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Accounting is the process of preparing and explaining financial statements.

Definition (By American Accounting Association)
Accounting is defined as the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.

Accounting is an information system. It measures business activities, process data into reports and communicate result to people. Accounting is 'the language of business'.

Accounting produces financial statements, which report information about a business entity. Financial statements measure performance and tell where a business stands in financial terms.

KINDS OF ACCOUNTING

Accounting can be classified into two branches regarding the users of accounting information i.e. external users and internal users of accounting information.

Financial Accounting.

This provides information for people outside the firm, such as investors, bankers, government agencies and the public. The information must meet standards of *relevance** and *reliability**.

* Relevant – means '*able to affect a decision'; being specific to particular need.*

* Reliable – means *verifiable and free from bias.*

Management Accounting.

Generates information for the managers of an organization. Management accounting does not have to meet external standards of reliability because only company employees use these data.

NEED FOR KEEPING ACCOUNTING RECORDS.

There are many reasons for keeping accounting records depending on whether the business is operated by a sole trader, partnership or company.

These reasons include;

1. To prevent cash and other items owned by the business (e.g. vehicles, stock, and property) from being improperly used and stolen.

2. To monitor the cash available to the business, checking whether the amount available is sufficient to pay bills as they fall due.

3. To keep checking whether the business is doing well i.e. whether is sufficient reasons for continuing to carry on with the business.

4. To satisfy tax inspectors.

5. For partners to be confident that they are receiving their fair share of what the business earns.

6. It is essential to maintain accurate accounts to avoid disputes and possible litigation.

   Many professionals carry on business as partnerships e.g. solicitors, doctors, chiropodists and auditors.

7. Legal requirements that directors who manage companies to keep proper accounting records and to report financial information to those who have invested their cash in the company.

USERS OF ACCOUNTING INFORMATION

Decisions markers need information, as to satisfy some of their different needs of information. These needs include the following:-

(i) Owners (or Investors)

Need financial information relating to the enterprise to assess how effectively the managers are running it and to make judgments about likely levels of risk and return in the future.

Shareholders need information to assess the ability of the enterprise to pay them a return (dividend). This also applied to potential shareholders.

(ii) Employees and their Representative Groups.

Are interested in information about the stability and profitability of their employers. They also need information to be able to assess the enterprise's ability to provide remuneration, retirement benefits and employment opportunities.

(iii) Lenders.

Need information about the enterprises in order to assess its ability to meet its obligations, pay interest and to repay the amount borrowed.

(iv) Suppliers and other Trader Creditors.

Need information to enable them determine whether amounts owed to them will be paid when due.

(v) Customers.

Have an interest about the continuance of an enterprise, especially when they have a long term involvement with or are depend on the enterprise.

(vi) Government and its Agencies.

Need information in order to regulate the activities of an enterprise, to assess whether they comply with agreed pricing policies, whether financial support is needed, and how much tax they should pay. They also need information in order to determine taxation policies and as the basis for national income and statistics.

(i) Members of the Public.

Are affected by enterprises in a variety of ways e.g. enterprises may make substantial contributions to the national economy in many was. Including the number of people they employ or their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the enterprise and the range of its activities.

(ii) Investment Analysis.

Need financial information relating to an enterprise to assess the likely risks and returns associated with the enterprise in order to determine its investment potential and to advise clients accordingly.

(ix) Competitors

Need financial information relating to an enterprise to assess the threat to sales and profits posed by those businesses and to provide a benchmark against which the competitor's performance can be measured.

(x) Managers.

Ned financial information relating to an enterprise to help make decisions and plans for the business and to exercise control so that plans come to fruitions.

SPECIFIC REASONS WHY MANAGERS WITHIN THE BUSINESS NEED ACCOUNTING INFORMATION.

1. To ensure that business resources (including cash) are protected and applied in best manner possible.
2. To plan the business activities within the available resources.
3. To establish targets such as how much they plan to earn and the amount of expense they are likely to incur.
4. To control costs – which is an essential task for survival in a competitive market.
5. To establish business strategies e.g. whether to buy or rent the business premises; whether to invest in a different machine, whether to diversify the products, whether to maintain competitive advantage.

ELEMENTS OF FINANCIAL STATEMENTS.

SFAC 6 (Statements of Financial Accounting Concepts) defines 10 elements of financial statements. These elements are "the building blocks within which financial statements are constructed – ie. the classes of items that financial statements comprise'. They focus directly on items measuring performance and to reporting financial position. The definitions of these elements operationalize the resources, claims and changes identified in the third objective of financial reporting in SFAC 1.

The accrual accounting model is actually embodied in the element definitions.

FASB recognized that accrual accounting produces information that is more successful in predicting future cash flows than is cash flow accounting.

The 10 elements are:-

(i)	Assets	(ii)	Liabilities	(iii)	Equity
(iv)	Investments by owners	(v)	Distributions to owners	(vi)	Gains
(vii)	Revenues	(viii)	Expenses	(ix)	Losses
(x)	Comprehensive income				

These 10 elements of financial statements describe financial position and periodic performance.

1. **Assets.**

These are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. A key characteristic of this definition is that an asset represents probable future economic benefit. Thus a receivable is an asset only if it is probable that the benefit will result, that cash will be collected. They are controlled by aspect of the definition is also important. This is because for example, employees of a company represent future economic benefits to a company but they are not owned or controlled by the company and thus don to qualify as assets.

2. **Liabilities.**

These are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.

Most liabilities require the future payment of cash the amount and timing of which are specified by a legally enforceable contract. However, a liability need not be payable in cash. Instead, it may require the company to transfer other assets or to provide services e.g. a warranty liability is created for the seller when a product is sold and the seller guarantees to fix or replace the product if it proves defective.

A liability also need not be represented by a written agreement, nor be legally enforceable e.g. a company might choose to pay a terminated employee's salary for a period of time after termination even though not legally required to do so. The commitment creates a liability at the date of termination.

3. **Equity or Net Assets (Shareholders / Stock Holder's Equity)**

This is the residual interest in the assets of an entity that remains after deducting liabilities. Assets and liabilities are measured directly. Equity is not. It's a residual amount. The accounting equation illustrates this position:

$$\underset{\text{Net Assets}}{\underline{A - L}} = \text{Equity}$$

Equity arises from two sources:-

(i) Amounts invested by shareholders in a company (reported as paid-in capital) and

(ii) Amounts earned by the company on behalf of its shareholders (reported as retained earnings).

4. **Investments by Owners.**

These are increases in equity resulting from transfers of resources (usually cash) to a company in exchange of ownership interest.

5. **Distributions to Owners.**

These are decreases in equity resulting from transfers to owners. The most common distribution to owners is cash dividend.

6. **Revenues**

Are inflows or other enhancements of assets or settlements of liabilities from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major, or central, operations. A business enterprise acquires something (inflow of revenue) in exchange for providing goods and services to customers, which is also a major operation to an enterprise.

On the other hand if selling an item is not central operation of an enterprise but only an incidental result of those operations, the inflow of assets would produce again rather than revenue.

7. **Gains.**

Are increases in equity from peripheral or incidental transactions of an entity. Gains are net inflows, the difference between the amount received and book value. Revenues are gross inflows, measured as the amount received/receivable for the good/service without regard to the cost of providing the good or services.

8. **Expenses. (Outflows of resources incurred in generating revenues).**

These are outflows or other using up of assets or incurrence or liabilities during a period from delivering or producing goods, rendering services or other activities that constitute the entity's ongoing major or cents operations.

9. **Losses.**

Represent decrease in equity arising from peripheral or incidental transactions of an entity. Revenues plus gains less expenses and losses for a period equals net income or net loss.

10. **Comprehensive Income.**

Is the change in equity of a business enterprises during a period from transactions and other events and circumstances from non owner resources. It includes all changes in equity except those resulting from investments by owners and distributions to owners.