# ACCOUNTING CYCLE AND THE DEVELOPMENT OF ACCOUNTING PRACTICES IN NIGERIA

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***Abstract***

*As business and public entities keep on expanding, there also the need for accounting practices to keep to date as to meet the organizational objectives. Whatever decision is to be taken by management such decision depend on how well accounting data is collected, analyzed, summarized and interpreted. Accounting as an information tool passes through six critical stages, which if care is not taken at any stage the aims and objectives of the exercise can easily be jeopardized. The objective of the paper is to assess the stages and find out the six stages and analyzed the characteristic of each stage. In doing so secondary data including text books and journals are consulted. The study found that irrespective of whatever method employed,( human, mechanical or computer) human error is the central focus. The paper recommended that intensive accounting training should be given to accounting technicians. Similarly, the paper also recommends that accountants and accounting technicians should duly comply with accounting professional ethics.*

***Keywords:*** *Accounting, Accounting development Accounting cycle, journal, Ledger, Trial Balance, Income Statement, Balance Sheet*

## Introduction

The need of accounting in all human endeavors cannot be over emphasized, as people throughout history keep and maintains records of their daily economic activities. History reveals that, some of these records were in a clay tablets indicating the payment of wages in Babylon around 3600BC, similar – records keeping also found in ancient Egypt and Greek city – States (Warren, Fess and Reeve, 1996).

The complexity and dynamic nature of our environment (social, political, economic and technology) pose a great challenge to business entities, schools, and public parastatals in searching for more viable means of keeping records that will go with the phase of time. This means the more entities are becoming lager and progressing the more complex they became and the more proper accounting information they required for onward decision making. This is why Welsch and Antony (1981) argues that accounting is man-made act and continuously is undergoing change to meet the evolving needs of the society.

The major factors that influences the development of accounting practice as examined by (Warren, et el, 1996) include the development of double entry system in 1494, the industrial revolution which changes the method of producing, marketable goods from handicraft method to factory system between mid of eighteenth century to early nineteenth century, the evolvement of first corporate form of organization in 1845 in England, with immediate need for an independent review or audit reports prepared by the corporation management are all influential factors that made accounting what it is today. Other influential factors include the influence of government both at three level (federal, state and local) on recording and maintaining financial data for a variety of government laws and regulations. Similarly, the desire by the above mentioned governments in collection and maintaining tax records and policies are of paramount significant development to accounting practice.

Salisu (2011), traces the development of accounting in Nigeria prior to the establishment of professional accounting bodies in the country. However the first indigenous professional accounting body is the Institute of Chartered Accountants of Nigeria (ICAN), which was established in 1965 by an act of parliament. It provides training; participate in provision of account guidelines and regulations in Nigeria. In 1993 the Association of National Accountants of Nigeria (ANAN) came into being, The association is responsible for ensuring accounting practices, and providing regulation of accounting practices similar to that provided by its counterpart (ANAN).

**Conceptual Frame-Work**

**What is accounting?**

There are various definitions given to the term accounting, Welsch and Anthony (1981) defined the term as “the measurement and reporting in monetary terms of the flows of resources into (inflows) and out of (out flows) an organization of the resources controlled by the organizations and the claims against those resources’’.

In his contribution to the discipline, Marshall (1993) attributed accounting to the process of indentifying, measuring and communicating economic information about an organization for the purpose of making decisions and informed judgment.

To concur with the above definition, the American accounting association (1966) defined accounting as the process of identifying, measuring and communicating economic information to permit informed judgments and decision by the users of the information.

To sum it up, the definitions above reflected on three key issues.

(i) Accounting communicates monetary information to both external and internal users.
(ii) Accounting quantifies and measures economic activity in monetary term.
(iii) Accounting provides information, upon which both the internal and external users can use in decision making process.

It is obvious to note that information and decision making are the vital ingredients required for any successful entity to achieve its organizational objective. Similarly, decision making, good or bad depends on how well or bad data is collected and processed. To ensure an effective decision based on sound information, accounting records must be processed through stages and these stages are what constitute the accounting cycle. (Owen, 2011, Melsay and Chesley, 1990).

**Accounting Cycle**

A cycle means the happening of events in systematic manner and re-occurring of the same at regular intervals. Owens (2011) define accounting cycles as a series of steps that happen over a predetermined period of time, each period begins and ends with the same steps in the process. Hoskin, Davidson and Fizzel (1997) looks at accounting cycle as a whole system in which transactions are measured, recorded and communicated.

There are a lot of controversies to the number of stages or phases an accounting cycle suppose to witness for example McNair, Edmond, Millan and Old (1998) identified three distinct stages which include (i) Data is recorded (ii) Data is used to prepare financial statement (iii) Nominal account is closed, after this three stages have been completed a new cycle begin.

Unlike McNair et al (1998) others including (1970) and Walgenbatch, Earnest and Norman (1987) believe that accounting cycle passes through six stages, which are;

(i) Journalizing (ii) Posting to the ledger and balancing the ledger account (iii) extracting the trial balance (iv) Adjusting entries in the ledger (v) Income statement (vi) Position statement.

In their contribution Welsch and Chesley (1990) argued, there are nine stages to complete an accounting cycle. They included three more stages to the earlier six claimed by Tuisian (1970), (i) The accounting work sheet, (ii) Journalize and post the adjusting entries. (iii) As well as collection of economic data about each transaction. They argued further, the differences in number of stages/phases is immaterial as it is a matter of personal convenience, what matters most is the objective to which the accounting cycle is set to achieve, and these include;

(a) To be able to handle large volumes of accounting data.
(b) To facilitate the end of period accounting activities.
(c) To minimize the accounting errors and omissions.

Horngren, Harrison and Bamber (1999), observe that, the number of activities in accounting cycle can be performed under two distinctive time period. During the period activities such as journalizing transactions, posting to the ledger are expected to be carried out, while end of the period, includes activities such as adjusting the account, closing the account and preparing the financial statement.

## STAGES OF ACCOUNTING CYCLE

Since it is a matter of personal choice, the way out is to harmonize some phases that are hardly to strike a line of difference, as to maintain the six stages put forward by Tulsian (1970) and Walgenbatch et el (1987).

### Stage one: Identification and Recording

The first activity in accounting cycle is the identification of source of record /information. This stage is very important as all the subsequent stages depend on the source information. If the source is faulty all the remaining stages will be faulty. Among the source-documents that is to be identified includes, sales invoices, whenever there is sales, receipts whenever money comes into the business, cheques when making payment as well as deposit slip when money is remitted into the account of the business in a bank.

It should be noted, sources of errors either by omission or commission started from source documents, a dubious cashier can alter and change figures in these document, and therefore any suspicious utterances should be reported immediately.

After ascertaining the authenticity of source document, the next is to record the data in the primary book, which is known as a journal. A journal is a book in, which day to day transactions are recorded in debit = credit format (Welsch and Chelsey, 1990). The book is also called a book of prime entry or original entry. (Tulsian, 1970).

To keep an informed record the journal is divided into five columns. (i) Date, when did the transaction took place? (ii) Particular, what happened/transacted (iii) Ledger folio, used for reference purpose (ledger folio number , invoice number, cheque number etc.) (iv)Debit side which denoted by Dr is the receiving side and lastly (v) credit which is denoted by Cr is the giving side.

Journal is classified into two; General Journal and Proper Journal. A general journal is that, which records the daily transactions. These include; purchases, sales,

received and payment of cash. On the other hand, journal proper is that, which records of special events are found, for example determination of capital by an ongoing business by the end of a particular business period, using the business assets and liabilities.
Tuisian (1970) provides the following steps, when journalizing:-

(i) Ascertain what and the nature of accounts involved in a transaction.
(ii) Ascertain which rule of credit and debit is applicable for each transaction involve.
(iii) Ascertain which account to be debited and which is to be credited.
(iv) Record the date, particulars, what to be debited and what to be credited in appropriate column.
(v) Write narration, which is a brief description about the transaction.
(vi) Draw a line to separate one journal entry from another.

Critical points to note in this stage include when entries are made not in relevant accounts or a situation where a complete transaction is omitted, un recorded asset will reduce the book value of the assets thereby affecting the total market value of the organization.

**Stage two: Posting to the Ledger**

The second stage in accounting cycle is posting entries from primary book (journal) to ledger account. A ledger account is a page of a book divided into two equal parts. It is called an account when there is a name written on it. Unlike journal, a ledger is guided by accounting rules, governing personal, real and nominal transactions.
To post effectively, the three accounting rules must be observed where necessary.

(i) Personal account rule: when transactions involve individuals, the rule says: (Dr. The receiver and Cr. The giver)
(ii) Real account rule, when transactions involve anything real, tangible and visible, (Dr. What comes in and Cr. What goes out)
(iii) Nominal account rule, when transactions involve intangibles such as expenses and incomes. (Dr. All expenses and losses and Cr. All incomes or gains)

As a matter of fact, an organization can have as much as possible different number of ledgers depending on the scope of its operation, similarly, the number of columns that a ledger supposed to have depends on the nature of its operation (one, two or three columns.)

` A ledger has two equal sides, the left hand (Dr) which is the receiving side is called debit side and the right hard side which is called the credit side (Cr). Each side is further being divided into equal number of columns, which contains the date, particulars, ledger folio and amount. The columns perform the same functions, only the debit side columns are used when receiving and the credit columns are used when giving. The importance of these columns can be referred back to the importance of the columns in the book of original entry.

The items entered in a general journal must be transferred to the general ledger; this procedure of posting is part of summarizing and classifying process (Kieso, Weygandt and warfield, 1993).

This posting to the ledger, re-orders the data from the chronological order in the journal to the classification in the fundamental accounting mode (Welsch and Chesley, 1990), Assets = Liabilities + Owners equity. In addition to this it is also viewed as the basic accounting records that will be used in completing the remaining phases of the accounting information processing cycle.

After finishing all the posting from journals into relevant accounts (ledgers), each ledger account has to be closed marking the end of the transaction as far as the business period is concerned. In closing the balance, where the ledger has only one posting a line should be drawn beneath the amount, indicating as the last value for that period.

If there are more than one postings appearing only on the debit (Dr) or (Cr) side, the said amount has to be sum up to give a single figure. But in a situation where there are many postings appearing in both sides of the ledger account, each side must have it balance separately, the side with the lowest balance will be subtracted from the side with the highest value, their by determining the balance carry down.

**Stage three: Extracting a Trial Balance**

A trial balance is not an account, but a list of accounts and their balances at a given time (Kieso, et el, 1993). The main objectives of a Trial balance as put forward by Tulsian (1970) are to:

(i) Ascertain the arithmetical accuracy of ledger account
(ii) To help or facilitate in the preparation of final account
(iii) To help in locating errors

Upon all the three objectives, locating errors faces a lot of bottlenecks due to the fact that, it is not all errors that a trial balance can identify, some errors such as error of principle, compensating error, error of omission, error of recording in the book of original entry as well as error of posting the correct amount in wrong account does not all affect the trial balance. These errors occurred most often and hardly to be noticed in the trial balance. In most cases a fictitious account (suspense account) is used to cover errors and frauds. To control these errors, of internal control must be placed into action. Similarly, establishing rotation among the accounting clerks will checkmate some of the wanted practices.

Balance brought down from ledger accounts are transferred into their relevant side in the trial balance, each ledger account must be ensured that, its balance is duly recorded either in debit or credit side of the trial balance depending where the balance brought down come from.

After all balances are incorporated in the trial balance, an independent addition of each side is expected to be carried out. Where the values of the two sides tally that means agreeing with each other, then it assumes that a high level of arithmetical accuracy is achieved. However, if the two sides do not tally, then an error is said to be committed somewhere, and this will call for corrections and adjustments.

**Stage 4: Adjusting the Trial Balance**

Walganbatch, et el (1987) pointed out that it is important that accounts appearing in financial statement at the end of an accounting period be properly stated, which means all expenses and revenues incurred during the business period must be stated. This process of aligning costs and expenses with related revenue is what constitute the matching concept in accounting.

To achieve proper matching, accounts balance must be adjusted by the end of each accounting period. The adjustment as advance by Payle et al (1990) is based on two accounting principles, the recognition principle and the matching principle. The recognition principle requires that revenue be assigned to the accounting period in which it is earned rather than the period it is collected in cash and the matching principle requires that revenue and expenses be matched.

There are four general types of adjustment to be made at the end of each accounting period, as provided by Walgenbatch et al (1987) .

1. Aligning recorded costs with the appropriate accounting periods.
2. Aligning recorded revenue with appropriate accounting period
3. Reflecting unrecorded expense incurred during the accounting period
4. Reflecting unrecorded revenue earned during the accounting period.

These four general types of adjustment can be broken down into five classes as found in Pyle, White, Larson and Zin (1990) and these include;

(i) Prepaid expenses; this means payment in advance, a situation where the payment has already been made without enjoying or consuming the services or products paid for, a good example includes payment of insurance and rents.

(ii) Depreciation. This refers to wear and tear as a result of continuous use of fixed assets, such as machinery, Motor van, building etc. the more assets are put into use the more its value depreciated. Depreciation reduces the value of an asset and at the same time increases the value of expenses.

(iii) Accrued expenses. These are expenses that are supposed to be paid within the accounting period, which was incurred, but not yet paid, this includes wages, interest owed to creditor on loan (Solomon, Vargo and Walther, 1990).

(iv) Unearned revenue. This is when payment is received for goods or service in advance of their delivery. This increases a cashflow at the same time and created for it a liability

(v) Accrued Revenue. This is revenue earned but not collected because payment is not due.

**Stage Five: Preparation of Income Statement**

From the balances in the adjusted trial balance, the next is to prepare income statement, which will shows the results of business operation during the accounting period. Income statement, which is popularly called trading, profit and loss a/c is divided into two segments. The trading segment attempts to ascertain the gross margin from the trading activities, while the profit and loss segment is determining the net income or loss after taking both expenses and incomes into consideration. it is at the disposal of the business to determine, which format to adopt in preparing and presenting income statement, the two formats are vertical and horizontal income statement.

**Stage 6 preparation of position statement (Balance sheet)**

This is the last stage in accounting circle. A balance sheet is a statement of assets and liabilities of an enterprise in a given date, the reason why it is called a balance sheet is put forward by Tulsian (1970) is that it balances those ledger accounts which have not been close till the preparation of trading and profit and loss a/c.

Some of the reasons why balance sheet is prepared among others includes, ascertaining the value of assets and liabilities of the business as well as to determine the level of solvency of the organization. However, balance sheet can be prepared either in order of liquidity or order of performance, using vertical or horizontal format.

Preparation of work sheet is not part of stages of accounting circles as some assume, but it is an optional working paper that can simplify the accountant’s effort in preparing financial statements (Larson, Jansen and Carrol, 2002).Hermonson, Edwards and Salmonson (1981) argued that it is a tool used by accountants, which is not part of the formal accounting records, this is why it varies from organization to organization, and normally prepared in pencil so that errors can easily be corrected. Larson, et al (2002) Argued that computerized accounting has taken care of the need for a work sheet. However, still it has several potential benefits which include; it captures the entire accounting process, it avoids errors when working with information involving many accounts and adjustments.

**Research Methodology**

The paper is literature based study; the research design is therefore an explanatory research design. The data used is secondary in nature, source of information including text books, journals and other relevant materials in existence are used in explaining the research variables.

**Findings**

The paper found that, there were some inconsistencies, regarding the number of stages in accounting cycle. The maximum numbers of stages as observed are nine to a minimum of three stages. These inconsistencies are a challenge to accounting practice.

Similarly, the paper noted that, error be it in human, mechanical or in computer form was the major concerns in accounting practices. Data entered manually, electronically and processed by whatever means will not provide the desired results.

Furthermore, the paper observed that organizations keep on expanding vis- a- vis their volume of transactions, but only negligible number of organizations improved and expand their accounting practices.

Most of the accounting technicians, lack the pre requisite training and skills to keep records in proper shape, and this is the genesis of accounting or postings errors at every possible stage of accounting cycle.

It is noted that, most accounting personnel lack discipline in observance of professional accounting ethics, this is what culminate some of them commit various dubious and unethical practices, while making entries and postings into books of account.

**Summary**

From the discussion using available means at the disposal of the paper, accounting is very important to every organization that it cannot take the risk of abandoning or misusing the concept. The paper noted how accounting system helps in administration of tax as well administrative duties in the olden days. The paper also lamented the importance of accounting practices in providing training and establishment of accounting guidelines and regulations. Similarly, the course help in determination of income, equitable distribution of proceeds, and ensuring proper record keeping, elimination or minimizing posting errors as well as detection frauds to mentioned but just a few. Despite all these roles played by accounting as a discipline, the course faces a lot of challenges as a highlighted above,

**Recommendations**

Based on the findings of the paper, the paper is recommending the followings: Accountants, professionals, academicians and stakeholders, should reconsider the number of stages in accounting cycle. Having a unified number of stages will make the accounting practice easy.

The paper is also recommending to various organizations to consider human effort and gives it due respect, payment of allowances when due, bonuses for wonderful performance, good payments will not only motivate, but equally will reduce temptations.

As organizations keep on expanding both in size and volume, the paper is recommending for more hands, and where the need call for computer accounting software's to reduce time and ensure efficiency, organizations should endeavor.

Organizations, schools, and professional institutes are recommended to find ways of inculcating accounting ethics in the minds of stakeholders.

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