LESSON I: INTRODUCTION TO ACCOUNTING: Nature, Development, Branches, and Users of Accounting Information

1. DEFINITION OF ACCOUNTING

a. Accounting Standards Council (ASC)
a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities, that is intended to be useful in making economic decisions.

b. American Accounting Association (AAA)
is the process of identifying, measuring, and communicating, economic information to permit informed judgment and decisions by users of the information.

c. American Institute of Certified Public Accountants (AICPA)
is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of financial in character, and interpreting the results thereof.

d. "Accounting is the process of IDENTIFYING, RECORDING, and COMMUNICATING economic events of an organization to interested users." (Weygandt, J. et. al)

Therefore, accounting involves the following:

a. **IDENTIFYING** – this involves selecting economic events that are relevant to a particular business transaction The economic events of an organization are referred to as transactions. Examples of economic events or transactions - In a bakery business:
   • sales of bread and other bakery products
   • purchases of flour that will be used for baking
   • purchases of trucks needed to deliver the products
b. **RECORDING** – this involves keeping a chronological diary of events that are measured in pesos. The diary referred to in the definition are the journals and ledgers which will be discussed in future chapters.
c. **COMMUNICATING** – occurs through the preparation and distribution of financial and other accounting reports.

"Accounting is a systematic recording of financial transactions and the presentation of the related information to appropriate persons."

2. NATURE OF ACCOUNTNG

a. Accounting is a service activity.
As defined by the Accounting Standards Council (ASC), accounting is a service activity because its function is to provide quantitative information, primarily financial in nature, that is intended to be useful in making economic decisions.
Accounting **provides assistance to decision makers** by providing them financial reports that will guide them in coming up with sound decisions.

b. Accounting is a process.
It is not a random task but a systematic series of steps. *Weygandt, Kimmel, and Kieso (2019)* describe this as a cycle consisting of three core processes:

1. IDENTIFYING: This involves selecting specific economic events that are relevant to a particular business. These events are called transactions (e.g., selling goods or paying rent).
2. RECORDING: This involves keeping a chronological (date-ordered) record of transactions, measured in monetary terms (Pesos). These are written in accounting books called Journals and Ledgers.
3. COMMUNICATING: This occurs when the recorded data is summarized and presented to users through Financial Reports (such as financial statements). This makes the data understandable for decision-makers.

c. Accounting is both an art and a discipline

- Art: The AICPA defines accounting as the "art of recording, classifying, and summarizing in a significant manner." It requires skill, experience, and professional judgment to interpret what the numbers truly mean for a business.

- Discipline: It is a discipline because it follows a strict body of knowledge and rules, such as the Philippine Financial Reporting Standards (PFRS) and professional ethics.

d. Accounting deals with financial information and transactions

e. Accounting only recognizes transactions that can be **measured in monetary terms.** Events that are important but cannot be quantified in money (such as a manager's leadership skills or employee morale) are generally not recorded in the books (Millan 2019).

At every stage, from start to finish, accounting deals with financial information and financial information only. It does not deal with non-monetary or non-financial aspects of such information

f. Accounting is an Information System

It functions as a cycle that collects raw data (receipts/invoices), processes it through the accounting cycle, and communicates the resulting information (reports) to help different users make sound choices (Millan 2019).

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Accounting is recognized and characterized as a storehouse of information. As a service function, it collects processes and communicates financial information of any entity. This discipline of knowledge has evolved to meet the need for financial information as required by various interested groups.

3. FUNCTIONS OF ACCOUNTING IN BUSINESS

Accounting is the means by which business information is communicated to business owners and stakeholders. The role of accounting in business:

a. "Accounting is the language of business". (Millan 2019)
   Accounting is a systematic process used to identify, record, organize, and communicate the financial information of a business.
b. Decision-Making
   The goal of accounting is to provide facts. Without these reports, owners make decisions without sufficient financial basis. Accounting provides the data needed to make sound business decisions. Accounting information allows business owners to assess the efficiency and effectiveness of their business operations.

ILLUSTRATION:
Mr. Juan is a retired government employee who is good at baking. One day he decides to put up a bakery shop in your barangay. He renovates a portion of his house to serve as the area for the production of bread. He purchases baking equipment and raw materials to produce five different types of bread.

Mr. Juan also hires Jose to help him with the baking and, at the same time, to be in-charge of sales. Mr. Juan pays Jose on a weekly basis. Every day, Mr. Juan's wife deposits the daily cash sales in their bank account at XY Savings Bank.

With the help of accounting, what possible decisions or questions of Mr. Juan can accounting provide an answer to?

4. HISTORY OF ACCOUNTING

Accounting is as old as civilization itself. It has evolved in response to various social and economic needs of men. Accounting started as a simple recording of repetitive exchanges. The history of accounting is often seen as indistinguishable from the history of finance and business. Following is the evolution of accounting:

• **The Cradle of Civilization Around 3600 B.C.**, record-keeping was already common from Mesopotamia, China and India to Central and South America. The oldest evidence of this practice was the "clay tablet" of Mesopotamia which dealt with commercial transactions at the time such as listing of accounts receivable and accounts payable.

• **14th Century - Double-Entry Bookkeeping** The most important event in accounting history is generally considered to be the dissemination of double entry bookkeeping by Luca Pacioli ('The Father of Accounting') in 14th century Italy. Pacioli was much revered in his day, and was a friend and contemporary of Leonardo da Vinci. The Italians of the 14th to 16th centuries are widely acknowledged as the fathers of modern accounting and were the first to commonly use Arabic numerals, rather than Roman, for tracking business accounts. Luca Pacioli wrote Summa de Arithmetica, the first book published that contained a detailed chapter on double-entry bookkeeping.

• **French Revolution (1700s)** The thorough study of accounting and development of accounting theory began during this period. Social upheavals affecting government, finances, laws, customs and business had greatly influenced the development of accounting.

• **The Industrial Revolution (1760-1830)** Mass production and the great importance of fixed assets were given attention during this period.

• **19th Century** – The Beginnings of Modern Accounting in Europe and America The modern, formal accounting profession emerged in Scotland in 1854 when Queen Victoria granted a Royal Charter to the Institute of Accountants in Glasgow, creating the profession of the Chartered Accountant (CA). In the late 1800s, chartered accountants from Scotland and Britain came to the U.S. to audit British investments. Some of these accountants stayed in the U.S., setting up accounting practices and becoming the origins of several U.S. accounting firms. The first national U.S. accounting society was set up in 1887. The American Association of Public Accountants was the forerunner to the current American Institute of Certified Public Accountants (AICPA). In this period rapid changes in accounting practice and reports were made. Accounting standards to be observed by accounting professionals were promulgated. Notable practices such as mergers, acquisitions and growth of multinational corporations were developed. A merger is when one company takes over all the operations of another business entity resulting in the dissolution of another business. Businesses expanded by acquiring other companies. These types of transactions have challenged accounting professionals to develop new standards that will address accounting issues related to these business combinations.

• **The Present** - The Development of Modern Accounting Standards and Commerce The accounting profession in the 20th century developed around state requirements for financial statement audits. Beyond the industry's self-regulation, the government also sets accounting standards, through laws and agencies such as the Securities and Exchange Commission (SEC). As economies worldwide continued to globalize, accounting regulatory bodies required accounting practitioners to observe International Accounting Standards. This is to assure transparency and reliability, and to obtain greater confidence on accounting information used by global investors. Nowadays, investors seek investment opportunities all over the world. To remain competitive, businesses everywhere feel the need to operate globally. The trend now for accounting professionals is to observe one single set of global accounting standards in order to have greater transparency and comparability of financial data across borders.

Additional info:

Many believe that accounting evolved from the concept of "possession".

As mankind learned to amass food, objects and territorial claims, it became important to determine just how much had been collected and owned.

Evidence of one of the first tally systems has been linked to the jawbone of a wolf found in the Cro-Magnon cave that was discovered in Czechoslovakia in 1937. Research revealed that the said jawboned had fifty-five slashes carved into it and that the slashes were presented in groups of five.

In a separate archaeological find in Africa, a piece of animal bone was discovered which contained notches expressed in groups of 11, 13, 17 & 19, which represent numbers that cannot be distributed equally. It was apparent that making a permanent record of "how many" was of great relevance and significance even at the early period.

As more artifacts were discovered, researchers became more convince that, even during prehistoric times, man became conscious of recording and monitoring his possessions became more and more obvious.

When the Stone Age became the Bronze Age, and when the Bronze Age later transitioned into the Iron Age, metal possessions apparently became more valuable than the previous earthenware belonging.
Tokens of varying forms and sizes have been found, and are surmised to have been used to denote value, a significant development that heralded an improvement in trading methods.

❖ ***The Earliest Forms of Accounting***

The beginnings of ancient human civilizations oftentimes involved war and conflict, which turned tribes into nations when these conquered other tribes, and nations to empires by vanquishing other nations.

The idea of acquiring possessions had evolved into the concept of amassing wealth, which allowed those who had more to gain control or power over those who had less.
It was in the ancient lands of Mesopotamia, Babylonia and Egypt that earliest forms of accounting were introduced.

As mankind evolved from being hunters to being farmers, certain complexities necessitated the development of a system for managing wealth and possessions.
Invaders and conquerors oftentimes turned their captives into slaves, whom they had to account for because they were traded and distributed.

Subjects were likewise required to pay taxes to their overlords or rulers if they wanted to reside within the city walls and thus benefit from the protection that a walled city provided.

Agricultural crops had to be counted and recorded to make sure that the people were paying the correct amount of taxes.

The earliest known accounting records have been traced to the ancient biblical walled city of Jericho, the oldest known continuously inhabited city on Earth.

Anthropologists and archaeologists have found stone markers and envelopes which apparently served as documents that resembled a balance sheet.
Each document was specific to a certain individual, along with specific entries for agricultural inventories and number of tokens.

In the cities of Sumer and Mesopotamia, bookkeeping records were unearthed in the form of clay tablets, which bore indentations to mark the number of precious metals and goods that were traded.

The clay, which was impressed while wet and which would later be left under the sun to dry and harden, would serve as permanent records.

Moreover, the "abax", a device invented as an improvement over the tokens that were being used as markers in Sumeria, is said to be the original form of the abacus.

❖ ***The Renaissance and the birth of modern accounting***

It was during the Renaissance in the 14th century after the fall of the Roman Empire, that Italian scholars, led by Frater Luca Bartolomes Pacioli, developed the foundations of modern accounting .

However, his works were not published until much later, when accounting, as a scholarly discipline, was taken up as a separate subject matter.

In his book, *Summa de Arithmetica, Geometria, Proportioni et Proportionalita (Everything About Arithmetic, Geometry and Proportion),* the bookkeeping system was included among the guidelines for mathematical knowledge and applications.

Pacioli's guidelines included three (3) important books namely:

1. The Daybook- *contained the chronological order or recording all business transactions, and provided columns for various monetary units.*
2. Journal – *contained explanations of the transactions that were recorded in the daybook but were written in narrative form.*

3. Ledger – *had entries posted on the left page and on the right page, both of which referred to a single account (cash, goods, etc.)*

Pacioli's cycle of recording and monitoring ended with a **trial balance.**

The Renaissance man's final bookkeeping instruction was to make sure that the total of the ledger accounts on the left and right pages should be the same, otherwise, an error or several errors were made in recording the entries.

Thus, due diligence and intelligence were to be applied in seeking and correcting such errors.

A. Ancient Beginnings: Accounting in Early Civilizations
- Mesopotamia (around 3000 BCE): Clay tablets used for recording trade and taxes.
- Egypt: Record of harvests and labor for pyramid construction.
- China: Early bookkeeping for managing imperial treasures and taxes.
- Greece & Rome: Used accounting to track property, trade, and government spending.

"In ancient times, accounting was simple recordkeeping — writing on clay, papyrus, or bamboo to track goods, taxes, and trade."

B. The Middle Ages: Growth of Commerce and Double-Entry System
- Trade and banking expanded in Europe.
- Merchants needed better ways to track profit and loss.
- Luca Pacioli (1494): An Italian mathematician who described the double-entry bookkeeping system in his book Summa de Arithmetica, Geometia, Proportioni e Proportionalita.
- Known as the Father of Accounting

"This period was crucial - double-entry bookkeeping became the foundation of modern accounting. Every transaction had two sides: debit and credit."

C. Industrial Revolution: The Birth of Professional Accounting
- 18th–19th centuries: Factories and businesses grew rapidly.
- Need for detailed cost and management accounting.
- Accountants began forming professional organizations (e.g., 1854 - first professional body in Scotland).

"Accounting became more than recordkeeping - it turned into a profession that required training and standards."

D. 20th Century to Present: Modern and Digital Accounting
- Development of Generally Accepted Accounting Principles (GAAP).
- Formation of International Accounting Standards (IAS) / IFRS.
- Use of computers and accounting software (QuickBooks, SAP, Xero).
- Today: Accounting uses cloud systems and AI for accuracy and efficiency.

"Technology has transformed accounting from manual books to digital systems — faster, more accurate, and globally connected."

Summary:

Period	Key Development
Ancient	Basic recordkeeping on clay or papyrus
Middle Ages	Double-entry system (Luca Pacioli)
Industrial Age	Professional accounting and cost analysis
Modern Era	Global standards and digital accounting

"Accounting evolved because society evolved — from recording simple trades to managing complex global businesses."

5. BRANCHES OF ACCOUNTING

"Accounting is divided into several branches to better serve the needs of different users with varying information needs. These branches sometimes overlap and they are often closely intertwined."

1. Financial Accounting

- Financial accounting is the broadest branch and is focused on the needs of external users. Financial accounting is primarily concerned with the recognition, measurement and communication of economic activities. This information is communicated in a complete set of financial statements. It is assumed under this branch that the users have one common information need.
- Financial accounting conforms with accounting standards developed by standard-setting bodies. In the Philippines, there is a Council created to set these standards. Examples of these financial reports include:
  - the balance sheet (statement of financial condition)
  - income statement (the profit and loss statement, or P&L)
  - statement of cash flows
- Financial accounting is primarily concerned with processing historical data. Although financial accounting generally meets the needs of external users, internal users of accounting information also use these information for their decision-making needs.

2. Management (or Managerial) Accounting

- Management accounting emphasizes the preparation and analysis of accounting information within the organization. The objective of managerial accounting is to provide timely and relevant information for those internal users of accounting information, such as the managers and employees in their decision-making needs. Oftentimes, these are sensitive information and is not distributed to those outside the business - for example, prices, plans to open up branches, customer list, etc. Managerial accounting involves financial analysis, budgeting and forecasting, cost analysis, evaluation of business decisions, and similar areas.

3. Government Accounting

- Government accounting is the process of recording, analyzing, classifying, summarizing, communicating and interpreting financial information about the government in aggregate and in detail reflecting transactions and other economic events involving the receipt, spending, transfer, usability and disposition of assets and liabilities. This branch of accounting deals with how the funds of the government are recorded and reported.

4. Auditing

- There are two types of auditing:
  a. **External auditing** refers to the examination of financial statements by an independent CPA (Certified Public Accountant) with the purpose of expressing an opinion as to fairness of presentation and compliance with the generally accepted accounting principles (GAAP). The audit does not cover 100% of the accounting records but the CPA reviews a selected sample of these records and issues an audit report.
  b. **Internal auditing** deals with determining the operational efficiency of the company regarding the protection of the company's assets, accuracy and reliability of the accounting data, and adherence to certain management policies. It focuses on evaluating the adequacy of a company's internal control structure by testing segregation of duties, policies and procedures, degrees of authorization, and other controls implemented by management.

5. Tax Accounting

- Tax accounting helps clients follow rules set by tax authorities. It includes tax planning and preparation of tax returns. It also involves determination of income tax and other taxes, tax advisory services such as ways to minimize taxes legally, evaluation of the consequences of tax decisions, and other tax-related matters.

6. Cost Accounting

- Sometimes considered as a subset of management accounting, cost accounting refers to the recording, presentation, and analysis of manufacturing costs. Cost accounting is very useful in manufacturing businesses since they have the most complicated costing process. Cost accountants also analyze actual and standard costs to help managers determine future courses of action regarding the company's operations. Cost accounting will also help the owner set the selling price of his products. For example, if the cost accounting records shows that the total cost to produce one can of sardines is ₱50, then the owner can set the selling price at ₱60.

7. **Accounting Education**
   - This branch of accounting deals with developing future accountants by creating relevant accounting curriculum. Accounting professionals can become faculty members of educational institutions. Accounting educators contribute to the development of the profession through their effective teaching, publications of their research and influencing students to pursue careers in accounting. Accounting teachers share their knowledge on accounting so that students are informed of the importance of accounting and its use in our daily lives.

8. **Accounting Research**
   - Accounting research focuses on the search for new knowledge on the effects of economic events on the process of summarizing, analyzing, verifying, and reporting standardized financial information, and on the effects of reported information on economic events. Researchers typically choose a subject area and a methodology on which to focus their efforts. The subject matter of accounting research may include information systems, auditing and assurance, corporate governance, financials, managerial, and tax.
   - Accounting research plays an essential part in creating new knowledge. Academic accounting research "addresses all aspects of the accounting profession" using a scientific method. Practicing accountants also conduct accounting research that focuses on solving problems for a client or group of clients. The Accounting research helps standard-setting bodies around the world to develop new standards that will address recent issues or trend in global business.

CPA'S in Specialized Areas:

1. **Forensic Accounting** – forensic accountants provide the detective work needed to investigate and examine evidence of white-collar financial crimes such as stealing and fraud. They often act as expert to witnesses in legal proceedings and prepare evidence to be presented in court.

2. **Information** Technology Services - businesses often seek individuals who can design and implement customized software systems. CPA's who possess strong skills in information technology can work with e-commerce ventures and consult with other to determine which decisions are the financially and technologically sound for a company.

3. **Environmental Accounting** – CPA's involved in environmental accounting determine how companies can be both profitable and environmentally responsible. They do environmental compliance audits and set up preventative systems to ensure compliance and avoid future environmental related claims or disputes.

4. **International Accounting** – International accountants are knowledgeable in international trade rules and regulations, international mergers, government regulations, tax laws, and overseas transactions. CPA's who work in this area often travel abroad and can speak and understand different languages.

BOOKKEEPING – confined with the recording of monetary transactions (recording phase) which is one part of the accounting process.

ACCOUNTING PRACTICE

1.PUBLIC ACCOUNTING SERVICES:

- firms of accountants that serve or render independent and expert financial services to the public or clients such as businesses (retailers, manufacturers, service companies, etc.), individuals, nonprofits and governments.

Examples:

a. External Auditing

- public accountants examine the financial statements in order to express an opinion on whether statements have been fairly presented or not.
- the auditor critically examines the accounting records of the client to check if business transactions have been properly recorded then issues an independent audit report.

b. Tax Preparation and Planning Services

- advice and help clients in tax planning and preparing tax returns as a tax specialist
- the accountant here is expected to be knowledgeable about revenue regulations and tax laws and also represents the client in any tax-related case filed by the BIR.

c. Management Advisory Services

- management consulting, involves financial planning and control, and the development of accounting and computer systems.
- the accountant advises management on matters such as the installation of an accounting system, finance, budgeting, business processes, introduction of new products, and other business activities.

2. PRIVATE:

- private accountant is a salaried employee (employed) in business entities in various capacity as accounting staff, chief accountant, internal auditor and controller the highest accounting officer in an entity.
- the private accountant assists management in planning and controlling the entities operations.

5. USERS OF ACCOUNTING INFORMATION

A. External Users

- External users of accounting information are parties outside the operation of a business who use its accounting and financial information in making important decisions.
- Since these users do not have direct access to accounting information, they are given access to records by the business in the form of financial statements.
- External users make their decisions based on the company's financial information.

The following are the external users of financial information:

1. Potential Investors

- *they need information to help them decide whether they should invest or not in the business.*

Through past performance or operating results of the company, they would want to know potential returns on their investments should they decide to invest.

2. Creditors and potential creditors

- they assess the credit worthiness and capability of the business pay its obligation including the related interest on maturity date.

- A creditor, such as a bank, may need to know the liquidity and profits of a business. This information is necessary during loan applications. Also, investors may need access to the internal operations of a company.

- The issuance of financial statements to parties such as these helps them to understand the performance and operations of the company. This information may be used by the creditors, investors and other parties to design business plans and to make vital decisions regarding the company.

3. Customers

- they assess the financial position of their suppliers which is necessary for them to maintain a stable source of supply in the long term. They are interested to know whether the business will continue to honor its product warranties.

- customers may also need to know a company´s information to determine the financial state of its suppliers. This lets them determine if the company is capable of ensuring a stable source of supply.

One of the main objectives of accounting is to provide enough information required by external users to make right decisions. In the long run, the access to such information helps to benefit the company in many ways.

4. Suppliers

- they use the financial statement of their customers to determine whether the debts owed to them will be paid when due or whether the customer has enough funds or resources to pay the goods ro be delivered.

5. Tax Authorities

- they use the financial reports to determine the credibility of the tax returns filed on behalf of the company. They are interested to know if the business paid the correct amount of taxes.

6. Regulatory Bodies

- they want to ensure that the company's disclosure of accounting information is in accordance with the rules and regulations set in order to protect the interest of the stakeholders who rely on such information.

Example: SEC – Securities & Exchange Commission
BSP – Bangko Sentral ng Pilipinas

7. Public

- they use the financial information to know how the business helps the economy and whether employment is available in the company.

B. INTERNAL USERS

- those who make decisions that affect the internal operations of the company. The following are internal users of financial statements:

a. Managers – plan, organize, and run a business.
b. Employees/labor unions – assess the company's profitability, its consequence on their future salary and job security.
c. Owners – they provide the capital to the business. Owners need the accounting information to help them decide whether they should withdraw or increase their investments. They are interested to know the return of their investment.

Common information needs of the internal users:
1. *Do we have enough cash to pay bills?*
2. *Can the company afford to give salary increase?*
3. *How much is the company's sales growth for the month?*
4. *How much is the cost of producing each unit of product?*
5. *Which product line is more profitable?*
6. *How much is the tax payable to the government?*

The accounting information provided to internal users can be in the form of:

- management reports
- budgets
- financial statements

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