

Section 1: The fundamentals of accounting

1 The purpose of accounting

Activity 1

- 1 The following are not financial data:

b, c, f, g

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	Classifying financial data	Interpreting financial data	Communicating financial data
Deciding whether an item in a business transaction is an asset or a liability	✓		
Publishing the statement of profit or loss on the business website			✓
Measuring the performance of a business using ratios		✓	
Deciding whether an item in a business transaction is an income or an expense	✓		
Measuring the cash position of a business using ratios		✓	
Sending the financial statements of a business to shareholders by email			✓

Activity 2

- 1 Amrita should keep financial records of her transactions so that she can monitor the business' performance and growth. On the basis of this information she can make important financial decisions. Financial records ensure that business transactions do not get forgotten or lost.

- 2 A book-keeper does not have the skills that an accountant has. A book-keeper makes sure that accurate records are kept. An accountant goes on to use those records to prepare financial statements that interested parties analyse and interpret to make important financial decisions. Therefore a book-keeper's job is not as specialised as an accountant's is and is not as well paid.
- 3 Amrita should employ an accountant. As she does not have any accounting knowledge, the accountant will ensure that all the business' transactions are collected, recorded, summarised, classified, analysed, interpreted and communicated to her. Based on this, Amrita will be able to know how well her business is performing and growing.

Activity 3

- 1 These interested parties use the financial information conveyed to them in the following ways:
 - a **The owner/s of the business:** They will want to know how well their investment in the business is doing. Is the business profitable enough to return a good profit year after year? The owners will also want to know what the net worth of the business is.
 - b **Prospective owners:** They will wish to know how well their investment will do in the future by studying present and past accounting records of the business they are intending to invest in. Good profitability and increasing net worth are good signs that the business is on a growth path and will therefore be a good investment.
 - c **The bank manager:** The bank manager will ask for and use past and present accounting records of the business before granting a loan or any other service, such as an overdraft facility, to the business. The business may not have enough money or cash flow to service a loan, and this could be a reason for the bank not to grant a loan. If the business already has a lot of existing long-term loans, the bank will be less willing to lend them money.
 - d **Business trade payables:** A lot of transactions conducted in the business world are credit transactions. This means that payments are made some time after the transaction has taken place. As a result of such credit transactions, the business could have a number of people or businesses that it owes money to. They are called trade payables (creditors). Suppliers and other payables of the business will want to know whether they will be paid on time, if at all. Accounting records will give them this information.
 - e **The government:** The government will need to know what profit the business has made, to calculate the tax that has to be paid.
- 2 Four interested parties are:
 - a suppliers
 - b the bank
 - c the government
 - d the customers.

Practice questions

- 1 B [1]
- 2 A [1]
- 3 A [1]

4 B [1]

5 B [1]

6 [6]

Features of the accounting records	Interested parties
Whether the business can pay interest when it is due	Lender
	Bank manager
The market value of the assets that the business owns	Potential partner
	Arjun Patel (owner)
Whether the business is profitable	Potential partner
	Arjun Patel (owner)
Whether the business has enough cash available	Trade creditor
	Lender

Chapter review questions

- Accounting is a process of collecting, recording, classifying, summarising, analysing, interpreting and communicating financial data to allow the users of accounting information to make informed judgements and decisions.
- Book-keeping is largely concerned with the development and maintenance of accounting records. It is often referred to as the 'how' of accounting and is concerned with procedure. It involves the detailed recording of all the financial transactions that have taken place over a period in a business. Book-keeping is a subset of accounting.
Accounting, on the other hand, is conceptual and concerned with the 'why' of accounting. It involves the collection, recording, classifying, summarising, analysing and interpreting of financial data.
- The purpose of accounting is:
To provide important financial information that helps interested parties monitor progress.
To help interested parties make good financial decisions.
- Profits are compared from year to year and between businesses. If the profit has decreased, or is less than that of a similar business, then owners and managers will want to take steps to remedy the situation by either decreasing expenses or increasing revenue.
If the business has been consistently profitable, then managers may want to grow the business by expanding its operations into other markets or increase product range.
- Recording; book-keeping; financial; classifying; owners; interpreting; trade payables; analysing; decision making; bankers; communicating):
 - Book-keeping is concerned with the maintenance of accounting records.
 - Recording, classifying, analysing, interpreting and communicating make up the process that is called accounting.
 - Owners, trade payables and bankers are possible interested parties in a business.
 - The purpose of accounting is to take financial data and convert it to a form that can be used for good decision making.

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- a The owner/s of the business:** The owners of the internet business have invested in it, so they will need to know how well their investment is doing. They will be keen to know what the net worth of the business is and whether the business will be profitable enough to return a good profit each year.
- b The bank manager:** The bank will require access to the business' accounting records in order to offer further finance such as a loan or overdraft facility, if required. If the business already has a number of long-term loans, the bank may be less willing to lend the business further money.
- d Employees:** The employees will want to know that the business is continuing to make a profit and is not making a loss, as financial problems with the business could affect their job, making them at risk of redundancy. They will also be keen to know whether the internet company is continuing to grow, as this could mean better promotion prospects and an increase in wages/salaries for existing employees.

Other answers, with suitable detail, might include business trade payables, customers and the government (to calculate tax to be paid).

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1 There is no difference between accounting and book-keeping.	False
2 Accounting is only carried out at the end of a financial year.	False
3 Managers can use financial data to define and analyse the opportunities and challenges that a business faces.	True
4 The statement of financial position is used to calculate the profit of a business.	False
5 Business profit is often compared with a competitor's profit.	True