

Name _____

1.2 Formal accounting

Accounting is a form of communication that is used to convey a specific message about the finances of a business. It is essential that the receiver of this message (the user of financial information) understands it otherwise the information will have no value.

In our daily lives various things are repetitive in nature (in other words, are always the same, although the results may be different if we react differently in each case). If we do not have guidelines to guide our actions, our actions may be inconsistent. People may perceive us as unreliable.

The same applies to Accounting. Various transactions are repeated every month and businesses should follow a certain (accounting) policy in order to ensure that all transactions are consistent. The Accounting policy is a set of decisions about the way a business deals with the same transactions in order to achieve consistent results. If each person developed his/her own driving rules, there would be chaos. For this reason, there are generally accepted rules.

In Accounting we experience the same problem. If each business were recording financial information in their own way, it would result in chaos in the economic world. Therefore, a system for the measurement and disclosure of the results of financial actions (transactions) was developed. This system is the general framework of accounting concepts, principles, methods and procedures collectively known as **GAAP (Generally Accepted Accounting Practice)**. This will be discussed in 4 in depth.

The Board for Accounting Practice plays an important role in South Africa by developing the GAAP principles and setting accounting standards. The setting of accounting standards is an effort to manage the available accounting practices and to set uniform and rigid rules applicable to all situations and transactions. This is to enhance the application of certain standards in financial reporting in order to eliminate undesirable alternatives.

Everyone working in a business uses financial information. We also have to understand enough financial information and accounting to be able to manage our personal finances (e.g. to draw up a personal budget). A system of accounting or bookkeeping helps a business to organise its financial data properly. The accounting system that businesses use have been developed so that people understand it, no matter what business they run or where they are in the world. Many activities take place in a formal accounting environment. Accounting activities are divided into the following three groups:

Financial accounting	Managerial accounting	Tools in managing resources
Financial accounting includes the logical, systematic, and accurate recording of financial transactions as well as the analysis, interpretation and communication of Financial Statements by understanding the fundamental concepts regarding basic accounting principles and practices.	Managerial accounting includes concepts such as costing and budgeting. It puts emphasis on analysis, interpretation and communication of financial and managerial information for decision- making purposes.	Tools in managing resources include basic internal controls and internal audit processes and code of ethics. It put the emphasis on the knowledge, understanding and adherence to ethics in pursuit of human dignity, acknowledging human rights, values and equity, in financial and managerial activities.

Activity 2

Compare formal and informal (indigenous) accounting systems under the headings provided below:

INFORMAL	FORMAL
Capital	

Fixed assets	
Inventory	
Selling price	
Cost of sales	
Labour cost	
Income	
Expenses	

Credit transactions	
Bookkeeping	