

ACCOUNTING

for Non-Accounting Students

Tenth Edition

John R. Dyson & Ellie Franklin

ACCOUNTING

for Non-Accounting Students





Pearson

At Pearson, we have a simple mission: to help people make more of their lives through learning.

We combine innovative learning technology with trusted content and educational expertise to provide engaging and effective learning experiences that serve people wherever and whenever they are learning.

From classroom to boardroom, our curriculum materials, digital learning tools and testing programmes help to educate millions of people worldwide – more than any other private enterprise.

Every day our work helps learning flourish, and wherever learning flourishes, so do people.

To learn more, please visit us at www.pearson.com/uk

ACCOUNTING

for Non-Accounting Students

Tenth Edition

John R. Dyson & Ellie Franklin



Pearson

Harlow, England • London • New York • Boston • San Francisco • Toronto • Sydney • Dubai • Singapore • Hong Kong
Tokyo • Seoul • Taipei • New Delhi • Cape Town • São Paulo • Mexico City • Madrid • Amsterdam • Munich • Paris • Milan

PEARSON EDUCATION LIMITED

KAO Two
KAO Park
Harlow CM17 9SR
United Kingdom
Tel: +44 (0)1279 623623
Web: www.pearson.com/uk

First edition published in Great Britain under the Pitman Publishing imprint in 1987 (print and electronic)
Second edition published 1991 (print)
Third edition published 1994 (print)
Fourth edition published under the Financial Times Pitman Publishing imprint in 1997 (print)
Fifth edition published 2001 (print)
Sixth edition published 2004 (print and electronic)
Seventh edition published 2007 (print and electronic)
Eighth edition published 2010 (print and electronic)
Ninth edition published 2017 (print and electronic)
Tenth edition published 2020 (print and electronic)

© Pearson Education Limited 1987, 1991, 1994, 1997, 2001 (print)
© Pearson Education Limited 2004, 2007, 2010, 2017, 2020 (print and electronic)

The rights of John Dyson and Eliza Franklin to be identified as authors of this work have been asserted by them in accordance with the Copyright, Designs and Patents Act 1988.

The print publication is protected by copyright. Prior to any prohibited reproduction, storage in a retrieval system, distribution or transmission in any form or by any means, electronic, mechanical, recording or otherwise, permission should be obtained from the publisher or, where applicable, a licence permitting restricted copying in the United Kingdom should be obtained from the Copyright Licensing Agency Ltd, Barnard's Inn, 86 Fetter Lane, London EC4A 1EN.

The ePublication is protected by copyright and must not be copied, reproduced, transferred, distributed, leased, licensed or publicly performed or used in any way except as specifically permitted in writing by the publishers, as allowed under the terms and conditions under which it was purchased, or as strictly permitted by applicable copyright law. Any unauthorised distribution or use of this text may be a direct infringement of the authors' and the publisher's rights and those responsible may be liable in law accordingly.

All trademarks used herein are the property of their respective owners. The use of any trademark in this text does not vest in the author or publisher any trademark ownership rights in such trademarks, nor does the use of such trademarks imply any affiliation with or endorsement of this book by such owners.

Contains public sector information licensed under the Open Government Licence (OGL) v3.0. <http://www.nationalarchives.gov.uk/doc/open-government-licence/version/3/>.

The screenshots in this book are reprinted by permission of Microsoft Corporation.

Pearson Education is not responsible for the content of third-party internet sites.

The Financial Times. With a worldwide network of highly respected journalists, *The Financial Times* provides global business news, insightful opinion and expert analysis of business, finance and politics. With over 500 journalists reporting from 50 countries worldwide, our in-depth coverage of international news is objectively reported and analysed from an independent, global perspective. To find out more, visit www.ft.com/pearsonoffer.

This publication contains copyright material of the IFRS® Foundation in respect of which all rights are reserved. Reproduced by Pearson Education Ltd with the permission of the IFRS Foundation. No permission granted to third parties to reproduce or distribute.

For full access to IFRS Standards and the work of the IFRS Foundation please visit <http://eifrs.ifrs.org>

The International Accounting Standards Board®, the IFRS Foundation, the authors and the publishers do not accept responsibility for any loss caused by acting or refraining from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

ISBN: 978-1-292-28693-8 (print)
978-1-292-28696-9 (PDF)
978-1-292-28697-6 (ePub)

British Library Cataloguing-in-Publication Data

A catalogue record for the print edition is available from the British Library

Library of Congress Cataloguing-in-Publication Data

Names: Dyson, J. R. (John R.), author. | Franklin, Ellie, author.
Title: Accounting for non-accounting students / John R. Dyson, Ellie Franklin.

Description: Tenth edition. | Hoboken : Pearson, 2020. | Includes bibliographical references and index. | Summary: "Picking up accounting as a language and as a skill will add credibility to your CV and enhance your employability. Any job role you may be involved with - from an HR manager, to investment banker, to a self-employed musician - they all require, and are done better with, a basic grasp and understanding of accounting to be able to make financially sound decisions on a daily basis. Warren Buffet is an example - not an accountant - but making a good use of accounting in his investment and business dealings to notable success"-- Provided by publisher.

Identifiers: LCCN 2019047246 | ISBN 9781292286938 (hardback) | ISBN 9781292286976 (epub)

Subjects: LCSH: Accounting.

Classification: LCC HF5636 .D97 2020 | DDC 657--dc23

LC record available at <https://lcn.loc.gov/2019047246>

10 9 8 7 6 5 4 3 2 1
24 23 22 21 20

Front cover image: Alfon No/500px/Getty Images
Print edition typeset in 10/12pt Sabon LT Pro by SPI Global
Printed in Slovakia by Neografia

NOTE THAT ANY PAGE CROSS-REFERENCES REFER TO THE PRINT EDITION.

Brief Contents

Preface	xi
Acknowledgements	xv
Abbreviations	xxi
Part 1 INTRODUCTION TO ACCOUNTING	1
1 Accounting and the business world	3
2 Accounting rules and regulations	25
Part 2 FINANCIAL ACCOUNTING	51
3 Recording data	53
4 Sole trader accounts	80
5 Company accounts	112
6 Other entity accounts	136
7 Statement of cash flows	154
Case studies	183
Part 3 FINANCIAL REPORTING	191
8 The annual report	193
9 The annual accounts	210
10 Interpretation of accounts	228
11 Contemporary issues	261
Case studies	276
Part 4 MANAGEMENT ACCOUNTING	277
12 Foundations	279
13 Direct costs	292
14 Indirect costs	307
15 Budgeting	331
16 Standard costing	354
17 Contribution analysis	377
18 Decision making	400
19 Capital investment	421
20 Emerging issues	446
Case studies	469
Appendices	475
Glossary	511
Index	515

Contents

Preface	xi		
Acknowledgements	xv		
Abbreviations	xxi		
Part 1		Part 2	
INTRODUCTION TO ACCOUNTING	1	FINANCIAL ACCOUNTING	51
1 Accounting and the business world	3	3 Recording data	53
About this chapter	4	About this chapter	54
Learning objectives	4	Learning objectives	54
Why accounting is important	4	Why this chapter is important	54
Nature and purpose of accounting	6	The accounting equation	54
Historical development	7	Double-entry bookkeeping	56
Branches of accounting	10	Working with accounts	58
Your relationship with your accountant	15	A ledger account example	63
The business entity you might be working within	16	Balancing the accounts	64
Conclusion	20	The trial balance	66
Key points	21	Trial balance errors	69
Check your learning	21	Computerisation	70
News stories and news clips critical thinking questions	22	Questions you should ask	70
Tutorial questions	23	Conclusion	71
		Key points	71
		Check your learning	72
		News stories and news clips critical thinking questions	72
		Tutorial questions	73
2 Accounting rules and regulations	25	4 Sole trader accounts	80
About this chapter	25	About this chapter	80
Learning objectives	26	Learning objectives	81
Why this chapter is important	26	Why this chapter is important	81
The 'rules' of the game	26	Preparing basic financial statements	82
Why have regulation?	28	Year-end adjustments	85
The need for regulation in accounting	29	Inventory	86
Agents and the agency problem	31	Depreciation	87
How regulation happens in the context of accounting	32	Accruals and prepayments	90
Changes in regulation	36	Bad and doubtful debts	92
What accounting regulation should a director know about	37	A comprehensive example	94
The <i>Conceptual Framework for Financial Reporting</i> (2018) – 'the framework'	37	Accounting defects	97
Other accounting concepts outside the framework	42	Questions you should ask	99
Rules versus principles based regulation	44	Conclusion	100
Questions you should ask	45	Key points	100
Key points	45	Check your learning	101
Check your learning	46	News stories and news clips critical thinking questions	101
News stories and news clips critical thinking questions	46	Tutorial questions	102
Tutorial questions	47		

5 Company accounts	112	Part 3	191
About this chapter	112	FINANCIAL REPORTING	
Learning objectives	113	8 The annual report	193
Why this chapter is important	113	About this chapter	194
Limited liability	113	Learning objectives	194
Structure and operation	114	Why this chapter is important	194
The statement of profit or loss	120	Overview	195
The statement of changes in equity	120	Introductory material	196
The statement of retained earnings	120	Corporate reporting	200
The statement of financial position	122	Shareholder information	206
A comprehensive example	124	Questions you should ask	207
Questions you should ask	128	Conclusion	207
Conclusion	128	Key points	208
Key points	128	Check your learning	208
Check your learning	129	News stories and news clips critical thinking questions	209
News stories and news clips critical thinking questions	129	Tutorial questions	209
Tutorial questions	129		
		9 The annual accounts	210
6 Other entity accounts	136	About this chapter	210
About this chapter	136	Learning objectives	211
Learning objectives	137	Why this chapter is important	211
Why this chapter is important	137	Setting the scene	212
Manufacturing accounts	137	Consolidated statement of profit or loss and other comprehensive income	214
Service entity accounts	142	Statement of changes in equity	216
Not-for-profit entity accounts	145	Consolidated statement of financial position	217
Government accounts	148	Consolidated statement of cash flows	220
Questions you should ask	149	Notes to the financial statements	221
Conclusion	149	Independent auditor's report	222
Key points	150	Periodic summary	223
Check your learning	151	Questions you should ask	225
News stories and news clips critical thinking questions	151	Conclusion	226
Tutorial questions	151	Key points	226
		Check your learning	226
		News stories and news clips critical thinking questions	227
		Tutorial questions	227
		10 Interpretation of accounts	228
7 Statement of cash flows	154	About this chapter	228
About this chapter	154	Learning objectives	229
Learning objectives	155	Why this chapter is important	229
Why this chapter is important	155	Nature and purpose	229
What is cash?	155	Procedure	232
Cash flow	156	Ratio analysis	236
Statement of cash flows (SCF) – nature and purpose	158	Illustrative examples	237
Statement of cash flows (SCF) – preparation	159	Questions you should ask	249
FRS 102 (Section 7) presentation	166	Conclusion	249
IAS 7 format	170	Key points	250
Questions you should ask	173	Check your learning	251
Conclusion	174	News stories and news clips critical thinking questions	251
Key points	174	Tutorial questions	251
Check your learning	174		
News stories and news clips critical thinking questions	175		
Tutorial questions	175		
CASE STUDIES			
Preparation of financial statements	183		
Accounting policies	185		
Statement of cash flows	188		

11 Contemporary issues	261	Conclusion	303
About this chapter	263	Key points	303
Learning objectives	263	Check your learning	304
Why this chapter is important	263	News stories and news clips critical thinking questions	304
Overview	264	Tutorial questions	304
Fraud and accounting scandals	264		
Auditor rotation	267	14 Indirect costs	307
Changing regulatory landscape	270	About this chapter	307
International projects	270	Learning objectives	308
UK projects	271	Why this chapter is important	308
ARGA replacing the FRC	272	Production overhead	308
Brexit	272	A comprehensive example	316
UK Corporate Governance Code 2018	272	Non-production overhead	318
UK Stewardship Code 2012 (under review in 2019)	272	Predetermined absorption rates	319
XBRL	273	Activity-based costing	320
Questions you should ask	273	Questions you should ask	324
Conclusion	273	Conclusion	324
Key points	273	Key points	325
Check your learning	274	Check your learning	326
News stories and news clips critical thinking questions	274	News stories and news clips critical thinking questions	326
Tutorial questions	274	Tutorial questions	326
CASE STUDIES		15 Budgeting	331
Interpretation of accounts	276	About this chapter	332
		Learning objectives	332
		Why this chapter is important	332
		Budgeting and budgetary control	332
		Procedure	334
		A comprehensive example	338
		Fixed and flexible budgets	342
		Behavioural consequences	345
		Questions you should ask	347
		Conclusion	347
		Key points	348
		Check your learning	348
		News stories and news clips critical thinking questions	348
		Tutorial questions	349
		16 Standard costing	354
		About this chapter	354
		Learning objectives	355
		Why this chapter is important	355
		Operation	355
		Performance measures	359
		Cost variances	361
		A comprehensive example	364
		Sales variances	368
		Operating statements	369
		Questions you should ask	371
		Conclusion	371
		Key points	372
		Check your learning	372
		News stories and news clips critical thinking questions	373
		Tutorial questions	373
Part 4			
MANAGEMENT ACCOUNTING	277		
12 Foundations	279		
About this chapter	280		
Learning objectives	280		
Why this chapter is important	280		
Nature and purpose	280		
Historical review	282		
Main functions	283		
Behavioural considerations	287		
Questions you should ask	288		
Conclusion	289		
Key points	289		
Check your learning	290		
News stories and news clips critical thinking questions	290		
Tutorial questions	290		
13 Direct costs	292		
About this chapter	292		
Learning objectives	293		
Why this chapter is important	293		
Responsibility accounting	293		
Classification of costs	294		
Direct materials	296		
Direct labour	301		
Other direct costs	302		
Questions you should ask	302		

17 Contribution analysis

About this chapter	377
Learning objectives	378
Why this chapter is important	378
Marginal costing	378
Contribution	379
Assumptions	380
Format	381
Application	382
Charts and graphs	384
Reservations	388
Formulae	389
Limiting factors	393
Questions you should ask	395
Conclusion	396
Key points	396
Check your learning	396
News stories and news clips critical thinking questions	397
Tutorial questions	397

18 Decision making

About this chapter	400
Learning objectives	401
Why this chapter is important	401
Nature and purpose	401
Cost classification	403
Types of decision	405
Questions you should ask	414
Conclusion	415
Key points	415
Check your learning	416
News stories and news clips critical thinking questions	416
Tutorial questions	416

19 Capital investment

About this chapter	422
Learning objectives	422
Why this chapter is important	422

Background	422
Main methods	423
Net cash flow	435
Sources of finance	436
Questions you should ask	439
Conclusion	439
Key points	440
Check your learning	440
News stories and news clips critical thinking questions	441
Tutorial questions	441

20 Emerging issues

About this chapter	446
Learning objectives	447
Why this chapter is important	447
The business environment	447
Management accounting changes	449
Selected techniques	450
And finally ... commingling	465
Questions you should ask	466
Conclusion	466
Key points	467
Check your learning	467
News stories and news clips critical thinking questions	468
Tutorial questions	468

CASE STUDIES

Fixed and flexible budgets	469
Standard cost operating statements	471
Pricing	473

Appendices

Further Reading	475
Discount Table	476
Answers to Selected Activities	477
Answers to Selected Tutorial Questions	480

Glossary	511
Index	515

Companion Website

For open-access **student resources** specifically written to complement this textbook and support your learning, please visit go.pearson.com/uk/he/resources



Lecturer Resources

For password-protected online resources tailored to support the use of this textbook in teaching, please visit go.pearson.com/uk/he/resources

Preface

For students

Dear Student,

Hello! My name is Ellie and I am one of the academics involved with the update of this edition of the textbook you are holding in your hands.

Let me tell you a little bit about it, the subject and topics it covers as well as key features that we think you will like and be of benefit to you.

Why accounting matters

Everyone has their own idea of what a prosperous life looks like. Any money you earn in employment or a business you run you have a choice about – to spend it, save it or invest it. Accounting and its techniques allow you to make informed choices and to keep a record of how your prosperity grows over time. Even though we tend to think of accounting as something confined to business it can be equally useful in your personal life.

The subject tends to have some negative connotations attached to it – that it is dull, static and incomprehensible. That is hardly the case!

- Take for example the many corporate scandals in recent times. They make the news and in all of them accounting has a part to play – for example in the way corporate fraud is concealed, as well as the way in which it is found out. Finding out about some of these fraud cases is quite curious and interesting.
- In the United Kingdom there are at this time many debates involving audit and accounting, and regulatory reforms are being shaped. Accounting rules and the way the profession is governed keep evolving.
- And while, initially, accounting may look like it is full of jargon, over time you will learn to understand it just like a new language. Once mastered – it will be useful to you both personally and professionally for years to come.

How this book will help

To help you get familiar with the terminology with this edition we have included, in a glossary, the definitions of nearly 100 key accounting concepts and terms.

Picking up accounting as a language and as a skill will add credibility to your CV and enhance your employability. Any job role you may be involved with – from an HR manager, to investment banker, to a self-employed musician – they all require, and are done better with, a basic grasp and understanding of accounting to be able to make financially sound decisions on a daily basis. Warren Buffett is an example – not an accountant – but making a good use of accounting in his investment and business dealings to notable success.

To help you impress potential employers when applying for jobs we have also included chapters discussing current topical issues in accounting. There are also 20 lead news stories and over 80 news clips dispersed throughout the text related to accounting and companies like Netflix, Tesla and many more – you are bound to find something of interest there. Not only are they interesting, current, relevant and taken from real life to help you make the connection between accounting and things you relate to, but they could also be the starting point for further reading and research – both to satisfy your own curiosity as well as to help you prepare to impress potential employers in interviews with your knowledge of current events and issues in business.

Just like in previous editions we have online resources accompanying the book at go.pearson.com/uk/he/resources as well as useful features to encourage active learning within the book itself, which include activities, critical thinking questions, and other problems and their solutions. Working through those will help you master the techniques explained as well as develop your understanding and critical thinking around the subject.

What next?

This textbook is intended as a light introduction for non-accountants. If you want to explore the topics further you might want to see any of the other Pearson accounting textbooks available via www.pearson.com/uk

If you find anything you would rather be changed or added to future editions – feel free to email me at e.franklin@mdx.ac.uk. I would be happy to hear from you and consider your suggestions and comments!

And if you would like to see my other outputs around Good Money Habits – I am on the web, Twitter, Facebook and YouTube – search for Ellie Franklin TV to find me.

All that remains for me to say is thank you for picking up this book and I hope you will find it useful and enjoy your studies!

For lecturers

Dear Colleague,

Thank you for picking up this textbook, I hope you like it and intend to use it with your students.

Recently the first known textbook on accounting – Pacioli’s *Summa* was on display in London before going to auction for an estimated €1.5 million – such is the perceived value of one of the greatest inventions of all time – double entry bookkeeping.

It is fascinating to share with students that some of the basic accounting techniques remain the same as they were in the 15th century while so much about accounting and the accounting and audit profession continues to evolve. In late 2018, Rachel Reeves MP, spoke in front an audience at the ICAEW (Institute of Chartered Accountants in England and Wales) about the ‘broken’ audit market. In the aftermath of the collapse of Carillion, Parliament launched its inquiry into the future of audit of financial statements. The accounting and audit regulator – the FRC (Financial Reporting Council) is set to be replaced by a new regulatory body accountable to Parliament in an effort to improve independence and objectivity of the profession’s ‘watchdog’. These are fascinating times to teach students about accounting and how it supports business in making informed strategy decisions and report how it has increased value for those who have backed it!

In addition to exposing students to such exciting topics it is important to encourage the younger generation to see their own personal financial affairs as an area in which they ought to invest some time and effort to understand. It is also important to bring ethics to their awareness in the hope that they become managers of the future who act with integrity and professionalism. Employers are wanting universities to deliver graduates to them with such skills and attitudes.

How can this textbook help?

- The textbook is split into financial accounting and management accounting parts which allows for those to be taught separately in institutions where teaching happens over the course of two semesters/shorter courses, as well as year-long courses that cover both branches of accounting.

- As in previous editions, each chapter begins with a news article related to the topic covered. There are also over 80 news clips dispersed throughout the text to engage students and help them cross the bridge between classroom and real life. We have taken care to select those articles about businesses students will immediately recognise and find exciting – such as Tesla, Netflix, Asos, Tottenham Hotspur and Amazon, as well as some they might not have heard about but would be good to know the story of – such as Patisserie Valerie and Carillion. This should help them increase their knowledge about current issues which could help to improve their employment prospects when applying for jobs.
- A new feature with this edition is the inclusion of critical thinking questions at the end of each chapter related to some of the in-chapter news stories. This will allow you to explore themes that go beyond accounting techniques in classroom discussions – perhaps including ethics and debates on controversial topics or around issues which require students to think for themselves and express a personal opinion.
- Another new feature with this edition is the glossary of definitions of nearly 100 key accounting concepts and terms, which we hope your students will find useful and will help non-accountants cope with accounting jargon.
- Just like in previous editions we have online resources accompanying the book which can be found at go.pearson.com/uk/he/resources and include a companion website with multiple choice questions for students, and instructor resources including PowerPoint slides and an instructor’s manual with solutions. There are also activities and other problems throughout the text, and their solutions are included in the appendices.
- There has been a full rewrite of Chapter 2 ‘Accounting rules and regulations’ to significantly simplify it as well as update it. It includes references to the proposed introduction of ARGA (Audit, Reporting and Governance Authority) and incorporates references to the 2018 Conceptual Framework of Financial Reporting. Reference to financial reporting and accounting standards has been kept light as is suitable to non-accounting students.
- Other chapters that have seen changes are:
 - Chapter 1 ‘Accounting and the business world’ – to include references to personal finances and the usefulness of accounting in that context, and
 - Chapter 7 ‘Statement of cash flows’ – to incorporate user feedback on the previous edition where that chapter was fully updated.
- As usual Chapter 11 ‘Contemporary issues’ in Financial Reporting and Chapter 20 ‘Emerging issues’ in Management Accounting have also been updated.

This textbook is intended as a light introduction for non-accountants. For some of your most able students you might want to refer them to additional reading such as other more advanced level Pearson accounting textbooks available via www.pearson.com/uk.

If you find anything you would rather be changed or added to future editions – feel free to email me at e.franklin@mdx.ac.uk. I would be happy to hear from you and consider your suggestions and comments!

Thank you again for picking up this book. I hope you will find it useful and interesting to work with.

Warm Regards,
Ellie



Photographer credits:
Iva Kostova of *Iva Photography Art*
<http://iva-photography-art.co.uk/>

Acknowledgements

Text

3 The Financial Times Limited: Beioley, K. (2019). Gig economy workers can flex their ISA strategy, *Financial Times*, 6 March. © The Financial Times Limited 2019. All Rights Reserved; **5 The Financial Times Limited:** Barrett, C. (2018). Have your finances got the January blues?, *Financial Times*, 18 January. © The Financial Times Limited 2019. All Rights Reserved; **9 The Financial Times Limited:** Pickford, J. (2019). Rare medieval accountancy book expected to sell for \$1.5m, *Financial Times*, 14 February. © The Financial Times Limited 2019. All Rights Reserved; **12-13 Chartered Institute of Management Accountants:** Reprinted with permission from Chartered Institute of Management Accountants (2005). CIMA Official Terminology, Oxford: CIMA Publishers; **13 The Financial Times Limited:** Marriage, M. (2019). Patisserie Valerie auditor was 'not looking for fraud', *Financial Times*, 30 January. © The Financial Times Limited 2019. All Rights Reserved; **15 Independent House:** Extract from McBride, L. (2014) How to choose the perfect accountant, Sunday Independent, 7 December; **25 The Financial Times Limited:** Marriage, M. (2019). UK accounting watchdog to be replaced by stronger regulator, *Financial Times*, 11 March. © The Financial Times Limited 2019. All Rights Reserved; **32 The Financial Reporting Council:** FRC Structure, Used with permission from The Financial Reporting Council, <https://www.frc.org.uk/about-the-frc/structure-of-the-frc>; **33, 37 The National Archives:** Companies Act 2006, CHAPTER 46; **35 Institute of Chartered Accountants in England and Wales:** *Economia*, an ICAEW magazine, March 2018; **40 The Financial Times Limited:** Gray, A. (2019). Lampert gets another chance to keep Sears from liquidation, *Financial Times*, 8 January. © The Financial Times Limited 2019. All Rights Reserved; **43 The National Archives:** Companies Act 2006, CHAPTER 46, S464(1); **43 The Financial Reporting Council:** FRS 100 Application of Financial Reporting Requirements, The Financial Reporting Council, March 2018; **48-49 The Financial Conduct Authority:** Principles of The Regulator/Businesses (2016). The Finance Conduct Authority, 15 April; **53 The Financial Times Limited:** Thomas, N. (2017). Former Npower boss joins energy blockchain start-up, *Financial Times*, 4 April. © The Financial Times Limited 2019. All Rights Reserved; **57 The Financial Times Limited:** Arnold, M. (2017). How business schools teach cryptocurrencies, *Financial Times*, 29 November. © The Financial Times Limited 2019. All Rights Reserved; **70 Accountancy Age:** Adapted from Kevin Reed (2015). Xero breaks 100,000 customer mark, *Accountancy Age*, 30 September; **80 The Financial Times Limited:** Beioley, K. and Provan, S. (2019). Provident Financial warns on profit after rise in bad debt, *Financial Times*, 15 January. © The Financial Times Limited 2019. All Rights Reserved; **81 The Financial Times Limited:** Marriage, M. (2018). BBC presenters say broadcaster badly let them down on tax, *Financial Times*, 20 March. © The Financial Times Limited 2019. All Rights Reserved; **87 The Financial Times Limited:** Powell, J. (2019). Tesla's profitability: how every little helped, *Financial Times*, 25 February. © The Financial Times Limited 2019. All Rights Reserved; **90 The Financial Times Limited:** Shrikanth, S. and Eley, J. (2019). Ocado strikes technology partnership with Australia's Coles, *Financial Times*, 26 March. © The Financial Times Limited 2019. All Rights Reserved; **92 The Financial Times Limited:** Weinland, D.

(2019). China bad debt disposals hit levels not seen for 20 years, *Financial Times*, 23 January. © The Financial Times Limited 2019. All Rights Reserved; **112 The Financial Times Limited:** Ahmed, M. (2019). Tottenham Hotspur scores football's biggest profit, *Financial Times*, 4 April. © The Financial Times Limited 2019. All Rights Reserved; **119 The Financial Times Limited:** Hampson, R. (2019). ETF dividend chasers told to 'do your homework', *Financial Times*, 1 April. © The Financial Times Limited 2019. All Rights Reserved; **122 The Financial Times Limited:** AstraZeneca: capital remedy, *Financial Times*, 29 March 2019. © The Financial Times Limited 2019. All Rights Reserved; **136 The Financial Times Limited:** Neville, S. (2018). Watchdog warns over NHS financial sustainability, *Financial Times*, 18 January. © The Financial Times Limited 2019. All Rights Reserved; **145 The Financial Times Limited:** Gordon, S. (2019). I covered the City for 20 years — here's what I learnt, *Financial Times*, 8 March. © The Financial Times Limited 2019. All Rights Reserved; **148 The Financial Times Limited:** Wolf, M. (2016). Public sector needs to do a better job with assets, *Financial Times*, 15 April. © The Financial Times Limited 2019. All Rights Reserved; **154 The Financial Times Limited:** Burgess, K. (2018). De La Rues the day, *Financial Times*, 20 March. © The Financial Times Limited 2019. All Rights Reserved; **155 The Financial Times Limited:** Spero, J. (2019). Oxford spinout prepares London bike-sharing launch, *Financial Times*, 17 March. © The Financial Times Limited 2019. All Rights Reserved; **158 The Financial Times Limited:** Boeing: crash implications, *Financial Times*, 11 March. 2019 © The Financial Times Limited 2019. All Rights Reserved; **159 Guardian News & Media Limited:** Rahul Thakrar, Starting a new business: how to avoid failure, *The Guardian*, 22 March 2016; **170 The Financial Times Limited:** Crooks, E. (2019). GE warns of negative cash flow for 2019, *Financial Times*, 5 March. © The Financial Times Limited 2019. All Rights Reserved; **171–172 De La Rue plc:** De La Rue Statement of Cash Flow extracted from the group Annual Report 2019, <https://cdn2.hubspot.net/hubfs/2752422/ar2019/De%20La%20Rue%20Annual%20Report%202019.pdf>; **173 The Financial Times Limited:** Plimmer, G. (2019). UK warns government contractors to pay suppliers promptly or risk ban, *Financial Times*, 4 April. © The Financial Times Limited 2019. All Rights Reserved; **189–190 J. Smart & Co. (Contractors) plc:** Reprinted with permission from J. Smart & Co. (Contractors) plc, Annual report and statement of accounts to 31st July 2018; **189–190 Aggreko Plc:** Aggreko Plc Annual Report and Accounts 2018; **193 The Financial Times Limited:** Thompson, J. (2019). 'Greenwashing is rampant', warns chief of global accounting body, *Financial Times*, 2 April. © The Financial Times Limited 2019. All Rights Reserved; **195 The Financial Times Limited:** Johnson, M. (2019). How investors failed to spot Carillion's mounting problems, *Financial Times*, 15 January. © The Financial Times Limited 2019. All Rights Reserved; **197 Aggreko plc:** Aggreko's 2018 Annual Report and Accounts; **197–225 easyJet plc:** easyJet plc, Annual Report and Accounts, 2018; **199 J. Smart & Co. (Contractors) plc:** Reprinted with permission from J. Smart & Co. (Contractors) plc, Annual report and statement of accounts to 31st July 2018; **205 The Financial Times Limited:** Thomas, N. (2019). Shell chief executive's pay more than doubles to €20m in 2018, *Financial Times*, 14 March. © The Financial Times Limited 2019. All Rights Reserved; **210 The Financial Times Limited:** Inagaki, K. (2018). US ends Toshiba accounting probe with no penalty, *Financial Times*, 25 June. © The Financial Times Limited 2019. All Rights Reserved; **213 The Financial Times Limited:** Ralph, O. (2017). UK insurers hit by biggest accounting shake-up in decades, *Financial Times*, 18 May. © The Financial Times Limited 2019. All Rights Reserved; **221 The Accounting Standards Board Limited:** Statement of Principles for Financial Reporting, The Accounting Standards Board Limited 1999; **222 The Financial Times Limited:** Ford, J. (2019). Scandal-hit London Capital & Financial was technically insolvent in 2017, *Financial Times*, 29 March. © The Financial Times Limited 2019. All Rights Reserved; **228 The Financial Times Limited:** Pfeifer, S. (2018). Aggreko gives power to hopes of a

turnround, *Financial Times*, 26 August. © The Financial Times Limited 2019. All Rights Reserved; **239 Investors Chronicle**: Adapted from Investors Chronicle, 28 January 2010; **243–248 Marks and Spencer plc**: M&S Annual Report and Financial Statements 2019; **248 The Financial Times Limited**: Authers, J. (2019). How to spot companies at risk of earnings manipulation, *Financial Times*, 7 September. © The Financial Times Limited 2019. All Rights Reserved; **257–259 J Sainsbury plc**: Annual Report and Financial Statements 2019, J Sainsbury plc. Reprinted with permission; **261–262 The Financial Times Limited**: Marriage, M. (2019). UK auditing shake-up looks set to hit company directors, *Financial Times*, 21 March. © The Financial Times Limited 2019. All Rights Reserved; **264 The Financial Times Limited**: Croft, J. (2018). Two ex-Tesco executives accused of improperly boosting profits, *Financial Times*, 8 October. © The Financial Times Limited 2019. All Rights Reserved; **265 The Financial Times Limited**: Eley, J. (2019). Patisserie Valerie goes into administration after accounting fraud, *Financial Times*, 22 January. © The Financial Times Limited 2019. All Rights Reserved; **266 ICAEW**: Fraud Act 2006, Business and Economic Crime in an International Context, ICAEW, November 2010; **266 Action Fraud**: False accounting fraud, Action Fraud, <http://www.actionfraud.police.uk/fraud-protection/false-accounting-fraud>, June 2016; **268 The Financial Times Limited**: Marriage, M. (2015). Audit firms called to account for cosy tenures, *Financial Times*, 14 June. © The Financial Times Limited 2019. All Rights Reserved; **269 The Financial Times Limited**: Marriage, M. (2019). Whistleblower accuses PwC of failings over private jet trip, *Financial Times*, 24 March. © The Financial Times Limited 2019. All Rights Reserved; **269 The Financial Times Limited**: Auditors have a duty to follow the scent of fraud, *Financial Times*, 3 February 2019. © The Financial Times Limited 2019. All Rights Reserved; **270 Association of International Certified Professional Accountants**: Maria L. Murphy, CPA (2015). Will simpler also be better?, *Journal of Accountancy*, Association of International Certified Professional Accountants, 13 April, www.journalofaccountancy.com; **270–271 The International Financial Reporting Standards Foundation**: International Accounting Standards Board (IASB) © IFRS Foundation 2017; **271 Accountancy Age**: Can principles overrule the rules?, *Accountancy Age*, 24 January 2012; **279 The Financial Times Limited**: Moules, J. (2018). Brompton's Will Butler-Adams on how to succeed an illustrious founder, *Financial Times*, 8 April. © The Financial Times Limited 2019. All Rights Reserved; **281, 286 Chartered Institute of Management Accountants**: Graham Eaton, Management Accounting Official Terminology, CIMA, Official Terminology, 2005. Reprinted with permission from CIMA; **286 The Financial Times Limited**: Ahmed, M. (2018). England rugby chief quits as financial crisis and infighting mount, *Financial Times*, 16 November. © The Financial Times Limited 2019. All Rights Reserved; **292 The Financial Times Limited**: Agnew, H. (2019). Carrefour lifts cost cutting efforts as transformation ramps up, *Financial Times*, 28 February. © The Financial Times Limited 2019. All Rights Reserved; **295 Chartered Institute of Management Accountants**: Reprinted with permission from Chartered Institute of Management Accountants (2005). *CIMA Official Terminology*. Oxford: CIMA Publishers; **300 The Financial Times Limited**: Sanderson, H. (2019). LME backs Mercuria-led blockchain consortium to track global metals, *Financial Times*, 26 March. © The Financial Times Limited 2019. All Rights Reserved; **302 The Financial Times Limited**: Waters, R. (2018). Tesla burns less cash and cuts spending, *Financial Times*, 1 August. © The Financial Times Limited 2019. All Rights Reserved; **307 The Financial Times Limited**: Georgiadis, P. (2019). Hornby faces another year of losses on supply woes, *Financial Times*, 9 April. © The Financial Times Limited 2019. All Rights Reserved; **308 The Financial Times Limited**: Fiennes, C. (2017). Try not to judge a charity by its admin costs alone, *Financial Times*, 25 October. © The Financial Times Limited 2019. All Rights Reserved; **321 The Financial Times Limited**: Lambert, Y. (2018). In-house legal team takes new direction at Spotify, *Financial Times*, 11 December. © The Financial

Times Limited 2019. All Rights Reserved; 331 **The Financial Times Limited:** Mance, H. (2018). Music industry warns on decline in state school teaching, *Financial Times*, 15 September. © The Financial Times Limited 2019. All Rights Reserved; 332 **The Financial Times Limited:** Cook, L. (2019). Is Britain ready to go cashless?, *Financial Times*, 27 February. © The Financial Times Limited 2019. All Rights Reserved; 338 **Chartered Institute of Management Accountants:** Adapted from Chartered Institute of Management Accountants (2005). *CIMA Official Terminology*. Oxford: CIMA Publishers; 343 **The Financial Times Limited:** Hancock, A. (2019). UK wine sellers find themselves squeezed on all sides, *Financial Times*, 30 March. © The Financial Times Limited 2019. All Rights Reserved; 347 **Hearst Newspapers, LLC:** Adapted from Stephanie Faris (2019). Challenges of Budgeting & Budgetary Control, *Hearst Newspapers, LLC* small-business.chron.com/challenges-budgeting-budgetary-control-59231.html; 354 **The Financial Times Limited:** Beioley, K. (2019). Interactive Investor to roll out 'Netflix pricing', *Financial Times*, 8 April. © The Financial Times Limited 2019. All Rights Reserved; 355 **The Financial Times Limited:** Odell, M. (2013). KPMG defends key HS2 report, *Financial Times*, 5 November. © The Financial Times Limited 2019. All Rights Reserved; 361 **The Financial Times Limited:** Spero, J. and Ford, J. (2019). IAG hits out at aviation regulator over Heathrow deal, *Financial Times*, 25 February. © The Financial Times Limited 2019. All Rights Reserved; 377 **The Financial Times Limited:** Vincent, M. (2018). Opening Quote: Asos sees retail woes move online, *Financial Times*, 17 December. © The Financial Times Limited 2019. All Rights Reserved; 382 **The Financial Times Limited:** Powell, J. (2019). The cloud software kings are nuts, when's the crash?, *Financial Times*, 27 March. © The Financial Times Limited 2019. All Rights Reserved; 393 **The Financial Times Limited:** Bradshaw, T. (2018). Sonos rebounds as Beam speaker pumps up the volume, *Financial Times*, 15 November. © The Financial Times Limited 2019. All Rights Reserved; 400 **The Financial Times Limited:** Vincent, M. (2018). Lloyds channels inner David Brent in its digital banking drive, *Financial Times*, 6 November. © The Financial Times Limited 2019. All Rights Reserved; 401 **The Financial Times Limited:** Eley, J. (2018). Marks and Spencer confirms expanded store closure programme, *Financial Times*, 22 May. © The Financial Times Limited 2019. All Rights Reserved; 404 **The Financial Times Limited:** Samson, A. (2017). HelloFresh seeks valuation of up to €1.5bn in IPO, *Financial Times*, 23 October. © The Financial Times Limited 2019. All Rights Reserved; 406 **The Financial Times Limited:** Eley, J. (2019). Debenhams in administration as Ashley cries foul, *Financial Times*, 9 April. © The Financial Times Limited 2019. All Rights Reserved; 421 **The Financial Times Limited:** Waldmeir, P. (2019). Ford to exit heavy truck business in South America, *Financial Times*, 19 February © The Financial Times Limited 2019. All Rights Reserved; 422 **The Financial Times Limited:** Crooks, E. (2016). ExxonMobil's financial reporting under scrutiny, *Financial Times*, 31 October. © The Financial Times Limited 2019. All Rights Reserved; 423 **The Financial Times Limited:** Powell, J. (2019). The Tesla semi-truck is ready to reserve, *Financial Times*, 12 March. © The Financial Times Limited 2019. All Rights Reserved; 446 **Chartered Institute of Management Accountants:** Used with Permission from CIMA, Sustainable Development Goals and the role of the accountant, <https://www.cimaglobal.com/Research--Insight/sustainable-development-goals-and-the-role-of-the-accountant/>, August 2018; 448 **The Financial Times Limited:** Lewis, L. (2018). Kyoto strides ahead in regenerative medicine race, *Financial Times*, 11 June. © The Financial Times Limited 2019. All Rights Reserved; 452 **Harvard Business Publishing:** Kaplan, R.S. and Norton, D.P. (1992). The Balanced Scorecard – Measures That Drive Performance, *Harvard Business Review*, January/February; 453 **Harvard Business Publishing:** Adapted from Kaplan, R.S. and Norton, D.P. (1996). Using the balanced scorecard as a strategic management system, *Harvard Business Review*, January/February. With permission from Harvard Business School Publishing; 453 **Chartered Institute of Management Accountants:** Graham Eaton, Manage-

ment Accounting Official Terminology, CIMA, Official Terminology, 2005. Reprinted with permission from CIMA; **455 Chartered Institute of Management Accountants:** Graham Eaton, Management Accounting Official Terminology, CIMA, Official Terminology, 2005. Reprinted with permission from CIMA; **458 Federal Reserve Bank of Atlanta:** Fox, H. (1973). A framework for functional coordination, *Atlanta Economic Review*, 23(6): 8–11. With permission from the Federal Reserve Bank of Atlanta; **459 World Book Inc.:** Funk, C.E., Editor (1946). *New Standard Dictionary of the English Language*. New York: Funk and Wagnall's Company; **464 Simon & Schuster, Inc.:** Based on Porter, M.E. (1985). *Competitive Advantage: Creating and Sustaining Superior Performance*. New York, NY: Free Press; **465 The Financial Times Limited:** Kamin-ska, I. (2019). Amazon (sub)Prime?, *Financial Times*, 20 March. © The Financial Times Limited 2019. All Rights Reserved.

Photos

xiii Iva Kostova/Ellie Franklin: Iva Kostova: Iva Kostova of Iva Photography Art, <http://iva-photography-art.co.uk/> and Reprinted with permission from Ellie Franklin; **3 Shutterstock:** michaeljung/Shutterstock; **53 Shutterstock:** panuwat phimpfa/Shutterstock; **157 Shutterstock:** Jesus Keller/Shutterstock; **193 123RF:** Ales Utouka/123RF; **279 Shutterstock:** Kristi Blokhin/Shutterstock.

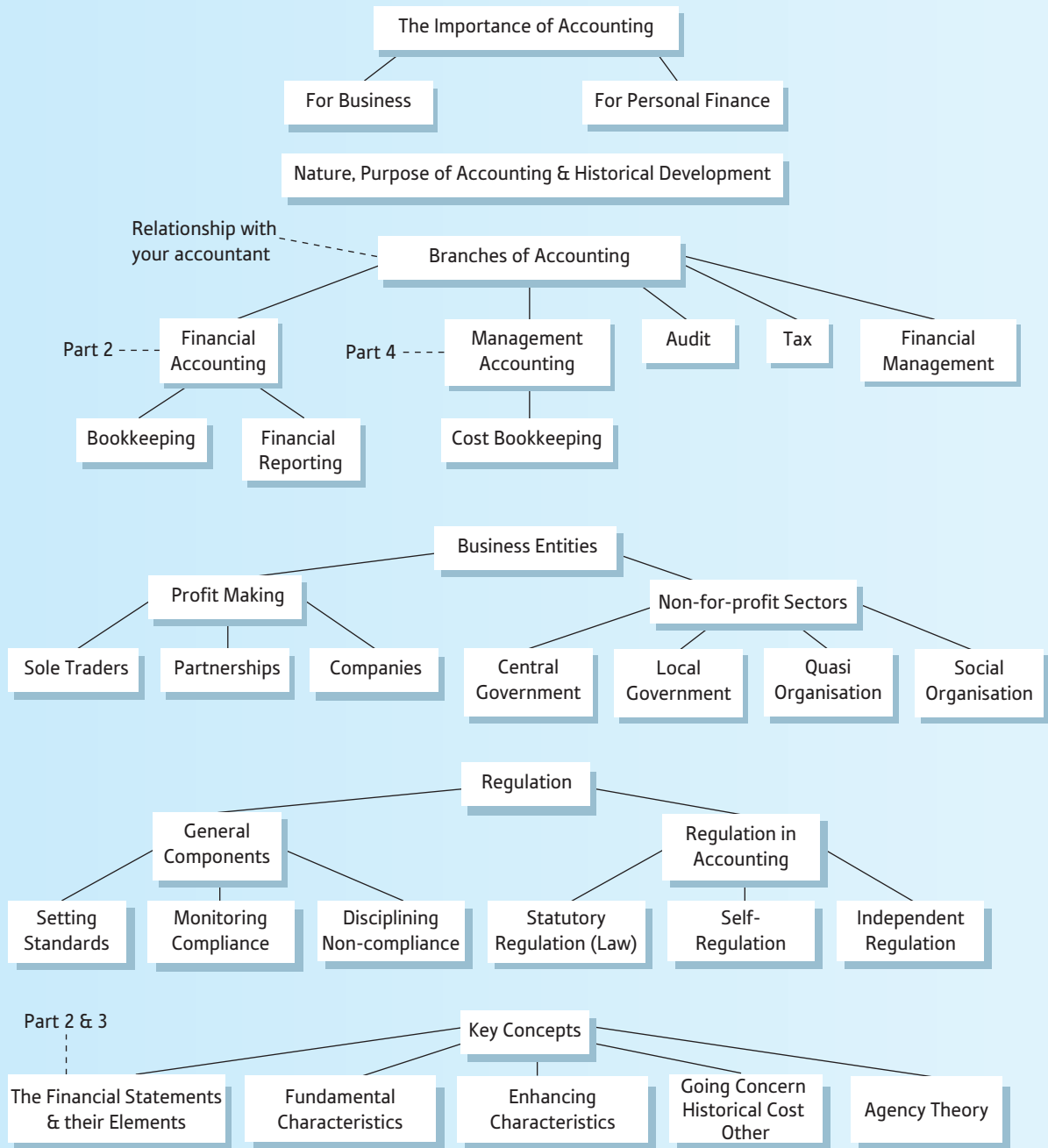
Abbreviations

AAT	Association of Accounting Technicians
ABB	Activity-based budgeting
ABC	Activity-based costing
ABCM	Activity-based cost management
ABM	Activity-based management
AC	Average cost
ACCA	Association of Chartered Certified Accountants
AMT	Advanced manufacturing technology
ARR	Accounting rate of return
BB	Beyond budgeting/Better budgeting
BBC	British Broadcasting Corporation
CA	Chartered Accountant Companies Act
CA06	Companies Act 2006
CE	Capital employed
CI	Capital investment
CIMA	Chartered Institute of Management Accountants
CIPFA	Chartered Institute of Public Finance and Accountancy
Cr	Credit
DCF	Discounted cash flow
Dr	Debit
EA	Environmental accounting
ED	Exposure draft
EMA	Environmental management accounting
EPS	Earnings per share
EU	European Union
FA	Financial accounting
FCA	Financial Conduct Authority
FIFO	First in, first out
FRC	Financial Reporting Council
FRS	Financial Reporting Standard
FTSE	Financial Times London Stock Exchange index
GAAP	Generally accepted accounting principles
GBV	Gross book value
HC	Historic cost
HP	Hire purchase
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICAI	Institute of Chartered Accountants in Ireland
ICAS	Institute of Chartered Accountants of Scotland
IFRS	International Financial Reporting Standards

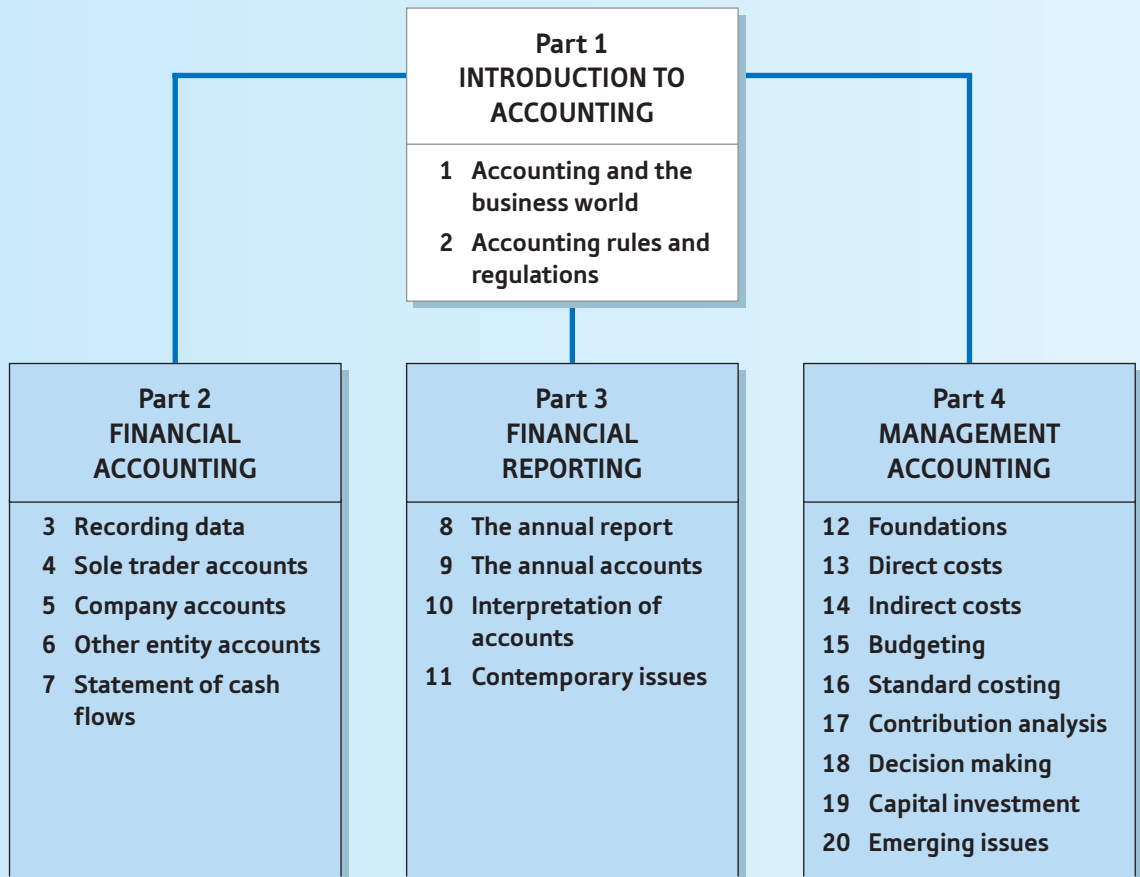
IRR	Internal rate of return
JIT	Just-in-time
KPI	Key performance indicator
LCC	Life cycle costing
LIFO	Last-in, first-out
LLP	Limited liability partnership
LSE	London Stock Exchange
LTD	Limited
MA	Management accounting
MV	Market value
NBV	Net book value
NCF	Net cash flow
NPV	Net present value
PBIT	Profit before interest and tax
PFI	Private finance initiative
PI	Performance indicator
PLC	Public limited company
PLCC	Product/project life cycle costing
R&D	Research and development
RI	Residual income
ROCE	Return on capital employed
SBU	Strategic business unit
SC	Standard cost/costing
SCE	Statement of changes in equity
SCF	Statement of cash flows
SFP	Statement of financial position
SMA	Strategic management accounting
SME	Small and medium-sized enterprise
SPL	Statement of profit or loss
SRE	Statement of retained earnings
TB	Trial balance
TOC	Theory of constraints
TQM	Total quality management
UK	United Kingdom
VA	Value added
VCA	Value chain analysis
WACC	Weighted average cost of capital
ZBB	Zero based budgeting

INTRODUCTION TO ACCOUNTING

Part 1



This book is divided into four main parts, as shown below. Part 1 contains two chapters. In Chapter 1 we provide some background about accounting and the accountancy profession and how accounting might be relevant to you. In Chapter 2 we outline the rules and regulations that are applicable to the preparation of accounting statements for which you may be responsible.



News story

Gig economy workers can flex their ISA strategy

By Kate Beioley

There is an unspoken reason why many millennials aren't saving into an Isa. It is hard to save when you aren't getting paid, and for many self-employed and gig workers that is the case due to the number of companies failing to pay freelancers on time or, in some cases, not at all.

Self-employment has risen sharply since 2000. Millennials are set to make up an increasing proportion of freelancers working in the 'gig economy' within the next decade, according to the Resolution Foundation, a think-tank.

Those freelancers might look like they're #winning, perching in cafés with their laptops and flat whites. In reality, their finances could be on a losing streak. Freelance workers lost an average £5,394 a year in 2017 through unpaid work, according to research by the Association of Independent Professionals and the Self Employed (IPSE).

As well as the challenges of chasing payments and managing an irregular income, self-employed workers don't receive sick pay, holiday pay, or contributions into a workplace pension – increasing the need for a financial safety net.

According to Resolution, two-thirds of employment growth since 2008 has been in 'atypical' roles such as self-employment, zero-hours contracts or agency work.

Within that, agency workers have risen as a share of the workforce by 30 per cent since 2011. Those in their 20s and 30s are around twice as likely to be agency workers as those in their 50s and 60s.



Source: michaeljung/Shutterstock

FT

Source: Beioley, K. (2019) Gig economy workers can flex their ISA strategy, *Financial Times*, 6 March
© The Financial Times Limited 2019. All Rights Reserved.

Critical thinking questions relating to this news story can be found at the end of this chapter. ➔

About this chapter

This chapter sets the scene for the rest of the book.

The chapter begins with what accounting is and an explanation of why it is vital for everybody. It then gives a brief explanation of the nature and purpose of accounting and of its historical development. This is followed by an outline of the main branches of accounting and how one becomes an accounting professional. The last main section of the chapter gives a brief overview of the main forms and structures used to set up and run businesses and other enterprises.

Learning objectives

By the end of this chapter you should be able to:

- explain the nature and purpose of accounting, and the expectation gap;
- outline the history of accounting;
- explain why you need to know something about it in the context of your main subject of study and your career aspirations, as well as your personal life;
- identify the main branches of accounting;
- list the principal UK accountancy bodies;
- describe the most important types of public and private entities.



Why accounting is important

You've probably got hold of this book because you're a student. You may be doing a certificate, diploma or degree course in perhaps business, marketing, human resource management, economics, banking, engineering, languages, law, management or one of the sciences, to name but a few possibilities. And then you find to your horror that you have to do some accounting. Why should you?

OK, we'll try to explain. You probably have a vague idea that accounting has something to do with numbers and profits and tax and, er, *stuff* but you are certainly not sure what that has to do with the subject you're studying. And you may be even resent it.

Right. You might be surprised then to find out that accounting and finance information is fundamental to the running of any business, government or household. It has to do with many things in a business (for example, from procurement of a new IT systems, through hiring or firing staff, to financing the development of a new product) and impacts on many people involved with a business (from the marketing manager who has to manage an advertising budget to a banker who has to make lending decisions to a small jewellery shop owner who has to price her products appropriately). Not to mention that we all use accounting in our personal affairs – managing the income that we get from our employer or business and allocating that to various items of spending, calculating and paying our taxes and saving and investing to grow our personal wealth.

Accounting information is just information. Its power is that like all information it can be useful for making decisions – if you get hold of it, understand it and act on it. Which is why studying it may be a good idea, even if you don't have any aspirations of becoming an accountant.

Accounting and the finances of businesses

Accounting (the process by which accounting information is generated) is basically about recording business transactions and summarising them in a way which is useful to people who need to know that information to make decisions – like shareholders and managers (e.g. the marketing managers, the human resource managers and the production managers). Perhaps just what you hope to be. 'So what?' you might well ask. 'If I need it or want it, I'll just ask the accountants to get it for me.' That's

fine, but if you were a manager, would you really be quite happy to accept at face value all that the accountants gave you? Would you know what it means, how reliable it is, what you are supposed to do with it or what are the right decisions to be made on the basis of it? We suspect that if you really think about the repercussions of not questioning what your accountants gave you, you would be (to say the least) open to making costly mistakes, taking unnecessary risks or causing yourself confusion and embarrassment. You might be a bit worried, especially if you were legally responsible for it all (and under UK law, the directors are responsible for the accounting records and the preparation of accounts by the businesses they manage).

The point we are making is that accountants provide a service for other people. Most accountants are probably highly qualified, experienced and good at their job, but as accountants they should not make the *decisions*. That is the manager's job – it could be your job and you will know much more about your business than any accountant. Rest assured that there is no doubt that you will be able to make even *better* decisions: (a) if you have some knowledge and some understanding of the nature of accounting information and (b) if you know what it can and what it cannot do in helping you plan and control your business.

So in a sentence, if you know something about accounting, you will become a *better* manager. By the end of this book you will be well on the way to becoming one.

Accounting and your personal finances

But this is not all. Accounting and finance literacy is really important for your personal finances and you are possibly very aware of that already. Your journey into the world of accounting and finance began the moment you started getting pocket money or birthday money gifts. Since then you have had to make decisions about what to spend your money on, how to save for bigger items, possibly having to take a student loan to be able to study at university. You are probably bombarded with numerous finance offers for credit cards and free trial offers that then become monthly subscriptions. You may have had to make choices about phone deals or gym memberships. You may have had to budget your holiday spend. You may have had to consider the implications of contactless payments and not carrying cash. The realm of finance decisions that you are already involved with and that you have to keep track of (or an account of) is endless. You are having to do that possibly every single day of your life. As such it is vital that you understand more about how accounting can support you in making sound choices around your personal finances.

News clip 1.1

The importance of financial education

By Claer Barrett

70 guests to the FT offices on Monday night debated the results of research published in FT's last issue about the difficulties young people have managing their finances. The statistic that attracted the most attention from our audience of finance professionals, educators and charities was that 85 per cent of young people said they wished they had been taught more at school about how to manage money. The issues that young people say they want help with include credit cards, budgeting, understanding investments and pensions.

FT

Source: Barrett, C. (2018) Have your finances got the January blues?, *Financial Times*, 18 January
© The Financial Times Limited 2019. All Rights Reserved.

So in summary, this chapter (and the whole book) is important because it provides you with the necessary background information to enable you to become a better manager of your business and personal financial affairs.

Nature and purpose of accounting

We begin our accounting studies by giving a brief explanation of what accounting *is* and what it *does*. We will then tell you something of what it *doesn't* do. For our purposes we will use the following definition of accounting:

Accounting is a service provided for those who need information about an entity's financial performance and its financial position.

This definition contains a number of features that require some explanation:

- *Service*. Accounting is of assistance to other people – if nobody wanted the service, there would be no such thing as accounting.
- *Information*. The information traditionally collected by accountants is restricted to what can be quantified and translated into monetary terms. Surprisingly for most people, however, numbers are not the only thing included in *accounts* (or *financial statements*). They also have a whole range of wordy notes (called 'disclosures') explaining the numbers.
- *Entity*. An entity is a term used by accountants to describe any type of organisation, e.g. a company or a person running his (or her) own business.
- *Financial performance*. That shows how an entity has performed over the period (in other words – was it profitable?). The financial performance is usually judged by matching *incomes* earned with *expenses* incurred over a period of time (usually one year) to calculate *profit* made in that period.
- *Financial position*. The financial position of an entity at a point in time is a snapshot of what it has net of what it owes at that point. In other words the financial position is the same as net asset (or all *assets* – all *liabilities*).

We will define incomes, expenses, assets and liabilities in Chapter 2 (and you can also see the definitions in the Glossary).

The above summary shows that accounting information is somewhat restricted:

- It relates to only one entity (although it is possible to aggregate or 'consolidate' accounting information for groups of entities).
- It has to be quantifiable.
- It must be capable of being converted into monetary terms (e.g. in £ or \$).
- It relates to an arbitrary period of time.
- A distinction is made between economic benefits that relate to past, current and future periods.

Non-accountants are often surprised when they realise that accounting information is restricted in such ways. This gives rise to what is sometimes called the *expectations gap*, i.e. when users expect accounting to do more than it can.

The expectations gap often causes considerable misunderstanding between accountants and the public, especially when an 'accounting scandal' erupts from time to time. Such scandals are often the result of genuine accounting problems but the public tend to think that they can all be put down to fraud. There have been many examples of high-profile financial fraud and accounting scandals in recent times. In 2008, Lehman Brothers, a global financial services firm, went bankrupt (curiously only in 2007 it had been voted Number 1 'Most Admired Securities Firm' by *Fortune* Magazine). It allegedly hid billions of loans disguised as sales. Closer to home, in early autumn 2014, we saw billions wiped off Tesco's value as the profit overstating scandal broke: Tesco had been artificially manipulating payments to and from suppliers. And even more recently,

in 2019 Patisserie Valerie became headline news as its past accounts were found to be false, showing large cash positions when in fact the business was in debt. Questionable accounting practices certainly come to the fore in such high-profile cases.

Activity 1.1

Look up the definition of accounting in three different sources. Copy the definitions into a notebook. Then outline your ideas about:

- how could accounting and accounting information, as defined in the sources you referred to, be helpful to you in the job or career you aspire to be in (in, say, 5 or 10 years time). Maybe you plan to run your own business, or to be involved in product design, or work in an advertising agency, or invest on the stock market while working for a big bank? Whatever your dream is – consider how accounting and accounting information might be used in your professional life.
- how could accounting and accounting information be helpful to you in your personal life and what benefits would that bring to you?

Having considered the nature and purpose of accounting and accounting information we now move on to give you a brief overview of the historical development of accounting.

Historical development

The word *account* in everyday language is often used as a substitute for an *explanation* or a *report* of certain actions or events. If you are an employee, for example, you may have to explain to your employer just how you have been spending your time or if you are a manager you may have to report to the owner on how the business is doing. In order to explain or to report, you will, of course, have to remember what you were doing or what happened. As it is not always easy to remember, you may need to keep some written records. In effect, such records can be said to provide the basis of a simple accounting system.

In a primitive sense, man has always been involved in some form of accounting. It may have gone no further than a farmer measuring his wealth simply by counting the number of livestock and possessions that he owned (Figure 1.1).

His possessions	A year ago	Now	Change
Cows	••••••••	••••••••••	+5
Hens [$\bullet = 10$]	••••••••	••••••	-30
Pigs	••••••••	••••	-2
Sheep [$\bullet = 10$]	•••••	••••••••	+20
Land [$\bullet = 1$ acre]	••••	••••	No change
Cottage	•	•	No change
Carts	•••	•	-2
Ploughs	•	••	+1

Figure 1.1 Accounting for a farmer's wealth

Activity 1.2

A-a-a-h! Counting! Is that what accounting is all about?
How many sheep do you (ac)count in this flock?

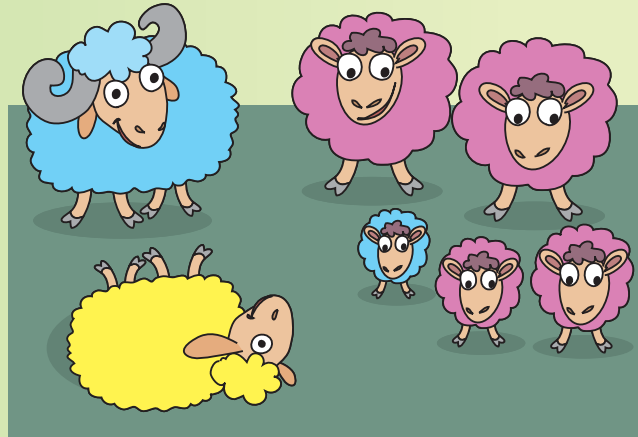


Figure 1.2 Your imaginary flock of sheep

Accounting may be about counting, but that is not quite so straightforward as you may think. Are rams sheep? Or do we need to introduce categories to be able to (ac)count for what we have got here – 2 sheep, 1 ram and 3 lambs? And after how many days does a lamb become a sheep? We can make up an arbitrary rule (say, 3 months) so on the last day of that period there are 2 sheep, 1 ram and 3 lambs in the field but as soon as the clock ticks over to the next day there is all of a sudden a 150% increase in the population of sheep – 1 ram and 5 sheep, no lambs! If one of them dies – do we still (ac)count for it? If yes, why yes? If no, why not? (Ac)counting is full of judgements and made-up rules such as these that change over time. It is not just about adding numbers and not as straightforward as you may think! We will start introducing the accounting rules in Chapter 2.

The growth of a monetary system enabled an even more sophisticated method to be developed. It then became possible to calculate the increase or decrease in individual wealth over a period of time and to assess whether a farmer with perhaps 10 cows and 50 sheep was wealthier than one who had 60 pigs. Figure 1.3 illustrates just how difficult it would be to assess the wealth of a farmer in a non-monetary system. Simple counts do little to indicate value but accounting deals with that too.

It is perhaps debatable what came first: money or accounting (just like the old question about the chicken and the egg). There are exhibits in room 68 of the British Museum which suggest that simple tax records (a form of accounting records) predate the earliest found example of money. In any case, with the growth of a monetary system, formal documentary accounting systems became commonplace, even though it took a very long time. It is possible to trace the origins of modern bookkeeping back to at least the twelfth century. We know that from about that time, traders began to adopt a system of recording information called *double-entry bookkeeping*. By the end of the fifteenth century, double-entry bookkeeping was widely used in Venice and the surrounding areas (the first-known book on the subject was published in 1494 by an Italian mathematician called Luca Pacioli, who is often referred to as ‘The Father of Accounting’). Modern bookkeeping systems are still based on the same old principles, although they have had to be adapted to suit modern conditions.

News clip 1.2

Rare medieval accountancy book expected to sell for \$1.5m

By James Pickford

A rare copy of a 15th-century printed book that set down the principles of modern accounting and double-entry bookkeeping is to go up for sale with an estimated value of up to \$1.5m.

Luca Pacioli, a Franciscan friar, mathematics professor and friend of Leonardo da Vinci, published his *Summa de arithmetica*,

geometria, proportioni et proportionalita in 1494, just 40 years after Gutenberg's innovations in moveable type launched the printing revolution.

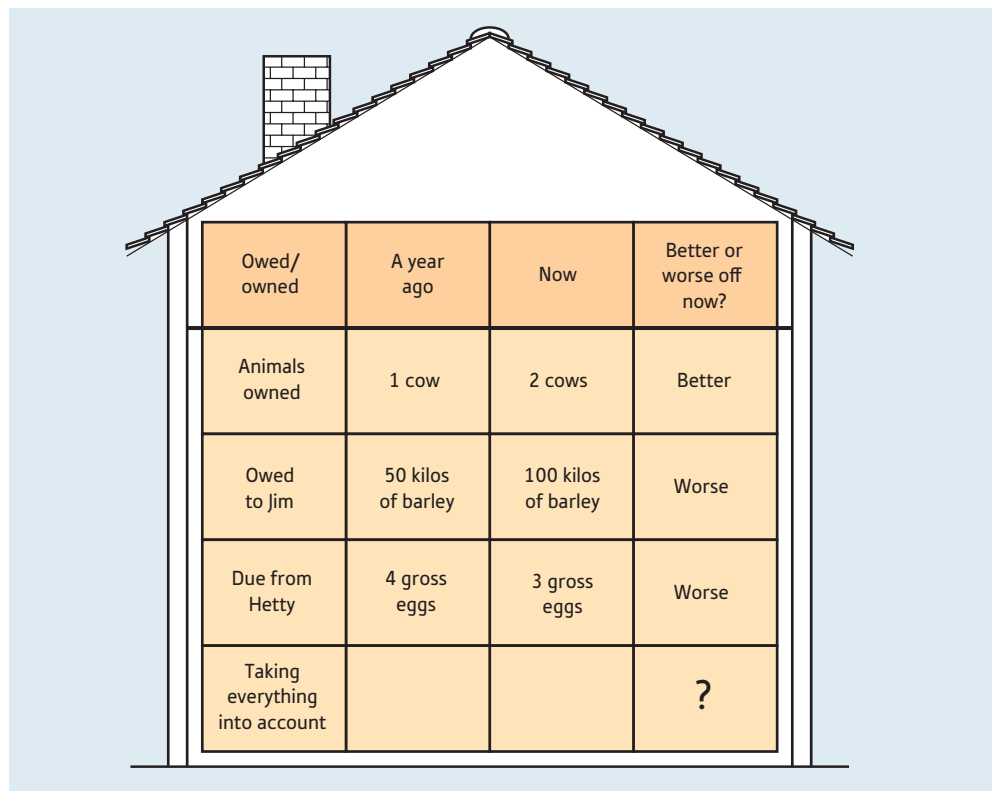
The *Summa de arithmetica* is a compendium of everything known at the time about mathematics, but also a practical, how-to guide to succeeding in business.

FT

Source: Pickford, J. (2019) Rare medieval accountancy book expected to sell for \$1.5m, *Financial Times*, 14 February © The Financial Times Limited 2019. All Rights Reserved.

There are two main reasons why a recording system devised in medieval times has lasted for so long:

- It provides an accurate record of what has happened to a business over a given period of time.
- Information extracted from the system can help the owner or the manager to operate the business much more effectively.



Owed/owned	A year ago	Now	Better or worse off now?
Animals owned	1 cow	2 cows	Better
Owed to Jim	50 kilos of barley	100 kilos of barley	Worse
Due from Hetty	4 gross eggs	3 gross eggs	Worse
Taking everything into account			?

Figure 1.3 An owner's vital question: how much better or worse off am I now?