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Exploring the Nexus between Books of Account and Financial Reporting: A Comprehensive Literature Review

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ABSTRACT:

The nexus between books of account and financial reporting forms the foundation of accurate and reliable financial information within organizations. This study examines the significance of these linkages and the challenges associated with them. The study explores issues such as data integrity and accuracy, weak internal controls and governance, non-compliance with accounting standards, inadequate audit trail and assurance, and complexity in interpretation. The accuracy and completeness of financial transactions recorded in books of account are crucial for preparing financial statements and complying with accounting standards. Weak internal controls and governance practices can undermine the reliability of financial information. Non-compliance with accounting standards raises concerns about the accuracy of financial statements and hampers comparability. Insufficient audit trails and complex accounting treatments can compromise the assurance provided by auditors. Understanding and addressing these challenges are essential for enhancing the quality and transparency of financial reporting, thus enabling stakeholders to make informed decisions.

Keywords: books of account, financial reporting, data integrity, internal controls, accounting standards, audit trail, complexity, financial information.

1. Introduction

The capability of corporate entities to generate healthy financial reporting is a critical determinant for the formation of books of account (Sutrisno et al., 2020). Epstein and Jemakowich (2016) opine that the creation of books of account requires different ledgers and journals, especially in this modern period. The demand from the business organization to provide and embark on an accounting cycle that would improve the financial reporting quality necessitates the strengthening of books of account (Bala & Ibrahim, 2017). Suharli (2015) notes that business entity faces more challenges in terms of struggling to be dependent on source documents for healthy financial reporting.

Given this, books of account are the main sources of generating financial information globally. The books of account serve as the foundation for financial reporting. They provide the source data for preparing financial reporting and ensure the accuracy and completeness of the reported financial information (Sutrisno et al., 2020). The financial statements are derived from the transactions recorded in the books of account through a series of accounting processes, such as journalizing, posting, adjusting, and closing entries. In summary, the books of account serve as the underlying records for financial reporting. Books of account provide the necessary data and documentation to ensure accurate financial statements are prepared, and they establish the integrity and reliability of the financial information presented to external stakeholders (Bala & Ibrahim, 2017).

Despite the numerous books of account that are available to the business entity, over 55% of the annual financial reporting globally still comes from creative and window-dressing accounting and has been so over the past two decades (Ezeani et al., 2012). Window dressing and creative accounting are the major elements of GAAP non-compliance, as a result of this high rate of GAAP non-compliance, Government authority through its arm Companies Allied Matter Act (CAMA) stipulates that “every company shall cause accounting records to be kept and the accounting records shall be sufficient to show and explain the transaction of the company” (CAMA, 2004).

How corporate entities comply with CAMA rules may depend on the strength of their accounting cycle (Uswatun et al., 2022). This accounting cycle arose from the threat caused by the negative impact of poor record-keeping among corporate entities. Various actions (such as internal controls and corporate governance mechanisms; compliance with accounting standards; corporate code of ethics; data integrity and accuracy; automation and auditing and assurance) have been taken towards the protection of the shareholders and stakeholders from GAAP non-compliance, corporate distress, and loss of investors’ confidence, as a result of the consideration for health financial reporting (Alexander et al., 2017). The linkage between books of account and financial reporting is crucial for accurate and reliable financial reporting. Books of account refer to the detailed records and documentation that an organization maintains to track its financial transactions. This study aims to explore the significance of these linkages and their impact on financial reporting quality.

2. Literature Review

This section was centered on a review of related literature, issues to be examined include the concept of books of account and financial reporting, the evolution of books of account and financial reporting, positive issues and negative issues regarding the linkages between books of account and financial reporting; and current development in the books of account and financial reporting.

2.1 Concept of Books of Account and Financial Reporting

Books of account refer to the systematic recording of financial transactions and activities of a business entity. These books serve as a primary source of information for preparing financial statements, tracking financial performance, and ensuring proper financial management. Books of account are a set of records that document all financial transactions, including sales, purchases, receipts, payments, and expenses, chronologically and systematically. Books of account provide an organized and complete record of a company's financial activities, enabling accurate financial reporting, analysis, and decision-making (Paul et al., 2020). Shirley et al. (2018) outline various types of books of account and this depends on the nature and size of the business. Common types include the general ledger, cash book, sales journal, purchase journal, and subsidiary ledgers. Each book serves a specific purpose in recording and summarizing different types of transactions. Books of account are essential for compliance with legal requirements and regulations in many jurisdictions as it provide an audit trail and evidence of financial transactions, supporting transparency, accountability, and proper financial management. Specific laws and regulations may dictate the format, content, and retention period for maintaining books of account (Jae & Joel, 2019). Maintaining accurate and complete books of account is crucial for financial management (Paul et al., 2020). Books of account facilitate the preparation of financial statements, budgeting, tax compliance, and internal control. Reliable and up-to-date records help detect errors, fraud, and irregularities and provide a basis for informed decision-making (Bahri, 2016). Spiceland et al. (2020) opined that the book of account is closely tied to the double-entry bookkeeping system, which forms the foundation of modern accounting. Under this system, every transaction has a dual effect, with equal debits and credits recorded in appropriate accounts. Kieso et al. (2018) argue that books of account create an audit trail, which is a chronological record of financial transactions. This trail helps in tracing the origin and flow of financial data and facilitating audits and internal control processes. Maintaining accurate and complete books of account supports internal control measures, such as segregation of duties, review of transactions, and prevention of fraud.

Financial reporting, on the other hand, is the process of providing relevant and reliable financial information to users, such as investors, creditors, regulators, and other interested parties. Financial reporting's purpose is to enable stakeholders (such as investors, creditors, lenders, employees, suppliers, customers, regulatory authorities, and the general public) to make informed economic decisions regarding the organization (Shirley et al., 2018). Financial statements are the primary output of financial reporting. They include the statement of financial position; statement of profit or loss and comprehensive income; statement of cash flows, and statement of changes in equity. These statements provide a summary of an organization's financial performance, financial position, and cash flows over a specific period (Walter et al., 2017). ICAN (2020) opined that financial reporting serves several objectives, including providing useful information for decision-making, assessing the organization's financial performance, facilitating accountability and stewardship, and fulfilling regulatory and legal requirements. Financial reporting aims to meet the needs of different stakeholders by providing relevant, reliable, timely, comparable, and understandable financial information. The qualitative characteristics of financial reporting include relevance (information that influences users' decisions), faithful representation (information that is complete, neutral, and free from error), comparability (information that can be compared across entities and periods), and understandability (information that is clear and concise) to make informed decisions or evaluate the organization's financial health and sustainability to assess the profitability, liquidity, solvency, and efficiency of an organization, aiding in investment decisions, credit evaluations, and performance evaluations. (Shirley et al., 2018).

2.2 Evolution of Books of Account and Financial Reporting

The earliest known evidence of bookkeeping can be traced to ancient Mesopotamia 3500-3000 BCE, where clay tablets were used to record transactions. These tablets contained information such as goods received, goods sold, and debts owed, establishing a basic system of financial records. The Egyptians also developed systems for recording financial transactions in 2000 BCE. They used papyrus scrolls to maintain detailed records of agricultural production, taxes, and other economic activities. These records were crucial for efficient administration and tax collection (Glautier & Underdown, 2001; Scott & Taylor, 2019).

The ancient Greeks (5th century BCE) made significant contributions to the development of accounting. Prominent philosophers like Plato and Aristotle discussed economic and financial matters. Aristotle, in particular, emphasized the importance of accurate and reliable financial records. During the Renaissance, the Italian city-states became centers of commerce and banking. The growth of trade necessitated more sophisticated record-keeping practices. Luca Pacioli, an Italian mathematician and friar, published a book called "Summa de arithmetica, geometria, proportioni et proportionalita" in 1494, which included a section on double-entry bookkeeping. This work popularized the system and laid the foundation for modern accounting practices. The double-entry bookkeeping system, which records every financial transaction with equal debits and credits, evolved and became more widespread during the 15th and 16th centuries. Its principles, including the concept of balancing accounts, continue to form the foundation of modern accounting practices (Ahmed, 2019; ATSWA, 2020).

The Industrial Revolution in the 18th and 19th centuries brought significant changes to business and commerce. As companies grew in size and complexity, the need for more standardized and comprehensive financial reporting increased. In response, professional accounting bodies were established, such as the Institute of Chartered Accountants in England and Wales (ICAEW) in 1880. In the 20th century, financial reporting standards

underwent further developments. The establishment of the Financial Accounting Standards Board (FASB) in the United States in 1973 and the International Accounting Standards Committee (IASC), later replaced by the International Accounting Standards Board (IASB), in 1973 and 2001 respectively, played significant roles in setting global accounting standards called International Financial Reporting Standard (IFRS) and improving financial reporting practices. The International Financial Reporting Standards (IFRS), developed by the International Accounting Standards Board (IASB), aim to provide a common framework for financial reporting across different countries and jurisdictions. Many countries have adopted or converged with IFRS to enhance consistency and comparability in financial reporting. Generally Accepted Accounting Principles (GAAP) refer to a set of standard accounting principles, guidelines, and procedures that guide financial reporting in a particular jurisdiction. GAAP has evolved through the efforts of professional accounting bodies, standard-setting organizations, and regulatory authorities to provide consistent and reliable financial information (ICAN, 2020).

As business transactions became more complex and the need for independent verification of financial records arose, auditing and assurance practices began to develop. The earliest recorded audits can be traced back to ancient Egypt, where the Pharaoh's treasury was subject to regular examinations. However, the formalization of auditing practices occurred during the Industrial Revolution had gained prominence in the 20th century. In the United Kingdom, the Corporation Act of 1844 introduced mandatory financial reporting requirements for companies. This legislation mandated that corporations submit annual financial statements to the registrar, enhancing transparency and accountability in business operations. Following the stock market crash of 1929 and the subsequent Great Depression, the Securities and Exchange Commission (SEC) was established in the United States in 1934. The SEC was tasked with regulating securities markets and promoting fair and transparent financial reporting by requiring companies to disclose accurate and reliable financial information to investors. The Sarbanes-Oxley Act (SOX) was enacted in the United States in response to accounting scandals, such as the Enron and WorldCom cases. SOX introduced significant reforms to enhance corporate governance, strengthen internal controls, and improve financial reporting. It imposed stringent requirements on companies, including the certification of financial statements by CEOs and CFOs and the establishment of independent audit committees (Rick et al., 2015; ICAN, 2020).

2.3 Positive Issues on the Nexus between Books of Account and Financial Reporting

The linkages between books of account and financial reporting play a crucial role in maintaining accurate and reliable financial information for businesses. These linkages ensure that the financial statements reflect the true financial position and performance of the organization. Here are some positive issues related to the linkages between books of account and financial reporting.

The integration between books of account and financial reporting facilitates accurate financial reporting. The books of account, such as the general ledger, record all financial transactions, ensuring that all income, expenses, assets, and liabilities are properly recorded. This accurate recording of financial data enables the preparation of reliable financial statements, including the balance sheet, income statement, and cash flow statement (Côté et al., 2015). The linkage between books of account and financial reporting strengthens internal controls within an organization. Proper recording and reconciliation of transactions help identify errors, irregularities, or fraudulent activities. This promotes transparency, and accountability, and reduces the risk of financial misstatements. It also assists in detecting any discrepancies between the books of account and the financial statements, leading to prompt corrective actions (Arens et al., 2014). Pacter (2018) opined that accurate linkages between books of account and financial reporting are essential for complying with regulatory requirements, such as International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Principles (GAAP). These standards dictate specific rules and guidelines for preparing financial statements. Aligning books of account with these reporting standards ensures compliance and consistency in financial reporting across organizations.

In addition, the linkage between books of account and financial reporting provides relevant financial information necessary for effective decision-making. Accurate and timely financial statements help stakeholders, including investors, creditors, and management, to evaluate the financial health and performance of the organization. This, in turn, assists in making informed decisions regarding investments, lending, strategic planning, and resource allocation (Hansen, 2017). Reverte (2016) supports that the integration between books of account and financial reporting promotes transparency and increases stakeholder confidence in the organization. When financial statements accurately reflect the underlying financial transactions, stakeholders gain trust in the organization's financial reporting process. This trust is crucial for maintaining strong relationships with investors, creditors, and other stakeholders. In the study of Palepu (2015), The integration between books of account and financial reporting enables more comprehensive financial analysis. Financial statements derived from accurate books of account provide essential information for ratio analysis, trend analysis, and other financial performance assessments. These analyses aid in evaluating profitability, liquidity, solvency, and efficiency, allowing better insights into the organization's financial health. The linkage between books of account and financial reporting ensures compliance with auditing standards. Auditors rely on the accuracy and completeness of the books of account to conduct their audit procedures effectively. The integration helps in providing evidence to support the audit process and facilitates the auditor's ability to issue an opinion on the fairness of the financial statements (Louwers et al., 2016). Deegan and Samkin (2016) are of the view that accurate linkages between books of account and financial reporting contribute to improved investor relations. Reliable financial statements build investor confidence, attract potential investors, and maintain a positive image in the capital markets. Effective communication of financial information helps establish trust and fosters long-term relationships with investors.

Furthermore, the integration between books of account and financial reporting supports efficient tax reporting. Accurate books of account provide the necessary information for calculating taxable income and preparing tax returns. The linkage helps in identifying deductible expenses, tax credits, and other tax-related items, facilitating compliance with tax regulations. In compliance with auditing standards, auditors rely on the accuracy and completeness of the books of account to conduct their audit procedures effectively. The integration helps in providing evidence to support the audit process and facilitates the auditor's ability to issue an opinion on the fairness of the financial statements (Louwers et al., 2016). Elliott et al., (2017) argue that for

organizations with multiple subsidiaries or divisions, the linkages between books of account and financial reporting facilitate streamlined financial consolidation by ensuring consistency in financial reporting across all entities, the integration simplifies the consolidation process, reduces errors, and enhances the accuracy of consolidated financial statements. Bragg (2016) examines the integration between books of account and financial reporting, and the author concludes that the integration supports effective financial planning and budgeting. Accurate books of account provide a basis for analyzing historical financial data and making informed projections for future financial performance. This information is essential for developing realistic budgets, setting financial goals, and monitoring progress toward those goals.

2.4 Negative Issues on the Nexus between Books of Account and Financial Reporting

The linkages between books of account and financial reporting are crucial for maintaining accurate and reliable financial records. However, there are negative issues that arise in this area. Here are a few common problems with references and citations to support the information:

Mistakes in recording transactions or data entry can occur, leading to discrepancies between the books of account and the financial reports. These errors can affect the accuracy of financial information and misrepresent the company's financial position (Weygandt et al., 2018). Failure to reconcile the books of account with financial statements regularly can result in disparities. Reconciliation helps identify and rectify any discrepancies between the two records, ensuring they align accurately. The absence of this process may lead to incorrect financial reporting (Nobes & Parker, 2016). Weak internal control systems can contribute to the misalignment between books of account and financial reporting. Inadequate segregation of duties, lack of oversight, or insufficient checks and balances increase the risk of errors or fraudulent activities that impact the reliability of financial statements (Romney & Steinbart, 2017). Non-compliance with accounting standards and regulations can result in discrepancies between the books of account and financial reporting. Failure to adhere to recognized standards may lead to misclassifications, improper revenue recognition, or inaccurate valuation of assets and liabilities (FASB, 2019). Insufficient supporting documentation for financial transactions can pose challenges in linking the books of account with financial reporting. Without proper evidence, it becomes difficult to verify the accuracy and validity of recorded transactions, potentially leading to inconsistencies in financial statements (Needles et al., 2018). Deliberate manipulation of financial records, such as misrepresenting revenues or concealing liabilities, can distort the link between books of account and financial reporting. Fraudulent activities undermine the integrity of financial statements and mislead stakeholders (Wells, 2016).

In addition, complex transactions, such as mergers and acquisitions or long-term contracts, can pose challenges in accurately recording and reporting financial information. The interpretation and application of accounting principles in such scenarios may lead to errors or inconsistencies in the linkage between books of account and financial reporting (Spiceland et al., 2020). Inadequate documentation, missing data, or incomplete information can hinder the linkage between books of account and financial reporting. Lack of necessary details or supporting evidence can result in inaccuracies, gaps, or uncertainties in financial statements. (Stickney et al., 2019). Timing differences between recording transactions in the books of account and financial reporting can lead to discrepancies. For example, if a transaction occurs near the end of a reporting period but is recorded in the subsequent period, it can create inconsistencies between the two sets of records (Harrison et al., 2019). The interpretation and exercise of judgment in applying accounting policies can introduce subjectivity and variations in financial reporting. Different interpretations of accounting standards or subjective estimates can impact the linkages between books of account and financial reporting (Melville, 2018). Insufficient transparency in financial reporting can make it challenging to trace the link between the books of account and the financial statements. Lack of clear disclosure and presentation of financial information can obscure the understanding of how the numbers in the books of account translate into the reported figures. Incorrect valuation of assets, such as inventory or fixed assets, can lead to discrepancies between the books of account and financial reporting. Flawed valuation methods or failure to account for impairment can result in distorted financial statements (Pratt et al., 2019). Also, inadequate or outdated accounting systems may not effectively capture and integrate data, leading to difficulties in maintaining accurate linkages between the books of account and financial reporting. Manual processes, lack of automation, or incompatible software can contribute to errors and inconsistencies (Bagranoff et al., 2018). Evolving and complex reporting requirements, such as those introduced by new accounting standards or regulatory changes, can pose challenges in maintaining strong linkages between books of account and financial reporting. Adapting to new reporting frameworks may require adjustments to the accounting processes and systems (FASB, 2021). Ethical issues, such as lack of integrity, conflicts of interest, or pressure to manipulate financial results, can impact the linkages between books of account and financial reporting. Unethical behavior compromises the accuracy and reliability of financial information (Mintz & Morris, 2017).

Furthermore, insufficient documentation and a lack of a clear audit trail can make it difficult to trace and verify the accuracy of transactions between the books of account and financial reports. This can result in discrepancies and potential errors in financial reporting (Louwers et al., 2017). Also, inconsistencies or frequent changes in accounting policies across different periods or subsidiaries can lead to inconsistencies between the books of account and financial reporting. This can make it challenging to compare financial information and understand the true financial position of the organization (Schroeder et al., 2019). Insufficient internal controls, including segregation of duties, authorization processes, and monitoring mechanisms, can contribute to errors and discrepancies between the books of account and financial reporting. Weak controls increase the risk of misstatements and fraudulent activities (Arens et al., 2017). Failure to record certain transactions or omissions in the books of account can result in discrepancies with financial reporting. Unrecorded transactions can lead to incomplete and inaccurate financial statements (Epstein & Jermakowicz, 2016). Intentional manipulation of financial statements, such as inflating revenues or understating expenses, can distort the link between books of account and financial reporting. Manipulative practices can misrepresent the true financial position and performance of the company (Healy & Wahlen, 2019). Finally, insufficient knowledge and understanding of accounting principles, reporting standards, and financial analysis can result in errors and inconsistencies between the books of account and financial reporting. A lack of professional competence can compromise the reliability and accuracy of financial information (Melville, 2018).

3. Methodology

This study adopts an exploratory-based library research design, engaging in a theoretical review of documentary information on the researchable topic. Secondary sources of data, including textbooks, journals, and relevant materials, serve as the basis for explaining the research variables.

4. Conclusion, Recommendation, and Suggestion for Further Study

In conclusion, the nexus between books of account and financial reporting is crucial for the accurate and reliable presentation of an organization's financial information. Books of account serve as the foundation for financial reporting by providing a detailed record of all financial transactions. The proper maintenance of books of account ensures that financial statements are prepared following applicable accounting standards, enabling stakeholders to make informed decisions based on reliable information.

Based on the importance of the nexus between books of account and financial reporting, the following recommendations are made:

(i) Organizations should establish and maintain strong internal control systems to ensure the accuracy and integrity of their books of account. This includes clearly defined procedures for recording and documenting financial transactions, segregation of duties, regular review and reconciliation of accounts, and the use of accounting software or systems that facilitate efficient and accurate bookkeeping.

(ii) Adequate training should be provided to employees responsible for maintaining books of account to ensure they possess the necessary knowledge and skills. This includes training on accounting principles, financial reporting requirements, and the proper use of accounting software or systems. Ongoing training programs can help keep staff updated on changes in accounting standards and best practices.

(iii) Regular internal and external audits should be conducted to verify the accuracy and completeness of books of account and financial statements. Audits provide an independent assessment of an organization's financial reporting processes, identify any weaknesses or irregularities, and enhance overall financial transparency.

Although the nexus between books of account and financial reporting has been extensively studied, several areas warrant further research. The following suggestions highlight potential areas for future study:

(i) With the increasing adoption of advanced technologies such as cloud computing, artificial intelligence, and blockchain, it is essential to explore how these technologies are transforming the maintenance and reporting of books of account.

(ii) Different countries follow varying accounting systems, such as Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). Further research could investigate the similarities, differences, and implications of these systems on books of account and financial reporting. Comparative studies can contribute to a better understanding of the global harmonization of accounting standards and their impact on financial reporting quality.

(iii) Future research could explore the behavioral aspects of bookkeeping, including factors that may affect the accuracy and reliability of financial information. This could involve examining the impact of cognitive biases, ethical considerations, and professional judgment on the preparation of books of account and subsequent financial reporting.

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