FINANCIAL ACCOUNTING

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OUR PROGRAMMES ARE TAILORED FOR TODAY'S INTERCONNECTED WORLD, EQUIPPING LEARNERS WITH THE SKILLS, MINDSET, AND CONFIDENCE TO SHAPE THEIR FUTURES THROUGH INNOVATION, EXCELLENCE, AND LIFELONG LEARNING.

PREFACE

This book has been carefully written to serve as a **comprehensive study guide** for students pursuing **Financial Accounting** under the **CPA and ACCA syllabi**. The subject is foundational to professional accountancy training, and a strong mastery of its principles equips students not only for examinations but also for professional practice in the real world.

The purpose of this **study guide** is to introduce learners to the **nature and purpose of accounting**, the **regulatory framework**, and the **accounting treatment and presentation of transactions** in line with **International Financial Reporting Standards (IFRS)** and related guidelines. By working through the chapters systematically, candidates will build the confidence to:

- Prepare books of original entry and apply the double-entry system correctly.
- Draft and interpret financial statements for different entities, including sole traders, partnerships, companies, manufacturing concerns, and not-for-profit organisations.
- Apply accounting standards (IAS/IFRS) to transactions relating to assets, liabilities, and equity.
- Analyse financial performance using ratios and statements of cash flows.
- Demonstrate awareness of public sector accounting frameworks and the distinct reporting needs of government entities.

The text is structured to follow the **current syllabus**, ensuring syllabus coverage is complete, and no examinable topic is omitted. Each chapter begins with **clear learning outcomes**, followed by detailed explanations enriched with **worked examples, practical illustrations, and diagrams**..

A distinguishing feature of this book is its **student-friendly language**. Technical topics such as depreciation, financial instruments, or cash flow statements have been broken down into **step-by-step explanations**, ensuring that students at all levels of ability can grasp key concepts. Worked examples are crafted to balance perfectly, enabling learners to see clearly how the **accounting equation holds true in practice**.

Above all, this guide is intended not just as an exam companion, but also as a **practical reference** for early career accountants. Whether in audit, taxation, financial reporting, or management, the ability to prepare and analyse financial statements remains a core skill for every accountant.

It is my hope that this book will make the study of Financial Accounting both **approachable and engaging**, and that it will empower CPA and ACCA candidates to excel in their examinations and beyond.

Author's Note

I welcome feedback from students, lecturers, and practitioners to refine future editions. Accounting is a living subject, continuously shaped by international standards and local practice, and this guide will continue to evolve to reflect those changes.

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Dear Student

Welcome to your journey in **Financial Accounting**. This book has been designed with you in mind — to make even the most technical concepts clear, approachable, and relevant for your **CPA or ACCA exams**.

Each chapter begins with **learning outcomes** to guide your study, followed by **step-by-step explanations** in simple, student-friendly language. Worked examples are crafted to balance perfectly, so you can trace every figure with confidence.

Remember, Financial Accounting is not just about passing exams. The ability to prepare and interpret financial statements is a **core professional skill** that you will use throughout your career. Approach each topic with curiosity, practise consistently, and use the worked examples as your toolkit.

Stay motivated, stay disciplined, and believe in yourself. With focus and determination, success in CPA or ACCA is within your reach.

I wish you every success as you study with this guide.

CPA Ronoh Benson Benhard
Synapse Global Institute
2025

CHAPTER ONE

INTRODUCTION TO ACCOUNTING

1.1. NATURE AND PURPOSE OF ACCOUNTING



1.1 Nature and Purpose of Accounting

Nature of Accounting

1. **Definition of Accounting**
    - Accounting is the process of **recording, classifying, summarising, analysing, and communicating** financial information about an entity to users for decision-making.
    - It provides a **language of business** that communicates the financial health of an organisation.
2. **Accounting as an Art**
    - Requires judgement, skill, and discretion when making estimates and applying standards.
    - For example: choosing depreciation methods, setting provisions for doubtful debts, or valuing stock.
3. **Accounting as a Science**
    - Based on systematic methods, established principles (such as IFRS, IAS), and concepts.
    - Relies on evidence, verification, and logic.
4. **A Process (Systematic in Nature)**
    - *Recording*: capturing business transactions in books of prime entry.
    - *Classifying*: grouping transactions into categories

like expenses, revenues, assets.

- *Summarising*: preparing trial balances and financial statements.
- *Analysing and interpreting*: evaluating performance, liquidity, solvency, etc.
- *Communicating*: reporting information to stakeholders.

5. **A Service Activity**
    - Accounting does not exist for its own sake; it provides services by supplying useful information for decision-making, planning, and control.

Purpose of Accounting

1. **To Provide Information for Decision-Making**
    - Assists investors, creditors, and management in making informed choices.
    - Example: whether to invest in shares, grant a loan, or expand production.
2. **Stewardship and Accountability**
    - Management is accountable to owners/shareholders for resources entrusted to them.
    - Accounting provides evidence of how resources are used.
3. **Compliance with Legal and Regulatory Requirements**
    - Companies Acts (in many countries), tax authorities, and regulators require preparation of financial reports.
    - Ensures organisations comply with IFRS/IAS and local regulations.
4. **Performance Measurement**
    - Helps assess profitability, efficiency, and effectiveness.
    - For example, through ratios such as gross profit margin, return on assets, and liquidity ratios.
5. **Facilitating Planning and Control**
    - Budgets, forecasts, and variance analysis are based on accounting data.
    - Enables managers to control costs and allocate resources efficiently.
6. **Facilitating Comparability**
    - Users can compare results over time (trend analysis) and across firms in the same industry.
7. **Facilitating Credibility and Transparency**
    - Well-prepared accounts build trust with stakeholders and improve access to finance.
8. **Social Responsibility and Sustainability** *(modern perspective)*
    - Increasingly, accounting is expected to report on

environmental, social, and governance (ESG) issues.

- Example: integrated reporting under the International Integrated Reporting Framework.

Section 1.1 Summary

- Accounting is both an **art (judgement)** and a **science (systematic rules and standards)**.
- It is a **process** of recording, classifying, summarising, analysing, and communicating financial information.
- Its purpose is to:
  - Provide decision-useful information.
  - Ensure stewardship and accountability.
  - Comply with legal and regulatory frameworks.
  - Measure performance and support planning and control.
  - Promote transparency, comparability, and sustainability.

Practising Questions

Question 1 (Essay)
Discuss the nature of accounting. In your answer, highlight why accounting is considered both an art and a science, and explain the key stages of the accounting process.

Question 2 (Application)
XYZ Ltd. received Ksh 500,000 from investors, purchased machinery worth Ksh 200,000 in cash, and bought goods on credit worth Ksh 50,000.
Required:
(i) Show how these transactions illustrate the *dual nature* of accounting.
(ii) Explain how the preparation of financial statements from these transactions fulfils the purposes of accounting.

Question 3 (Analysis)
The stewardship function of accounting is becoming less important in the modern corporate world, as investors are more concerned with decision-useful information. Critically analyse this statement with reference to the objectives of accounting.

1.2. THE OBJECTIVE OF FINANCIAL ACCOUNTING

The Primary Objective of Financial Accounting

According to the **Conceptual Framework for Financial Reporting (IASB, 2018)**, the **primary objective** of financial accounting is:

To provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity.

This means financial accounting focuses on:

- **Decision-usefulness –** enabling stakeholders to decide whether to invest, lend, or continue association with the entity.
- **Economic resources and claims –** showing the assets (resources), liabilities (obligations), and equity.
- **Changes in resources and claims –** reporting income, expenses, gains, and losses.

Secondary Objectives of Financial Accounting

While decision-usefulness is central, financial accounting also pursues other important objectives:

1. **Stewardship and Accountability**
    - Management must account to shareholders for the use of resources entrusted to them.
    - Financial statements provide evidence of compliance and ethical use of funds.
2. **Compliance with Legal and Regulatory Requirements**
    - Many jurisdictions (e.g., Companies Acts, tax laws, securities regulations) mandate periodic preparation and publication of financial statements.
    - Helps entities avoid penalties and maintain good standing.
3. **Performance Measurement**
    - Through financial statements, users can measure profitability, efficiency, and effectiveness.
    - Ratios such as return on assets (ROA), net profit margin, or gearing provide insights.
4. **Providing a Basis for Planning and Control**
    - Historical data informs future budgets and strategies.
    - Variance analysis compares actual performance against planned results.
5. **Comparability and Transparency**
    - Standardised financial reporting under IFRS/IAS allows stakeholders to compare results:
        - Over time (trend analysis).
        - Across companies (benchmarking).

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