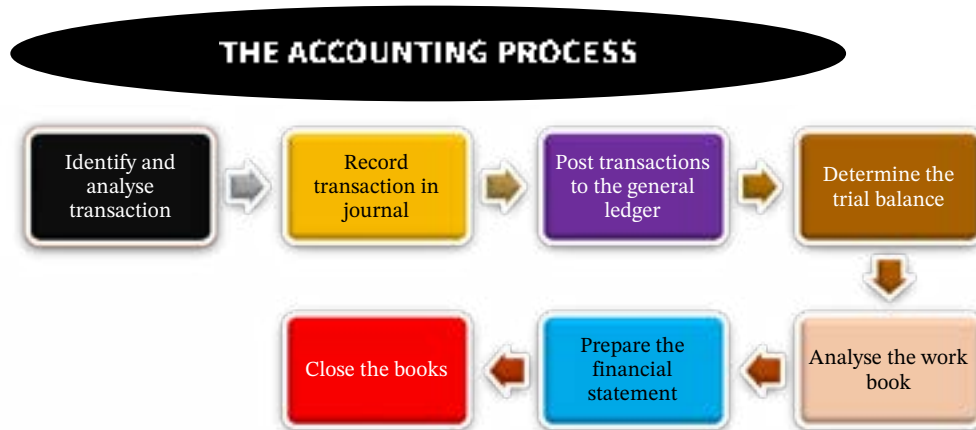


Fig. 5.1: The major steps in accounting

Activity 5.3

- Copy the diagram below into your book and draw lines to match each description of accounting processes to the correct step or sequence on the right.
- Share your answer with a colleague for discussion

DESCRIPTION	STEP
Post transactions to the ledger	1
Analyse the workbook	2
Close the books	3
Determine the trial balance	4
Identify and analyse transaction	5
Record transaction in journal	6
Prepare the financial statement	7

Characteristics of Accounting Information

In order to be considered useful, accounting information should have the following characteristics:

1. Understandability

This indicates the need for clarity in the expression of accounting information – it should be understandable to users who are generally expected to have a practical knowledge of business and economic activities.

2. Relevance

This implies that, to be useful, accounting information must assist a user to form, confirm or maybe revise a view or opinion - mostly in the context of making a decision.

3. Consistency

This implies the same treatment of similar items and consistent application of accounting policies. It seeks to ensure that transactions or events are recorded in the same way, from one accounting year to the next in order to prevent manipulation of financial statements, so that business reports are accurate and depict comparable information.

4. Comparability

The ability for users to be able to compare similar companies in the same industry group and to make comparisons of performance over time. Much of the work that goes into setting accounting standards is based around the need for comparability. Financial statements of one accounting period must be comparable to another in order for the users to derive meaningful conclusions about the trends in an entity's financial performance and position over time.

5. Reliability

Reliability requires that the accounting information be free from errors and bias and that this information can be depended upon by users to represent what they claim to or could reasonably be expected to represent.

6. Objectivity

This implies that accounting information is prepared and reported in a “neutral” way. In other words, the financial information should be unbiased and free from any kind of internal and external influence.

7. Timeliness

To be of maximum benefit, accounting information must be presented at the appropriate time. That is, accounting information should be available when it is needed and should not be out of date or presented in arrears.

Below is a diagram showing the characteristics of accounting information.



Fig 2: The characteristics of accounting information

Activity 5.4

1. Copy and complete the table below. State the accounting characteristic that applies to each description.
2. Share your answer with a colleague for discussion.

Description	Characteristic
a. Application of accounting policies as well as the treatment of similar items should be the same	Consistency
b. Accounting information should be free from material misstatement and bias so that users can depend on it	
c. It should be possible for users of accounting information to compare the performance of similar companies in the same industry over time	
d. There should be clarity in the expression of accounting information such that it will be understandable to users	
e. Accounting information should be unbiased and free from any kind of internal and external influence	
f. Accounting information should be useful and assist a user to make informed decision	
g. Accounting information must be presented at the appropriate time when it is needed	

ACCOUNTING INFORMATION

Users of accounting information

Users of accounting information are those persons or businesses who use financial statements to make decisions. Basically, there are two types of users of accounting information – internal and external users.

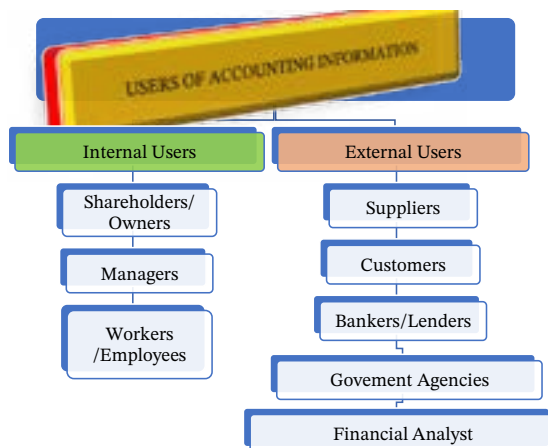


Fig 5.3: Users of accounting information

Informational needs of users of accounting information

Internal Users

1. Shareholders/Owners:

These are people who have invested capital into a business and are the owners of the business. The shareholders need the following:

- a. Timely information regarding the financial performance, economic position and changes in financial position of their organisation.
- b. Accounting information to assess the level of stability of the business over the years and the extent to which changes in economic factors have affected profits.
- c. Information on whether to invest more capital into the business or withdraw existing capital from the business.

2. Employees:

Employees are people who work in a business and are interested in the following:

- a. Information on their job security and income. They are interested in the profitability of the business to ensure payment of their salary, health benefits, other allowances and continuous employment.
- b. Employees use the accounting information to check payment of statutory obligations by the business. They need to check payment of their SSNIT contributions and PAYE to government agencies.
- c. Moreover, potential employees may also be interested to learn about the financial health of the organisation they aspire to join in the future.

3. Managers:

Managers are people who plan, organise, direct and control the activities of the business. Managers need accounting information to:

- a. Monitor the performance of business. They need to compare current performance against past performance. By this, they monitor sales, expenses and profits and compare them against the set targets / budgeted plans.
- b. Access or evaluate the business' performance and manage risks. Preparing and monitoring budgets effectively requires reliable accounting data relating to the various activities, processes, products, services, segments and departments of the business.
- c. Assess their performance against industrial benchmarks. They need to compare their performance with competitors in the industry.

External users

1. Suppliers:

Suppliers are the parties who supply the business with products or services, for example raw materials, finished goods and other services.

- a. Suppliers need to assess the ability of a business to repay goods/services supplied on credit.
- b. They need the assurance that a business will continue to buy their goods.

2. Customers:

Customers are the parties who buy goods and services produced by a business.

- a. Customers need assurance that a business will continue to produce goods/services for them to buy.
- b. Customers need assurance that a business will produce quality and standardised goods for them.

3. Lenders/Banks:

Lenders and banks are parties who have provided funds to a business and expect repayment of their monies with interest. Lenders want to know about the financial stability of a business to determine the debt servicing and interest service coverage.

4. Government /Regulatory Agencies:

It is a statutory requirement for businesses to send copies of their financial statements to government agencies. Government agencies and departments use accounting information for various reasons.

- a. The Registrar of Companies need a business's financial statements to ensure its existence.
- b. Ghana Revenue Authority (GRA) needs financial information to assess the tax liability of a business.
- c. SSNIT needs financial statements to ensure the payment of workers' SSNIT contributions.

5. Financial Analyst and Advisors:

Financial analysts are persons who study the financial statements of various businesses. Financial analysts go through the available statements in accordance with accounting principles and industrial standards. Financial analysts;

- a. measure the financial stability of a business to determine its continuous existence.
- b. establish industrial indicators which help to measure performances of businesses in the same industry.

Activity 5.5

1. Identify and describe seven users of accounting information.
2. Categorise each user as either an internal or external user of accounting information.
3. Identify the reason why they need accounting information.
4. Share with your answers with a colleague for discussion and feedback.

You may use the table below to support your work

	User	Description	Category	Reason For Information
	Financial Analysts or Advisors	They are persons who study the financial statements of various businesses	External User	1) To measure the financial stability of a business to determine its continuous existence. 2) To establish industrial indicators which help to measure performances of businesses in the same industry.
a.				
b.				
c.				
d.				
e.				
f.				
g.				

Activity 5.6

1. In groups, discuss the importance of accounting information.
 - a. Write down your points and share your thoughts to another group.
 - b. Use charts, maps or diagrams to summarise your points and make a poster presentation to other learners.
2. Explain the impact of presenting accounting information that does not meet the characteristics of accounting principles to users of this information.

ACCOUNTING STANDARDS

Definition/Introduction

An accounting standard is a set of principles, rules, guidelines and procedures that define the basis of financial accounting policies and practices.

Accounting standards ensure the financial statements from multiple companies are comparable, consistent and transparent. Accounting standards ensure that all entities follow the same rules, which will make the financial statements credible and allow for more economic decisions based on accurate and consistent information.

Types of Accounting Standards

Generally Accepted Accounting Principles (GAAP)

Generally Accepted Accounting Principles (GAAP) is the primary set of accounting standards that public and private organisations use within the United States of America.

GAAP compliance is mandatory for all publicly traded companies. These standards help create clarity in financial reporting and allow for comparison between the financial situations of different companies. GAAP standards also ensure that regulatory bodies can effectively monitor private companies and that investors and banks can make informed decisions about their business interactions.

International Financial Reporting Standards (IFRS)

International Financial Reporting Standards is the primary set of accounting standards that international companies use. They aim to provide consistency in accounting and reporting processes throughout various countries.

If you are interested in finding out more about accounting standards then additional examples are included below:

1. International Public Sector Accounting Standards (IPSAS)

IPSAS are accounting standards for public sector entities, developed by the International Public Sector Accounting Standards Board (IPSASB). They are designed to improve the quality of financial reporting by public sector entities, leading to better informed assessments of resource allocation decisions made by governments.

Examples:

- **IPSAS 1:** Presentation of Financial Statements
- **IPSAS 17:** Property, Plant, and Equipment
- **IPSAS 24:** Presentation of Budget Information in Financial Statements

2. Accounting Standards for Private Enterprises (ASPE)

ASPE are standards developed by the Canadian Accounting Standards Board (AcSB) specifically for private enterprises. They provide an alternative to IFRS for Canadian private companies.

Examples:

- **Section 1000:** Financial Statement Concepts
- **Section 3061:** Property, Plant, and Equipment
- **Section 3856:** Financial Instruments

3. National Accounting Standards

Many countries have their own national accounting standards, which are often aligned with or influenced by IFRS or GAAP but tailored to specific legal, economic, or cultural circumstances.

Examples:

- **UK GAAP:** Financial Reporting Standard (FRS) 102
- **Indian Accounting Standards (Ind AS):** Ind AS 115 - Revenue from Contracts with Customers
- **Japanese GAAP:** Business Accounting Standard No. 29 - Revenue Recognition

4. Industry-Specific Standards

Certain industries have specific accounting standards due to the unique nature of their operations. These standards ensure that financial reporting reflects the true financial position and performance of entities within these industries.

Examples:

- **Oil and Gas Industry:** Successful Efforts Method and Full Cost Method
- **Banking Industry:** Basel III Framework
- **Insurance Industry:** IFRS 17 - Insurance Contracts

Understanding these various types of accounting standards is crucial for professionals in accounting and finance, as they ensure that financial statements are prepared accurately and consistently. This, in turn, helps stakeholders make informed decisions based on reliable financial information.

Importance of Accounting Standards

Accounting standards allow multiple companies and institutions to operate as part of the same financial system. These are some of the most important benefits of accounting standards:

- 1. Clarity:** Accounting standards help to rule out ambiguities in recording of transactions. Accounting standards provide common ways for all organisations to record their transactions. By this, transactions are treated in the same manner by all organisations. This provides transparency to accountants, banks, investors, government regulators and the public.
- 2. Comparability:** Any investor would essentially want the financial statements to be comparable with others. Without any standardised regulation, it becomes difficult to compare financial statements of businesses within the same industry. Accounting standards ensures the use of one standard for treating similar transactions in different organisations.
- 3. Guidance:** Accounting standards are very helpful in providing daily guidance to accountants in the recording of transactions. It is the responsibility of an accountant to provide financial information which is reliable, relevant, neutral and comparable. These characteristics achieved through the use of accounting standards.
- 4. Uniformity:** Accounting standards provide a means of achieving uniformity within the accounting profession. The use of accounting standards provides a uniform method of recording and reporting for all institutions. This can facilitate transactions between businesses and allow comparisons between companies nationally or internationally.
- 5. Reliability:** Accounting standards help ensure that companies, non-profit organisations and government agencies provide accurate analysis of their financial operations. Any business concern has a large number of stakeholders and they rely on the information to make an informed decision on the company. Many stakeholders determine their next course of action based on the information provided by these financial statements. Moreover, potential investors rely on the financial statements to make decisions.
- 6. Reducing Fraud:** Accounting standards provides the accounting principles, procedures and methods that every entity must use. With the use of common principles, the manipulation of data is minimised or eliminated. By this, it becomes difficult to commit any fraud.
- 7. Assist Auditors:** The accounting standards lays down all the necessary policies, regulations and guidelines pertaining to recording of transactions to be followed by businesses. This helps auditors to check and follow prescribed procedures. Thus, all the financial statements presented are true and justified.

Activity 5.7

1. In groups, discuss at least three reasons why rules and regulation are important in the school.
2. Using the importance of school rules and regulation as a basis, identify the importance of accounting standards.
3. Share your thoughts and responses with other learners.
4. Summarise your points on manila cards for a presentation to the larger class.

Activity 5.8

1. In pairs, discuss the meaning and types of accounting standards.
 - a. Write down your thoughts on flash cards and share with another pair for feedback.
2. Write a short report summarising the class discussion on accounting standards (using examples) and their importance.

Review Questions

1. Explain the concept of financial accounting as a system.
2. As the accountant for a company, explain the processes you would follow to prepare financial statements for decision makers.
3. Evaluate the implications of poor financial accounting information on business activities.
4. Assess the need for accounting standards in a business, in accordance with the IFRS.

EXTENDED READING

- Adomako, R. K. (2019). *Contemporary Financial Accounting*. Tamale: Zeal Publishing. pp. 62-68, pp. 200-215
- Andoh, C. A. (2020). *Principles of Financial Accounting*. Accra: Best Books Ltd. pp 25-30, 45-53
- Boateng, A. A. (2018). *Essentials of Financial Accounting*. Tamale: Northern Publications. Pp 42-50, 65-70
- Owusu, P. Y. (2021). *Financial Accounting Made Simple*. Cape Coast: Coastal Press pp 10-15, 55-60
- Tetteh, M. A. (2020). *Financial Reporting and Analysis*. Accra: Bloom Publications. pp. 40-47, pp. 110-125
- Any Financial Accounting book approved by NaCCA

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2. ICAG (2019), *Study Text - Financial Accounting*.
3. NaCCa (2023), *Business Studies Curriculum*.
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5. Wood, F (1993) *Business Accounting*, London: Pitman Publishing

GLOSSARY

General Ledger	This is the master account that includes all subsidiary ledgers and holds a complete record of transactions within an accounting period.
Trial balance	This is the report of the balances of all general ledger accounts at a given point in time.
Double entry system	Double entry systems record all transactions twice: once as a debit and once as a credit.
Income statement	This document specifies the total revenue earned by a business within an accounting period, minus all expenses incurred during the same period.
Balance sheet	shows a business's current position regarding its assets, liabilities and equity.
Cash flow statement	Cash flow is the cash that moves in and out of a business during an accounting period. This can be tracked using a cash flow statement.

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