**ACCOUNTING FOR BUSINESS (AFB)**

**RATIONALE:** This module covers the nature and role of accounting and the processes used to record and present accounting information. Students will learn to prepare company financial statements, including statements of financial position, profit or loss, and other comprehensive income and cash flows for single entities. The module will enable students to evaluate, analyse and discuss financial performance. This module provides participants with a solid grounding in all aspects of management accounting, including the importance of cost behaviour and different cost accounting techniques such as marginal and absorption costing. Students will develop skills in analysis and interpretation of numbers for decision-making purposes.

**AIMS:** The module aims to develop a comprehensive understanding of fundamental concepts and techniques in financial and management accounting, including the ethical issues at stake in providing a `true and fair view` in public reporting so as to support and maintain good business practice and sustainable financial markets. It also provides students with the opportunity to use and apply financial and accounting concepts, constructs and frameworks in support of business problem appraisal and decision making.

**INDICATIVE CONTENT OF THE MODULE INCLUDES:**

* The environment of accounting and the accountant's role in the organisation.
* Accounting concepts and policies including the 'true and fair view' and the ethical requirements to support sustainable financial markets with good information.
* Income statement; the statement of financial position; cash flow; financial statements.
* Interpretation and evaluation of accounts. Ratios, comparisons and trends.
* An introduction to financial management.
* Investment appraisal and return on investment.
* An introduction to cost and management accounting, including marginal and absorption costing.
* Budgeting and budgetary control, including the behavioural implications of budgeting

**ASSESSMENT**

|  |  |  |  |
| --- | --- | --- | --- |
| **Component number** | **Form of assessment** | **Assessment size** | **Weighting (%)** |
| 1 | Individual Assignment | 1000 words | 30 |
| 2 | End of term examination | 3 hours | 70 |

**INDICATIVE READING**

* *Introduction to Financial Accounting*, 8th edition, Thomas, A. and Ward, A. M. (2015); London: McGraw Hill Education.
* Atrill & McLaney (2017) *Accounting and Finance for Non-specialists* 10th Ed, by, Pearson.
* Wood, F & Sangster, A (2011), *Business accounting I*, 12th edition, Prentice Hall Wood, F & Sangster, A (2011), *Business accounting II*, 12th edition, Prentice Hal
* Atrill, P. and McLaney, E., (2012). *Management accounting for decision makers.* 7th edition
* Accounting for Non-Accounting Students, 9th edition, J.R. Dyson, (2017)

**AFB – Week 1**

**ACCOUNTING FOR BUSINESS**

**LECTURE SEQUENCE**

1. Introduction and Overview
2. Introduction to Financial Accounting – Conceptual framework; Accounting process; Double entry system & applications to business transactions; Accounting equation; Trial balance preparation.
3. Basic financial statements for a sole trader.
4. Financial statements with adjustments for accrual, prepayments and depreciation
5. Financial statements with more adjustments to include accounting for bad and doubtful debts.
6. Financial statements for companies.
7. Users of financial statements.
8. Accounting ratios and its use in financial performance analysis.
9. Introduction to Management Accounting - Cost classification; cost behaviour; applications to product & service costing.

10. Cost- volume -profit analysis.

11. Decisions making scenarios (short-term)

12. Decision making scenarios (long term)/ Investment appraisal

13. Budgeting and cash budgets.

14. **Revision and Review.**

*All students must keep up with the weekly work in order to*

*progress well and benefit from the lectures.* ***This is a practical***

***module and requires application on your part****. Students may*

*contact me on:* [*sa.palan@lsclondon*](mailto:sa.palan@lsclondon)*.co.uk with your questions*

*and I will do my best to respond asap or within a day. Be*

*consistent with your work and success will follow. Thank YOU.*

**An introduction to financial accounting & financial**

**statements/final accounts**

**1. Influences upon financial accounting/reporting/financial statements:**

These can be grouped into the following:

* National law – the form and content of accounts may be regulated by national legislation. ‘Fair presentation’
* Accounting standards – The International Accounting Standards Board (IASB) produces accounting standards. These helps tackle issues/interpretation of standards.
* Accounting concepts and individual judgement – Accounting policies have developed over the centuries. These are based on generally accepted concepts: business entity concept, going concern, accruals, prudence, consistency, materiality, substance over form and more.
* GAAP – Drawn from local company law, accounting standards, statutory requirements in other countries and the stock exchanges (e.g. LSE)

**2. The main financial statements are:**

* **Income Statement and**
* **Statement of Financial Position (SOFP)**

**Sometimes these are also collectively referred to as the**

**‘final accounts’**

Be aware of old and new terminology used in various published materials in financial accounting - texts, articles etc

|  |  |
| --- | --- |
| **Old terminology** | **New terminology** |
| Profit statement | Income statement |
| Balance sheet | Statement of financial position (SOFP) |
| Stock | Inventory |
| Debtors | Receivables |
| Creditors | Payables |
| Fixed assets | Non-current assets |
| Long term liabilities | Non-current liabilities |

**3. Conceptual framework** - **Accounting concepts/principles:**

* These are principles/rules used in the preparation, use and interpretation of financial statements.
* Evolved over time; adopted for practical rather than theoretical purposes
* Not a rigid code – application of these concepts (via the choice of alternative accounting policies) are often subjective; a question of individual judgement/choice.
* Hence financial accounting/reporting/preparing financial statements is not an exact science?
* There are several accounting concepts. the **first (and not the most important)** of these is the **business** **entity concept:** The entity is treated as separate from its owners. Personal transactions of the owners separated from the transactions of the business.

**4. Some accounting terminology used in financial accounting**

* **Asset:** Something valuable which an entity **owns** or has use of e.g. a factory, motor vehicles, inventory for resale, receivables (amounts owed by customers), bank and cash balances.
* **Liability:** What the entity **owes** somebody else (other than the owner/owners) e.g. bank loan; payables (amounts owed to the suppliers);
* **Capital:** What the entity **owes** (cash/assets) the sole trader/owners. (for companies the owners are the shareholders)

**5. Accounting equation:** (based on the business entity concept)

* What the business owns = What the business owes at any point in time of the business.
* Assets (owns) = Liabilities + Capital (both are what the business owes)

The accounting equation underpins the entire accounting system. Here are some simple examples to show how the accounting equation works by examining a series of transactions through a period of time.

**Transaction 1**: Mrs A starts a business. She brings in cash of £4,000 and banks £36,000.

**Assets (Cash £4,000 + Bank £36,000) = Capital £40,000**

**Transaction 2:** Mrs A purchases equipment for the business for £9,000; paid for it with cash of £1000 and £8,000 by bank transfer.

**Assets (Cash £3,000 + Bank £28,000 +Equipment £9,000)**

**= Capital £40,000**

**Transaction 3:** Purchased inventory of goods for resale on credit for £2,000.

**Assets (Cash £3,000 + Bank £28,000 +Equipment £9,000 + Inventory £2,000) = Capital £40,000 + Payables £2,000**

**Transaction 4:** Banked £1,000 of the cash.

**Assets (Cash £2,000 + Bank £29,000 +Equipment £9,000 + Inventory £2,000) = Capital £40,000 + Payables £2,000**

**Transaction 5:** Paid cash £1,000 for purchase of inventory of goods for resale.

**Assets (Cash £1,000 + Bank £29,000 +Equipment £9,000 + Inventory £3,000) = Capital £40,000 + Payables £2,000**

**Transaction 6:** Paid the supplier for the earlier credit purchase of inventory £1,000 by bank transfer.

**Assets (Cash £1,000 + Bank £28,000 +Equipment £9,000 + Inventory £3,000) = Capital £40,000 + Payables £1,000**

**Transaction 7 [Dated 1st July 2021):** Obtained a bank loan of £6,000 repayable in 5 years’ time. This was banked**.**

**Assets (Cash £1,000 + Bank £34,000 +Equipment £9,000 + Inventory £3,000) = Capital £40,000 + Payables £1,000 + Bank loan £6,000.**

**A statement can now be produced for Mrs A’s business entity to represent all the above seven transactions.**

**Mrs A**

**Statement of Financial Position as at 01/07/2021**

**£ £**

**Non-current asset**

**Equipment 9,000**

**Current assets**

**Inventory 3,000**

**Bank 34,000**

**Cash 1,000 38,000**

**Total assets 47,000**

**Capital 40,000**

**Non-current liability**

**Bank loan 6,000**

**Current liability**

**Payables 1,000**

**Capital and liabilities 47,000**

The above **‘Statement of Financial Position’ or SOFP** also reflects the **accounting equation i.e. Total assets (**what the business entity **owns) = Capital (**what the entity **owes** the owner Mrs A**) + Liabilities (**what the entity **owes** the others**)**

**6. Other accounting concepts**: There are several other accounting concepts and these will be brought together as we progress through the preparation of final accounts: going concern, accruals, prudence, consistency, materiality, substance over form and more.

Please research these before the next lecture. (your homework, please)

------------------------------------------------------------------------------

**Requirements for preparing the final accounts**

In order to prepare the final accounts (an Income Statement and a Statement of Financial Position) the following are required:

* A **trial balance** - a list of accounts with their balances at the end of an accounting period.
* **Year-end additional information -** required to adjust some of these accounts in the trial balance provided.

**A trial balance**

**1.** In a trial balance there are several accounts with their balances - some of these accounts have debit balances and others have credit balances.

**2**. Why do these accounts have either debit or credit balances? This is the result of applying the double entry system in recording business transactions (or double entry bookkeeping).

* Each business transaction has a dual effect on the accounts (or every business transaction has two equal but opposite effects)
* All business transactions must be entered in the accounts using the double entry system: a debit entry in one account and an equal but opposite credit entry in another account.
* Periodically (monthly or yearly) the accounts are balanced off. Balancing of all these accounts periodically will result in each of these accounts having a either a debit or a credit balance. A listing of these accounts and their balances (debit or credit) is called the **trial** **balance**.

**3.** The correct application of the double entry system should enable the trial balance to balance (i.e. mathematically the total of debit balances = total of credit balances; since for each debit entry there is a corresponding credit entry in the ledger accounts).

**4.** Sometimes mistakes/errors are made in the application of the double entry system and this may produce one of these two effects on the trial balance:

* Errors that affect the trial balance (resulting in the trial balance totals not being equal or balancing). For example, posting a single entry (instead of double entries) for a transaction will affect the trial balance totals.
* there are also errors that will not affect the trial balance totals. For example, a simple case in point is the complete omission (i.e. not accounted for) of a business transaction; this omission will still enable the trial balance to balance (i.e. trial balance totals will agree).

**5.** The trial balance needs to balance before the final accounts can be prepared. However, bear in mind that a balancing trial balance does not mean it is free of errors as explained in (4) above.

**6.** There are 5 types of accounts within the trial balance:

* **Incomes** e.g. Sales, rental income, interest received etc
* **Expenses** e.g. Wages and salaries, purchases (of goods for resale), rent, rates, insurance etc
* **Assets** (what the business **owns**) e.g. Machinery, shop fittings, inventory, bank and cash balances, trade receivables etc
* **Liabilities** (what the business **owes** others) e.g. Bank loan, trade payables, accruals etc
* **Capital** (what the business **owes** the owner)

**7.** All assets and liabilities can be classified into non-current or current.

* **Non- current assets** are owned and used by the entity for more than one year (i.e. they are fixed financially for more than one year). Examples: Land, buildings, factories, plant and machinery, motor vehicles, fixtures & fittings
* **Current assets** are owned by the entity and change financially within a period of one year. Examples: inventories, trade receivables, prepayments, bank and cash balances.
* **Non-current liabilities** are what the business owes and require settlement beyond a year (owed for more than one year). Examples: long term bank loan, debentures or bonds (in the case of companies).
* **Current liabilities** are what the business owes and require settlement within a year. Examples: trade payables, short term bank loans, bank overdraft, accruals, taxation (for companies).

**Example 1**

**Let us use the example below to classify the following accounts into these types:**

**Revenues/incomes (I);**

**Expenses (E);**

**Current assets (CA);**

**Non-current assets (NCA);**

**Current liabilities (CL);**

**Non-current liabilities (NCL)**

**Capital (C)**

The following trial balance is for a sole trader, A, as at 30 June 2019.

|  |  |  |
| --- | --- | --- |
|  | **Dr** | **Cr** |
|  | £000 | £000 |
| Sales - **I** |  | 146 |
| Purchases-**E** | 60 |  |
| Inventory at 1 July 2018 - **CA** | 5 |  |
| Vehicle running expenses - E | 3 |  |
| Rent and business rates - E | 14 |  |
| Office expenses - E | 8 |  |
| Wages and salaries- E | 43 |  |
| Shop fittings – cost - NCA | 25 |  |
| Shop fittings–accumulated depreciation- CONTRA NCA |  | 11 |
| Vehicles- cost - NCA | 35 |  |
| Vehicles-accumulated depreciation – CONTRA NCA |  | 12 |
| Trade receivables- CA | 6 |  |
| Trade payables - CL |  | 5 |
| Capital - C |  | 31 |
| Drawings – **CONTRA C** | 11 |  |
| Bank - CA | 2 |  |
| Cash- CA | 1 |  |
| Long term bank loan - NCL |  | 8 |
| **Totals** | **213** | **213** |

**Example 2: (homework)**

**Please attempt before the next lecture** – remember making mistakes is part of learning.

**Classify the account balances into: revenues/incomes (I), expenses (E), current assets (CA), non-current assets (NCA), current liabilities (CL) and non-current liabilities (NCL) and capital (C).**

The following account balances were extracted as at 31/12/2019 from the books of B, who owns a retail business.

|  |  |  |
| --- | --- | --- |
|  | £000 | £000 |
| Sales |  | 1860 |
| Purchases | 1120 |  |
| Inventory at 1/1/2019 | 60 |  |
| Trade receivables | 64 |  |
| Trade payables |  | 176 |
| Business rates | 41 |  |
| Insurances | 40 |  |
| Heating and lighting | 55 |  |
| Motor running expenses | 27 |  |
| Selling expenses | 172 |  |
| Long term bank loan |  | 200 |
| Interest on bank loan | 4 |  |
| Land and buildings at cost | 850 |  |
| Motor vehicles at cost | 70 |  |
| Motor vehicles – accumulated depreciation |  | 20 |
| Wages and salaries | 295 |  |
| Bank | 3 |  |
| Cash | 1 |  |
| Capital |  | 600 |
| Drawings | 54 |  |
| Totals | 2856 | 2856 |

**Notes as at 31 December 2019**

• Inventory was valued at £65,000

• Wages accrued £5000 -- OWING

• Heating and lighting accrued £2000

• Business rates prepaid £3000

• Motor vehicles depreciated at 20% pa on cost

**Required:**

(a) Income statement for the year ended 31 December 2019.

(b) Statement of financial position as at 31 December 2019.

END OF LECTURE 1 NOTES