

FINANCIAL ACCOUNTING
WEEK 2 (LECTURE TWO)
CONSUMERS (USERS) OF FINANCIAL INFORMATION & VARIOUS FIELDS
(BRANCHES) OF ACCOUNTING

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Learning Objectives:

Upon completion of this chapter, you will be able to:

Explain the various fields of accounting

Explain the various consumers (users) of the financial statements

USERS (CONSUMERS) OF ACCOUNTING INFORMATION

Accounting information is produced in form of financial statements. These financial statements provide information about an entity's financial position, performance and changes in the financial position.

The financial position of a firm denotes the resources the business has and how much belongs to the owners and others.

The financial performance reflects how the business has performed, whether it has made profits or losses. Changes in financial positions determine whether the resources have increased or reduced.

The users of accounting information have an interest in the existence of the organization. Therefore, the information contained in the financial statements will affect the decision-making process.

The users of financial accounting information can be classified into two categories: Internal users involving the management, employees and the owners and the external users who include the potential investors, creditors, debtors, the government, competitors and the general public, among other users.

The following are the users of accounting information:

i.Owners:

These are the people who have invested in the business and examples of such owners include sole traders, partners (partnerships) and shareholders (company). They would like to have information on the financial performance, financial position and changes in the financial position.

This information will enable them to assess how the managers of the business are performing, whether the business is profitable or not and whether to make drawings or put in additional capital.

The owners of the firm are interested not only on short term stability of the organization but also the sustainability of the organization. Thus, well prepared and timely financial reports will enable sound decision-making to make the organization thrive.

ii. Customers

Customers rely on the business for goods and services. They would like to know how the business is performing and its financial position. This information would enable them to assess whether they can rely on the firm for future supplies especially in critical commodities depending on the nature of the industry that the organization is operating in. For example, a company in the transport industry will be keen to be assured of continuous supply of such products such as petroleum and spare parts among other items or services.

Customers at a university will be keen to be assured of availability of lecturers to teach and mentor students, facilitation in research activities, authentic fees statements and good learning environment among other critical services from the accounts department.

iii. Managers

The managers are involved in the day-to-day activities of the business. They would like to have information on the financial position, performance and changes in the financial position so as to determine whether the business is operating as per the established plans.

In case the plan is not achieved, then the managers come up with appropriate measures and strategies to ensure that the set plans are met.

These strategies that management may put in place may include reinforcing both primary and secondary controls in case there are indications from the financial reports that there are leakages,

losses or misuse of the organization's resources, stepping up marketing initiatives to improve on sales revenue, establishing new strategic partnerships and embracing new technology and innovations to improve on efficiency and cut down costs of doing business.

iv. Suppliers

They supply goods or services to the firm. The supplies are either for cash or credit. The suppliers would like to have information on the financial performance and position so as to assess whether the business would be able to pay up for the goods and services provided as and when the payments fall due.

For example, if the company is posting good profit margins and its cash flow is good, then the organization will be able to settle its obligation to its suppliers with a lot of ease. The suppliers will then become more motivated to supply more goods and services as they are assured of payments within a reasonable period of time.

v. The Lenders

They have provided loans and others sources of capital to the business. Such lenders include banks and other financial institutions.

They would like to have information on the financial performance and position of the business to assess whether the business is profitable enough to pay the interest on loans and whether it has enough resources to pay back the principal amount when it is due.

The lenders will be comfortable to transact with an organization whose liquidity position is strong.

vi. The Government and its Agencies

The government performs various functions for companies and organizations. This includes registration of organizations, establishing various mechanisms and public institutions to ensure that the interests and wellbeing of consumers are safeguarded.

These institutions on the other hand are obligated to pay tax apart from ensuring that they observe statutory requirements.

The Government is interested in the financial performance of the business to be able to assess the tax to be collected from businesses. Such taxes include Income tax, Value Added Tax, Pay as You Earn (PAYE), excise duty and custom duty.

The other government agencies are interested with the financial position and performance of the business to be able to come up with national statistics. These statistics measure the average performance of the economy.

vii.The Financial Analysts and Advisors

Financial analysts and advisors interpret the financial information. Examples include stockbrokers who advise investors on shares to buy in the stock market and other professional consultants like accountants. They are interested in the financial position and performance of the firm so that they can advise their clients on the value of their investment i.e. whether it is profitable or not and what the value is.

Other forms of advice that can be derived from the financial reports are whether to invest in a particular company or to exit by selling off shares of a poorly performing company.

viii.The Employees

They work for the business/entity. They would like to have information on the financial position and performance so as to make decisions on their terms of employment. This information would be important as they can use it to negotiate for better terms including salaries, training and other benefits.

They can also use it to assess whether the firm is financially sound and therefore whether their jobs are secure or not.

ix.The General Public

Institutions and other welfare associations and groups represent the public. They are interested with the financial performance of a company. This information will be important for them to assess how socially responsible the firm is.

This responsibility is in form of the employment opportunities the firm offers, charitable activities and the effect of the firm's activities on the environment. The general public, especially the surrounding communities would like to know the role of the enterprises around them in regards to their lives, environment and sustainability.

x.Investors

Majority of the investors except a few globally, carry out due diligence on their prospective investments or the organizations they would wish to put their money in. Compiling information from company to company or from one organization to another, can consume a lot of time or paying consultants to do the task on their behalf. The information contained in the financial information (Financial Statements) of an entity is very critical and useful to them. This is why financial information of registered companies and enterprises need to be certified or audited by credible financial auditors to give them credibility and reliability. This implies that financial information and financial statements must be prepared in a proper way, meeting the International Accounting Standards for any one in any part of the world to read and understand and make use of it as investors.

BRANCHES OF ACCOUNTING

Accounting is classified into several branches, namely Financial Accounting (FA), Cost Accounting (CA), Management Accounting (MA) and Social Accounting (SA). Cost Accounting in modern times has been merged with management accounting to form one and the same branch. In this case, for deeper understanding of accounting, it is good we delve deeper into these branches of accounting and make comparisons.

Financial Accounting:

This is the biggest branch of accounting and is involved with the preparation of financial statements which are mainly targeted for external users. Financial Accounting is entrenched into other sub-branches including, Specialised Accounting, Group Accounting, Accounting for Assets, Accounting for Liabilities, Accounting for Mergers and Acquisitions, Trust and Executorship Accounting, Accounting for Corporate Restructuring, among others. The information prepared in FA is regulated by International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) which requires that all FA information be prepared according to these standards for comparisons and other uses.

Comparison between Financial Accounting and Cost Accounting

Financial Accounting	Cost Accounting
Provides information to external users	Provides information to internal users
Produces general purpose financial statements	Produces special statements and reports
Must conform to generally accepted accounting principles.	Must conform to information needs of management
Provides accounting data in monetary terms	Provides accounting data in monetary and Non-monetary terms.
Financial statements are prepared on yearly, semi-annually or quarterly	Cost statements and reports are prepared more frequently: i.e. weekly, monthly or bi-monthly

Cost Accounting:

This is the second largest branch of accounting after financial accounting and mainly concentrates with internal reporting. Cost accounting prepares information which pertains to costs and costs accumulation so as to enable an organization to establish its costs and hence predict its costs with certainty alongside the revenues and profits. Classification of costs into either, fixed, variable, semi-variable, sunk costs, future costs among others is done by CA to enable managers' control function easier and to make it more organized. Both cost accounting and management accounting reports are consumed internally and mainly by the management and to an extent, by the owners of an entity. This is the main reason why in modern times, cost accounting and management accounting are being merged.

Management Accounting:

Management accounting is the third on the list in terms of volume of information produced by this branch of accounting. CA and MA combined, still form the second largest branch of accounting in the list. Management accounting as the name goes, produces reports for internal uses and mainly to the management to enable them make decisions on a day-to-day basis. The reports alongside those of cost accounting are produced frequently: monthly, weekly, bi-monthly and so on. For this reason, management accountants are usually very busy professionals as they work round the clock to ensure management have information to base their decisions on.

	FINANCIAL ACCOUNTING	MANAGEMENT ACCOUNTING
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Objectives	The main objectives of financial accounting are to disclose the end results of the business, and the financial condition of the business on a particular date	The main objective of managerial accounting is to help management by providing information that is used to plan, set goals and evaluate these goals.
Audience	Financial accounting produces information that is used by external parties, such as shareholders and lenders.	Managerial accounting produces information that is used within an organization, by managers and employees.
Legality	It is legally required to prepare financial accounting reports and share them with investors.	Managerial accounting reports are not legally required.
Segment Reporting	Pertains to the entire organization. Certain figures may be broken out for materially significant business units.	Pertains to individual departments in addition to the entire organization.
Focus	Financial accounting focuses on history; reports on the prior quarter or year.	Managerial accounting focuses on the present and forecasts for the future.
Format	Financial accounts are reported in a specific format, so that different organizations can be easily compared.	Format is informal and is on a per department/company basis as needed.
Rules	Rules in financial accounting are prescribed by standards such as IAS and IFRS. There are legal requirements for companies to follow financial accounting standards.	Managerial accounting reports are only used internally within the organization; so they are not subject to the legal requirements that financial accounts are.
Reporting Frequency	Defined-annually, semi-annually, quarterly, yearly.	As needed - daily, weekly, monthly.

Social Accounting:

This the newest branch of accounting and the smallest of the three. Social Accounting (SA) does not necessarily deal with numbers as FA, CA and MA does. SA deals with the welfare of the clientele, the general public, corporate social responsibility, and taking care of the less fortunate in the society so as to give back to society by entities including environment conservation and other conservation efforts. This enable organizations not to forget that they are part of the community in which they operate

Limitations of Accounting

- 1. Accounting information is expressed in terms of money:** Non-monetary events or transactions are completely omitted.
- 2. Fixed assets are recorded in the accounting records at the original cost:** The actual amount spent on the assets like buildings, machinery, plus all incidental charges is recorded. In this way

the effect of the rise in prices is not taken into consideration. As a result, the the Statement of Financial Position (Balance Sheet) does not represent the true financial position of the business.

3. Accounting information is sometimes based on estimates: Estimates are often inaccurate. For example, it is not possible to predict the actual life of an asset for the purpose of depreciation.

4. Accounting information cannot be used as the only test of managerial performance on the basis of mere profits: Profit for a period of one year can readily be manipulated by omitting certain expenses such as advertisement, research and development, depreciation etc. That is, window dressing is possible.

5. Accounting information is not neutral or unbiased: Accountants ascertain income as excess of revenue over expenses, but they consider selected revenue and expenses for calculating profit of the concern. They also do not include cost of such items as water, noise or air pollution i.e. social cost they may use different methods of valuation of stock or depreciations.

References

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