**DEFINITION**

**Accounting** is an information system that **measures**, **processes**, and **communicates** financial information about an economic entity. An economic entity is a unit that exists independently, such as a business, a hospital, or a governmental body.

Accountants focus on the needs of decision makers who use financial information, whether those decision makers are inside or outside a business or other economic entity. Accountants provide a vital service by supplying the information decision makers need to make “reasoned choices among alternative uses of scarce resources in the conduct of business and economic activities.”

1. Accounting measures business activities by recording data about them for future use.

2. The data are stored until needed and then processed to become useful information.

3. The information is communicated through reports to decision makers.

In other words, data about business activities are the input to the accounting system, and useful information for decision makers is the output.

**Fields/ Branches of Accounting**

Accounting is generally sub-divided into the following fields:

* Financial accounting.
* Management accounting.
* Tax accounting.
* Social accounting.

**Financial accounting vs. Management accounting**

**Management accounting** provides *internal* decision makers, who are charged with achieving the goals of profitability and liquidity, with information about operating, investing, and financing activities. Managers and employees who conduct the activities of the business need information that tells them how they have done in the past and what they can expect in the future. Examples of information produced by management accountants include the cost of producing new products, break even analysis, make or buy decisions, and performance reports of the various departments in an organization.

**Financial accounting** generates reports and communicates them to *external* decision makers so they can evaluate how well the business has achieved itsgoals. These reports are called **financial statements** e.g. The statement of comprehensive incomes (Profit and Loss Accounts), The Statement of Financial Position (Balance Sheet), The Statement of Cash flows, and the statement of changes in equity.

As part of **assignment 1**, research and develop a discussion the other branches of accounting.

**Ethical Financial Reporting**

**Ethics** is a code of conduct that applies to everyday life. It addresses the question of whether actions are right or wrong. Actions—whether ethical or unethical, right or wrong—are the product of individual decisions. Thus, when an organization acts unethically by using false advertising, cheating customers, polluting the environment, or treating employees unfairly, it is not the organization that is responsible—it is the members of management and other employees who have made a conscious decision to act in this manner. Ethics is especially important in preparing financial reports because users of these reports must depend on the good faith of the people involved in their preparation. Users have no other assurance that the reports are accurate and fully disclose all relevant facts. The intentional preparation of misleading financial statements is called **fraudulent** **financial reporting**.6 It can result from the distortion of records (e.g., the manipulation of inventory records), falsified transactions (e.g., fictitious sales), or the misapplication of various accounting principles. There are a number of motives for fraudulent reporting—for instance, to cover up financial weakness to obtain a higher price when a company is sold; to meet the expectations of investors, owners, and financial analysts; or to obtain a loan. The incentive can also be personal gain, such as additional compensation, promotion, or avoidance of penalties for poor performance. Can you think of an organization that has been caught up in Fraudulent financial reporting.

**Historical Development of Accounting: An Overview**

Accounting is a very old discipline. Forms of it have been essential to commerce for more than 5,000 years. Accounting, in a version close to what we know today, gained widespread use in the 1400s, especially in Italy, where it was instrumental in the development of shipping, trade, construction, and other forms of commerce. This system of double-entry bookkeeping was documented by the famous Italian mathematician, scholar, and philosopher Fra Luca Pacioli. In 1494, Pacioli published his most important work, *Summa de Arithmetica, Geometrica, Proportioni et* *Proportionalita*, which contained a detailed description of accounting as practiced in that age. This book became the most widely read book on mathematics in Italy and firmly established Pacioli as the “Father of Accounting.”

As part of **assignment 2**, identify the various users of accounting information (categorizing them as either internal or external users).

**Objectives of Accounting**

A **business** is an economic unit that aims to sell goods and services to customers at prices that will provide an adequate return to its owners. Businesses have similar goals and engage in similar activities, The two major goals of all businesses are profitability and liquidity.

**Profitability** is the ability to earn enough income to attract and hold investment capital.

**Liquidity** is the ability to have enough cash to pay debts when they are due.

For example, **TOYOTA** may meet the goal of profitability by selling many cars at a price that earns a profit, but if its customers do not pay for their cars quickly enough to enable Toyota to pay its suppliers and employees, the company may fail to meet the goal of liquidity. If a company is to survive and be successful, it must meet both goals. All businesses pursue their goals by engaging in operating, investing, and financing activities.

**Operating activities** include selling goods and services to customers, employing managers and workers, buying and producing goods and services, and paying taxes.

**Investing activities** involve spending the capital a company receives in productive ways that will help it achieve its objectives. These activities include buying land, buildings, equipment, and other resources that are needed to operate the business and selling them when they are no longer needed.

**Financing activities** involve obtaining adequate funds, or capital, to begin operations and to continue operating. These activities include obtaining capital from creditors, such as banks and suppliers, and from owners. They also include repaying creditors and paying a return to the owners. An important function of accounting is to provide **performance measures**, which indicate whether managers are achieving their business goals and whether the business activities are well managed. The evaluation and interpretation of financial statements and related performance measures is called **financial analysis**. For financial analysis to be useful, performance measures must be well aligned with the two major goals of business—profitability and liquidity.

Although it is important to know the amounts of earnings and cash flows in any given period and whether they are rising or falling, ratios of accounting measures are also useful tools of financial analysis.