CHAPTER ONE

NATURE OF ACCOUNTING

CHAPTER OUTLINE

- Definition
- Differences between accounting and book-keeping
- Scope of accounting
- Aims of accounting information
- Qualities of accounting information
- Users of accounting information

Learning objectives:

At the end of this chapter, the student should be able to:

- Define accounting.
- Differentiate between book-keeping and accounting
- Discuss the different stages (divisions) of accounting
- Explain the objectives of accounting information and its necessary features.
- Identify the users of accounting information and the need for such information

NATURE OF ACCOUNTING

1.1. DEFINITION: There are various definitions of accounting by different schools of thought. Such definitions include:
Accounting is the science and art of measurement of business transactions. Financial accounting system records the economic effect of transactions and other events on the economic resources that the company holds and on the composition of claimants on those resources (Bhattacharyya, 2012).

Millichamp (1992) defines accounting as "the systematic process of identifying, measuring and communicating economic information to permit informed judgement and decisions by the users of the information".

At this level, we are going to take a simple definition of accounting. It states that accounting is the systematic gathering, recording, summarizing, analyzing, interpreting and communicating financial transactions of a business in order to assist in various decision making.

From the above, we can see the key words such as:

1. Systematic recording
2. Analyzing.
3. Summarizing
4. Interpreting
5. Communicating

These key words appear in many definitions of accounting. They help to explain what accounting is. However, we believe that gathering of information should precede the other processes, hence its inclusion in our definition.

1.2 DIFFERENCES BETWEEN BOOK-KEEPING AND ACCOUNTING
These two words are interchangeably used by students, hence there is need to clearly explain the slim difference between the two.

BOOK-KEEPING: This is a systematic recording of transactions and performance of business activities. In other words, it is a systematic method by which the records of financial transactions of business are kept in such a manner that readily shows its financial position.

ACCOUNTING: This goes beyond mere book-keeping. It takes an extensive analysis of the financial records (accounts) and their interpretations so that businessmen can see the facts revealed as a pointer to the past and a guide to future decision taking.

One can easily see from the above that accounting is wider than book-keeping. Both however, talk about the systematic recording of financial transactions but accounting goes beyond to analyze and interpret the financial transactions so recorded. It can therefore, be stated that an Accountant is a book-keeper while a book-keeper is not an Accountant.

1.3 SCOPE OF ACCOUNTING: Accounting covers a wide range of business activities. The starting point in the study of accounting is the financial accounting. Other major classifications of accounting include Cost Accounting, Management accounting, Auditing, Tax Management and Government (Public Sector) Accounting.

Financial Accounting: Financial accounting records the economic effect of transactions and other events on the economic resources that the company holds. It starts with book-keeping and ends with the preparation, presentation and interpretation of financial statements. The primary aim of financial accounting is to identify and record all financial transactions of the business so as to determine the profit or loss at the end of the accounting period. This is always the starting point in the study of accounting. The officer in charge of this is known as Financial Accountant. It is his duty to obtain, record and communicate the necessary information to enable the users/stakeholders assess the performance of the business entity.

Cost Accounting: This is the branch of accounting that generates the procedure for accumulating data to provide information for managerial action. It systematically applies the necessary accounting procedure to accumulate costs such as cost of a product, cost of services, e.t.c. It is primarily designed to enable management of the enterprise take specific decisions. The officer responsible for this is known a Cost Accountant.

Management Accounting: This branch is concerned with the provision of information to management by utilizing the cost data accumulated by the Cost Accountant. This is to enable the management take decision concerning planning and control of the business. It is primarily concerned with providing information for decision making. Management accounting provides information to management of a business to help them take informed decision and to improve upon the efficiency and effectiveness of existing operations. The officer in charge is known as a Management Accountant.

Auditing: This is the independent examination of the books of accounts of an enterprise so as to guarantee its integrity and reliability. It is an aspect of accounting which examines the financial statement so as to form an opinion on whether the necessary acceptable procedure was maintained in arriving at the figures therein in the financial statement. To guarantee this, the account must be audited by an independent person known as an Auditor.

Accounting For Taxation: This branch of accounting aims at providing the required knowledge for the determination of tax liability or taxable profit of an enterprise. It utilizes the accounting profit generated by the Financial Accountant to determine the tax liability or taxable profit of the enterprise. It is necessary to state here that taxable profit is different from accounting profit of the business.

Government (Public Sector) Accounting: This is the process of recording and presenting fund generated by the government and its agencies; and how it is disbursed in a logical manner following the necessary accounting rules in such a way as to extract with ease, relevant financial information vital for appropriate decision making from time to time.

1.4 AIMS AND OBJECTIVES OF ACCOUNTING INFORMATION.

The aims and objectives of accounting information can be summarized as follows:

1. It provides information useful for making economic and/or vital business decisions.
2. It serves as the basic instrument that investors use when deciding on investment opportunities.

3. It is used for performance appraisal of management.
4. It provides information to government for calculating tax payable by companies.
5. It enables creditors to predict cash flows of business entities.

1.5 QUALITIES OF GOOD ACCOUNTING INFORMATION

Since accounting information is desired for certain purposes, there are necessary attributes or features that good accounting information must possess. Such include:

1. **Timeliness**: Accounting information is required for a purpose. If the information is not provided at the time of need, it becomes useless. Hence, accounting information must be available early enough and at the right time for its use. If the information is not provided at the right time, it will then be likened to scoring a beautiful goal in a football match when the final whistle is already blown.

2. **Relevance:** Different users of accounting information have different expectations. Hence, accounting information must be relevant or must be of use to achieve such expectation. All accounting information must contain enough facts to satisfy the needs of the user. It must be relevant to what it is needed for.

3. **Comparability**: Accounting information must be comparable between one accounting period and the other or even between one company and the other. That is, accounting information for year 2000 can be compared with that of year 2001 or even 2005. For this to be reasonable, consistency on the basis of preparation of the financial statement is necessary. A chosen standard must be maintained from year to year.

4. **Objectivity**: The presentation of accounting information should be objectively done. There should be no bias or subjective judgment. There should be free flow of information without personal influence of the accountant or whoever is preparing the statement.

5. **Comprehensiveness:** Accounting information should contain

necessary details for good understanding. It should not however, be verbose as to contain unrequired information.

1.6 USERS OF ACCOUNTING INFORMATION

Accounting information is presented for consumption by some stakeholders. The stakeholders who have different needs for the accounting information include:

1. Management
2. Creditors
3. Debtors
4. Customers
5. Government and its agencies
6. Employees
7. Prospective investors.
8. Journalists
9. Financial Analysts.

Management: The management's interest in the accounting information is to know the profit or loss made by the organization. This need becomes even personal if members of the management are paid certain bonuses based on the profit. Moreso as the management, it needs general knowledge about the activities of the business entity.

Creditors: These groups of people look into accounting information for assurances that the business still has the ability to offset what it owes to them.

Debtors: Debtors will want to know if the business is making sufficient profits so as to guarantee its continued existence in order to extend future debts to them whenever the need arises.

Customers: The interest of the customers lies on the ability of the company to continue to produce quality products whose prizes are competitive. This is anchored on the quantum of profit made by the business.

Government and its agencies: Government is interested in the profit

made by the business as it usually collects a portion of it as tax. Furthermore, agencies of government like Nigeria Stock Exchange, Securities and Exchange Commission, e.t.c. require different types of information for regulatory purposes.

Employees: Employees of organizations desire to know the prospect of their organization through accounting information. If the company's going concern is assured, the workers will have hope that their employment and by extension, their salaries are guaranteed.

Prospective Investors: Prospective investors rely heavily on accounting information for the choice of their investment. The more profitable an organization is, the more attractive it becomes to investors and vice-versa.

Journalists: Different accounting information tend to satisfy divergent information needs for Journalists. They find various aspects of the information news worthy.

Financial Analysts: Financial analysts and advisors require accounting information to be able to advise wisely prospective investors and all those that seek general knowledge about performance of various businesses.