What is Accounting

Accounting is a process of providing business information for the users of accounts / stakeholders to make decisions.

Objectives / Aims / Purposes of Accounting

Main Objective

The main objective of Accounting is
to provide business information for the users of accounts / stakeholders
to make decisions

Other Objectives

- To know the income, expense, profit and loss
- To know the values of assets, liability and equity
- To know the value of cash inflows and cash outflows
- To implement business controls
- For planning purpose
- For certain businesses legal requirement

Users (Stakeholders) of Accounts

Stakeholders are individuals or groups who have an interest in a business and can either affect or be affected by its activities.

They are simply the interested parties of a business and its accounts.

Users (Stakeholders) of Accounts

Logical Understanding

If the owner works inside the business, then the owner will be classified as an internal user.

Users can be divided into two categories.

- ❖ Internal users (Users who are there inside the business)
- ❖ External users (Users who are there outside the business)

Internal Users

- Management (Board of Directors)
- Managers
- Accountants
- Internal Auditors (Checks the company's processes and controls from inside the business to improve operations)
- Other Employees

External Users

- Shareholders / Investors
- Potential (future) shareholders / Investors
- Government (Eg: Tax Department)
- Financial Institutions (Eg: Banks, Insurance companies)
- Customers
- Suppliers
- Pressure Groups (Trade union outside company)
- Media
- General Public
- Competitors
- External Auditors (Checks the company's financial statements from outside to give an independent opinion)

Financial Accounting vs. Management Accounting

Financial Accounting	Management Accounting
Record Past (historical) information	Past and future forecasted information
Financial information	Financial and non financial both
There is a set format	Any format can be used as preferred by the company
Summarized	Detailed
Prepared for all the users	Prepared only for the internal users
Generally prepared for a 12-month period	Management can decide how regularly should be prepared

Functions of Financial Accounting

- ✅ **Collecting** – Gathering all financial data such as invoices, receipts, bills, etc. from daily business activities.
- ✍️ **Recording** – Systematically recording transactions in the books of original entry (like journals) using the double-entry system.
- 🗂️ **Classifying** – Grouping similar transactions under appropriate ledger accounts
- 📊 **Summarizing** – Preparing trial balances and financial statements (like income statements and balance sheets) to summarize the financial activities.
- 💡 **Interpreting** – Analyzing the information and explaining the meaning of the analyzed data to help stakeholders make informed decisions.
- 📑 **Presenting** – Providing the final financial reports to users like owners, investors, and regulatory authorities in a clear and understandable form.

Sole Trade Business

Business owned by one individual is known as sole proprietorship business / sole trader business

Characteristics:

01. Capital is provided by the single owner
◆ The owner uses their own money to start and run the business.

02. Entire profits or losses are for the single owner
◆ The owner keeps all the profit or bears the full loss.

03. Unlimited liability
◆ The owner's personal assets should be used to pay business debts.

04. No legal personality / identity
◆ The business and the owner are not separate in the eyes of the law.

05. No continued existence
◆ The business ends if the owner dies or stops operating it.

06. If the owner’s full name and business name are not the same, then the name must be registered
◆ Legally required to register the business name if it's different from the owner’s own name

Partnership Business

A business owned and run by two or more people who share profits, losses, and responsibilities.

Characteristics:

01. Capital is provided by the partners
🔷 Each partner invests money or assets into the business.

02. Shared profits and losses according to an agreement
🔷 Partners divide profits and losses based on a pre-agreed ratio.

03. Unlimited liability
🔷 Partners are personally responsible for all business debts.

04. No legal personality / identity
🔷 The business and partners are treated as one entity legally.

05. No continued existence (without agreement)
🔷 The partnership ends if a partner leaves unless the agreement says otherwise.

06. If the partners' full names and business name are different, then the business name must be registered
🔷 Legal requirement to register a business name if it differs from partners' names.

> **Logical Understanding**
>
> In a limited partnership, partner is NOT unlimitedly liable.

Advantages and Disadvantages of a Sole Trader Business

Advantages

- Easy to start and close – Simple registration, less paperwork
- Full control – The owner makes all decisions alone
- Keeps all the profits – No need to share profits with others
- Privacy – No need to publish financial statements
- Close customer relationships – Direct contact with customers builds trust

Disadvantages

- Unlimited liability – The owner's personal assets are at risk
- Limited capital – Hard to raise large amounts of money alone
- Limited skills – One person may not have all business skills
- Heavy workload – The owner handles everything alone
- No continued existence – Business may close if the owner dies or stops working

Advantages and Disadvantages of a Partnership Business

Advantages

- More capital – Multiple partners can contribute funds
- Shared responsibilities – Workload and decisions are shared
- Variety of skills – Different partners bring different expertise
- Simple to form – Easy to start with a partnership agreement
- Privacy – Financial accounts usually don't need to be published

Disadvantages

- Unlimited liability – Partners' personal assets may be at risk
- Disagreements – Conflicts may arise between partners
- Profit sharing – Profits must be divided among partners
- No separate legal identity – The business is not separate from the partners
- No automatic continued existence – If one partner dies or leaves, the partnership may end (unless stated otherwise in the agreement)

Private Sector and Public Sector

Private

- Owned by individuals, groups, or private companies
- To make profit for the owners or shareholders
- Funded by private capital (owners' money, loans)

Examples:
-Private hospital
-Restaurant
-Private schools

Sole Trade, Partnership, LLC

Public

- Owned and controlled by the government
- To provide public services for the community
- Funded by government funds

Examples:
-Public hospital
-Government postal service
-Public schools

Difference Between Sole Trader and Limited Liability Business

	Sole trader	Limited company
Legal background	Little statutory control over a sole trader's business. **No** legal requirement for the **public disclosure** of accounting information.	Required to comply with Companies Acts requirements. **Accounting information** and details of directors and shareholders must usually be made public.
Legal status	**Not a separate legal entity** from the proprietor as an individual. All the assets and rights belonging to the business and all the liabilities of the business are those of the proprietor personally.	A company constitutes a **separate legal entity** from its owners, the shareholders. A company can own assets, owe money, enter contracts, and sue or be sued in a court of law as a legal person, separate from its owners.
Owner's liability	The **proprietor has unlimited personal liability** to the payables of the business, to the full extent of his or her private as well as business assets.	The **liability of the owners** (the shareholders) is **limited** to the company's own assets plus any uncalled share capital. If the shares are fully paid and the company becomes insolvent, the shareholders have no further liability for the unpaid debts of the company.
Audit	**No annual audit** is required.	An **annual audit is usually required**.
Management	The owner **normally manages the business**, although this is not always the case.	Often, **shareholders do not run the company** themselves but **appoint directors to do so**. (Shareholders may, of course, also be directors, and many smaller companies are run by shareholder-directors).

Nature, principles and scope of financial reporting

Nature of Financial Reporting:

Financial reporting is the process of **presenting** financial information about a business.

It will present different financial information of a business.

This information is usually shared through formal reports (called **financial statements**) to people like owners, investors, banks, and the government.

Principles of Financial Reporting:

When preparing financial statements following principles should be followed

1. **Relevance –** The information must be useful to users.
2. **Reliability** – The information must be correct and trustworthy.
3. **Comparability –** Users should be able to compare results with other businesses or past years.
4. **Understandability –** Reports should be clear and easy to understand.
5. **Consistency –** Use the same methods every year unless there is a good reason to change.

Scope of Financial Reporting:

Financial reporting covers a wide range of activities and entities:

- **Entities**: It includes all types of entities, such as corporations, partnerships, sole proprietorships, and nonprofit organizations.
- **Financial Statements**: Scope includes the preparation of financial statements like the balance sheet, income statement, cash flow statement, and statement of changes in equity.
- **Regulatory Requirements**: Compliance with legal and regulatory requirements, such as accounting standards and disclosure requirements set by regulatory bodies.
- **Stakeholders**: Communication of financial information to various stakeholders, including shareholders, creditors, investors, regulators, and the general public.
- **Decision-making**: Facilitation of decision-making by providing relevant and reliable financial information.

Stakeholders' (users of accounts) needs

User	Type	Information Needs
Employees	Internal	Job security, performance bonuses, financial health of the company
Management / BOD	Internal	Decision-making, planning, budgeting, performance evaluation
Investors / Shareholder	External	Profitability, return on investment, financial stability
Customers	External	Company's ability to continue supplying goods/services, long-term reliability
Suppliers	External	Payment ability, creditworthiness, ongoing business relationship
Competitors	External	Benchmarking performance, market position, strategies (to a limited extent)
Lenders	External	Repayment capacity, financial risk
Government	External	Taxation, regulatory compliance, economic data
Public	External	Corporate social responsibility, employment contribution, economic impact

Components of Financial Statements

Financial statements are formal reports that provide information about a company’s financial performance and position. A complete set of financial statements typically includes:

1. Statement of Financial Position (Balance Sheet):
Shows the company’s assets, liabilities, and equity at a specific date.

2. Statement of Profit or Loss and Other Comprehensive Income (OCI):
Reports the company’s revenues, expenses, profit or loss, and other comprehensive income items (such as revaluation gains or foreign currency translation differences) over a period.

3. Statement of Changes in Equity:
Details changes in owners’ equity during the period, including profits, dividends, and other adjustments.

4. Statement of Cash Flows:
Shows cash inflows and outflows from operating, investing, and financing activities over a period.

5. Notes to the Financial Statements:
Provide additional explanations, accounting policies, and breakdowns of figures to help users fully understand the financial statements.

Five Elements of Financial Statements

Asset

Liability

Equity

Income

Expense

Asset

An asset is a present economic resource controlled by the entity as a result of past events.

- Cash 💵
- Buildings 🏢
- Machinery ⚙️
- Accounts receivable (Debtors) 👥
- Inventory (Stock) 📦

Liability

A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

- Bank loan 🏦
- Accounts payable (Creditors) 🧾
- Overdraft facility 💳
- Lease obligations 🚗
- Accrued expenses (e.g., unpaid salaries) 👔

Equity

Equity is the residual interest in the assets of the entity after deducting liabilities.

- Capital introduced by owner 👤
- Retained earnings 📈
- Share capital 📝
- Reserves 🏦
- Drawings (reduces equity) ✂️

Income

Income is increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from holders of equity claims.

- Sales revenue 🛒
- Rent income 🏠
- Interest income 💰
- Commission income 📊
- Dividend income 💵

Expense

Expenses are decreases in assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to holders of equity claims.

- Salaries & wages 🧑‍💼
- Rent expense 🏠
- Electricity bill 💡
- Depreciation 📉
- Advertising expense 📢

IFRS Standards

•Globalization of business means investors and companies operate internationally, so harmonized (standardized) financial reporting is needed.

•Different accounting methods make comparisons difficult; IFRS provides a common framework for consistency and comparability worldwide.

•IFRS Standards are developed internationally but are not automatically enforceable in any country.

•They become enforceable only when a country's national standard setter adopts them.

•Since 2005, the European Union requires IFRS for all listed companies.

•Other countries like Australia, Brazil, Canada, South Africa and more have adopted IFRS.

•Countries like the US, China, and India are converging their standards toward IFRS gradually.

Why Standards Alone Are Not Enough?

Accounting standards (like IFRS) are helpful, but they need legal support and enforcement.

So we also need:
📜 Laws – to make rules compulsory
📈 Market rules – like stock exchange regulations

Regulatory Framework in Accounting?

A regulatory framework means a system of rules (like laws and standards) that guide how companies prepare their financial statements.

Why Regulatory Framework Necessary

✅ To help users understand the financial statements

- People like investors, banks, and others who read financial statements need a **minimum amount of clear information**.

📊 To make financial statements consistent and comparable

- All companies should prepare financial statements in a **similar way**, so we can **compare** one company with another (even between countries 🌍).

💡 To build trust

- If companies follow standard rules, users will **trust the financial reports** more.

📏 To control companies and directors

- Rules make sure companies and their directors **act fairly** and give proper information to shareholders and other stakeholders.

National Regulatory Framework?

Every country has its own rules and systems to control and guide how businesses prepare their financial statements. These are called national regulatory frameworks.

What is included in this framework?

National financial reporting standards

These are the local accounting standards (rules for preparing accounts).

National law

Company laws that must be followed by all businesses.

Market regulations

Rules made by government or other authorities to make sure companies behave properly in the financial market.

Stock exchange rules

Rules made by the stock market for companies that are listed (public companies).

Example: United Kingdom (UK)

In the UK:

- **Financial Reporting Council (FRC)** gives the accounting standards.
- **Companies Act 2006** is the main law for businesses.
- Some **international laws** also affect UK businesses, like:
  - EU regulations
  - US **Sarbanes-Oxley Act** (for companies working with the US market)
- Some industries (like banks or finance) have special regulators, e.g.:
  - **Financial Services Authority (FSA)** for financial services
- Companies listed on the **London Stock Exchange** must follow its special rules.

Key Bodies & Their Roles

Body	Role
i) IFRS Foundation®	Oversees IASB & ISSB; ensures standards are developed transparently.
ii) International Accounting Standards Board (IASB®)	Develops and issues IFRS Accounting Standards for global use.
iii) IFRS® Advisory Council	Advises the IFRS Foundation and IASB on strategy and work priorities.
iv) IFRS Interpretations Committee (IFRIC®)	Issues guidance on how to apply IFRS Standards in specific situations.
v) International Sustainability Standards Board (ISSB™)	Develops global **sustainability** disclosure standards (e.g., climate risks).

Area	Example Disclosures
🌍 Environment	Carbon emissions, energy use, water saving
👥 Social	Workforce diversity, safety, employee welfare
⚖️ Governance	Anti-corruption, board structure, ethics policies

Role of IFRS Standards in Preparing Financial Statements

- Provide a common language for financial reporting worldwide.
- Ensure financial statements are relevant, faithful, comparable, and understandable.
- Help companies present a true and fair view of their financial position and performance.
- Make it easier for investors and other users to compare companies across borders.

Charged with Governance vs Responsible Parties

Those Charged with Governance	The people who **oversee and supervise** the preparation process — usually the **board of directors** or **audit committee**.
Responsible Parties	The people who **prepare** the financial statements — usually **management** (e.g., CFO, finance team).

Duties and Responsibilities of Those Charged with Governance

Who are "those charged with governance"?
They are the people responsible for overseeing the direction, control, and financial reporting of an organization.

Usually includes:

- ❖ Board of Directors
- ❖ Audit Committee
- ❖ Managing partners (in some organizations)

In the context of financial statements, their main role is to ensure that:

1) Financial statements are prepared properly
2) All accounting standards (like IFRS) are followed
3) Financial information is reliable and honest
4) Reports are prepared on time
5) There are internal controls to prevent fraud or errors
6) Important information is disclosed to users (like investors, lenders)

Those charged with governance have the duty to oversee the financial reporting process and make sure the accounts are true, fair, and compliant.

Context of financial statements, **GOVERNANCE** means ensuring that the accounts are accurate, prepared according to standards, and presented fairly and on time.