

TOPIC ONE- INTRODUCTION TO ACCOUNTING

Accounting is a process of identifying, recording, analyzing, summarizing and communicating financial information about an entity in financial reports to various users to facilitate decision making.

It is the provision info about the financial performance, financial position and changes in Financial Position of an enterprise that is useful to a wide range of users for decision making.

Accounting is the process of identifying, measuring & communicating economic information to permit informed judgments and decisions by users of the information (Wood, 1996)

Accounting generally means; giving explanation or justifying actions and results of the actions.

Normally managers are required to show evidence for the good custodianship of resources under their control and they do this by submitting accountability in the following ways.

WAYS OF ACCOUNTABILITY

- ❖ Production of documentary evidence like receipts, vouchers, invoices etc.
- ❖ Production of books of accounts in to which transactions are recoded to permit cross examination in case of queries
- ❖ Showing output results i.e. Physical evidence like building, machines, motor vehicles etc
- ❖ Production of financial statements like statement of profit or loss a/c, statement of financial position

Rationale/ Importance/Roles of Accounting

The major aim of accounting is provision of financial information on the financial performance, financial position and changes in financial position of an entity.

Specifically, the role of accounting lies in the following;

- » Ascertainment of profit or loss
- » Assessment of taxes
- » Facilitates credit transactions (How much is owed/ owing)
- » Monitoring of management by investors (if resources where– efficiently and effectively utilized)
- » Acts a mechanism for control by tracking expenses and incomes to ensure that expenses are minimized and revenues are maximized
- » Financial Institutions use financial information in assessing client who apply for loans

BRANCHES OF ACCOUNTING

To meet the ever increasing demands made on accounting by different interested parties such as owners, management, creditors, taxation authorities etc., the various branches have come into existence. There are as follows:

Major branches

- ❖ Management accounting
- ❖ Financial accounting

Other branches

- ❖ Cost accounting
- ❖ Auditing
- ❖ Environmental accounting
- ❖ Social responsibility accounting
- ❖ Tax accounting
- ❖ Public Sector Accounting
- ❖ Sustainability Reporting
- ❖ Integrated Reporting

Financial Accounting – Branch of account that deals with recording of business activities in financial terms and preparation of financial Statements for external users for decision making

Management Accounting- Deals with the provision, analysis and interpretation of both financial and non-financial information for use by management for purpose controlling, planning and making decisions

Cost Accounting - This deals with cost determination and allocation to products and services in accordance with costing principles, methods and techniques

Cost information is important for the purpose of controlling, price setting, stock valuation, budget preparation, decision making among others

Auditing - This is the independent examination of the financial statements to establish whether they have been prepared and presented complying with the International Financial Reporting Standards and whether they are free from material errors.

Public sector Accounting – **Branch of** accounting involving accountability and value for money in the provision of government services through, its agencies, Parastatals, ministries, Local Gov'ts,

Tax Accounting - This involves both tax planning and the preparation of tax returns. Tax accountants use financial statement information to prepare tax returns

Social/ Environmental Accounting - Process of communicating/ reporting on the social & environ effects of economic actions/ activities of organizations to interest groups in the society

Sustainability Reporting –

Integrated Reporting -

Question: Differentiate between Financial Accounting and Bookkeeping.

THE REGULATORY FRAMEWORK FOR FINANCIAL ACCOUNTING

A regulatory framework is a system of regulation and the means to enforce them, usually established by a governing body to regulate a specific activity.

- Financial statements provides financial information which serves the interest of various stakeholders (As discussed)
- The purpose of providing such information is to enable informed economic decisions to be made. **(To be discussed in topic four)**
- Therefore, the stakeholders must be protected by regulating the way accounting is done. (I.e. regulating the work of accountants)
- Regulations is achieved through the application of generally accepted accounting practices (GAAP)

Generally Accepted Accounting Practices

These are widely accepted set of rules, principles, standards and procedures that accountants follow in preparation of financial statements

GAAP is a combination of following forms of regulations

- The Companies Act of 2012
- International Financial Reporting Standards (IFRSs)
- Accounting principles
- Bank of Uganda Act/ Regulations
- Uganda Securities Exchange Regulations
- The Capital Markets regulations for listed companies
- Financial Institutions Act
- Accountants Act 2013 – Defines an Accountant, regulation
- Insurance Act – regulations for insurance Cos (Fin stability, Policyholder protection, Capital adequacy, mkt conduct-fairness)
- Other acceptable accounting practices in various industries

Therefore GAAP covers the following 4- key parts;

1 - Accounting principles / concepts

These are basic rules that are followed in preparing and presenting final A/cs and therefore form the foundation of accounting.

2 - Accounting bases

These are methods used in applying the accounting concepts to arrive at amounts to be included in the financial statements. They show how figured included in F.S are measured. E.g. Historical cost, Economic Value, Fair Value, etc.

3 - Accounting Standards

These are authoritative statements issued by a professional accounting body containing rules to be followed when accounting for transactions to be included in financial statements.

They are now referred to as International Financial Reporting Standards -IFRSs (since 2002)

They explain how specific business transactions are measured and disclosed in FS

In Uganda, the professional accounting body that issues the accounting standards is the Institute of Certified Public accountants of Uganda (ICPAU)

FUNCTIONS/ ROLES OF ICPAU

- To regulate and maintain the standard of accountancy in Uganda.
- To prescribe and regulate the conduct of accountants and practicing accountants in Uganda.(To adhere to the professional code of ethics for accountants **(To be discussed in Topic Three)**)

4 - Accounting Policies

These are specific principles, bases, standards, rules and practices applied by an entity in preparing and presenting financial statements.

Accounting policies deal with specific matters like the depreciation methods, valuation of inventory etc.

When a policy is chosen, it must be used consistently every year as most appropriate to the firm

Accounting policies must be disclosed in the annual financial statements.

ACCOUNTING PRINCIPLES/ CONCEPTS

- **Going concern (The only Assumption)** - This concept requires financial statements to be prepared on the basis/ assumption that the business will continue in operation in the foreseeable future without significantly reducing its activities or being liquidated.
- **Business Entity** - This concept requires that the financial transactions relating to the business must be recorded separately from the financial transactions of the owner of the business. The concept recognizes the business entity as separate from the owners.
- **Accruals concept** - The concept requires that income and expenses be recognized in the period to which they relate and not in the period in which cash is received or paid out.

It emphasizes that incomes must be recognized as earned even when cash is not received while expenses must be recognized as incurred even when cash is not paid out.

- **Historical cost** - This concept requires transactions to be recorded at the prices ruling at the time they occurred.
I.e. Assets and liabilities should be recorded at their original cost of acquisition and incurrence respectively without revising them to the current amounts.
- **Prudence/ Conservatism** - Prudence means that accountants should be cautious when estimating figures to be included in the financial statements under conditions of uncertainty.

The concept requires accountants not to anticipate profit or gains but to provide for all possible future losses. For example it requires accountants to provide for future costs arising from present obligations when they are likely to be incurred.

- **Substance over form** - This requires that transactions and other events be accounted for in accordance with their substance and economic /financial reality and not simply with their legal form. E.g.

Substance is normally determined by looking at the effect on the Balance sheet

- **Duality/ dual concept** - This concept states that for every single transaction, there must be double/ two recording effects with equal transaction amounts. (I.e. a single transaction is to be recorded twice in the books of account). For every, debit, there must be a credit
- **Money measurement** - This concept requires that all transactions that are recorded in accounting must be expressed only in monetary terms and currency units while those that cannot be expressed in monetary terms should be excluded.
- **Realization** - The concept states that a transaction should be recognized when the event from which it arises has taken place and not when cash is received or paid out.

I.e. Incomes must be recognized/ recorded in the books the moment the business supplies goods to the customers and expenses be recorded when the biz has received goods or services but not when cash is received or paid out

- **Accounting period/ Periodicity & disclosure** - This concept requires a firm to prepare and disclose financial report at the end of every financial year as per the requirements of the **Company's Act of Uganda**.

Accounting information only makes sense when they are presented period by period of the same timing usually 12 months period.

- **Matching concept** - This requires matching of expenses against income by writing off only those costs or expenses that were incurred in generating specific income for the period ended
- **Materiality** - This concept requires only material information to be given as stand alone items in the financial statements and the immaterial info need not be given. However, immaterial information be aggregated and disclosed separately under common grouping.

E.g. expenses on office sugar, tea leaves, bites, milk should be grouped under office tea expenses or canteen expenses.

NB: What is material information????

- **Consistency** - This concept requires that the accounting policies used in the preparation of financial statements should be used consistently from year to year.

The need for regulation of accounting

- Financial statements are used by a wide range of users.
- To make financial statements comparable to aid in D.M
- To ensure financial statements are useful to users.
- To ensure financial statements have the basic information on the entity's financial position and performance
- To increase the users understanding of and confidence in financial statements.
- To regulate the behavior of companies towards their investors.