



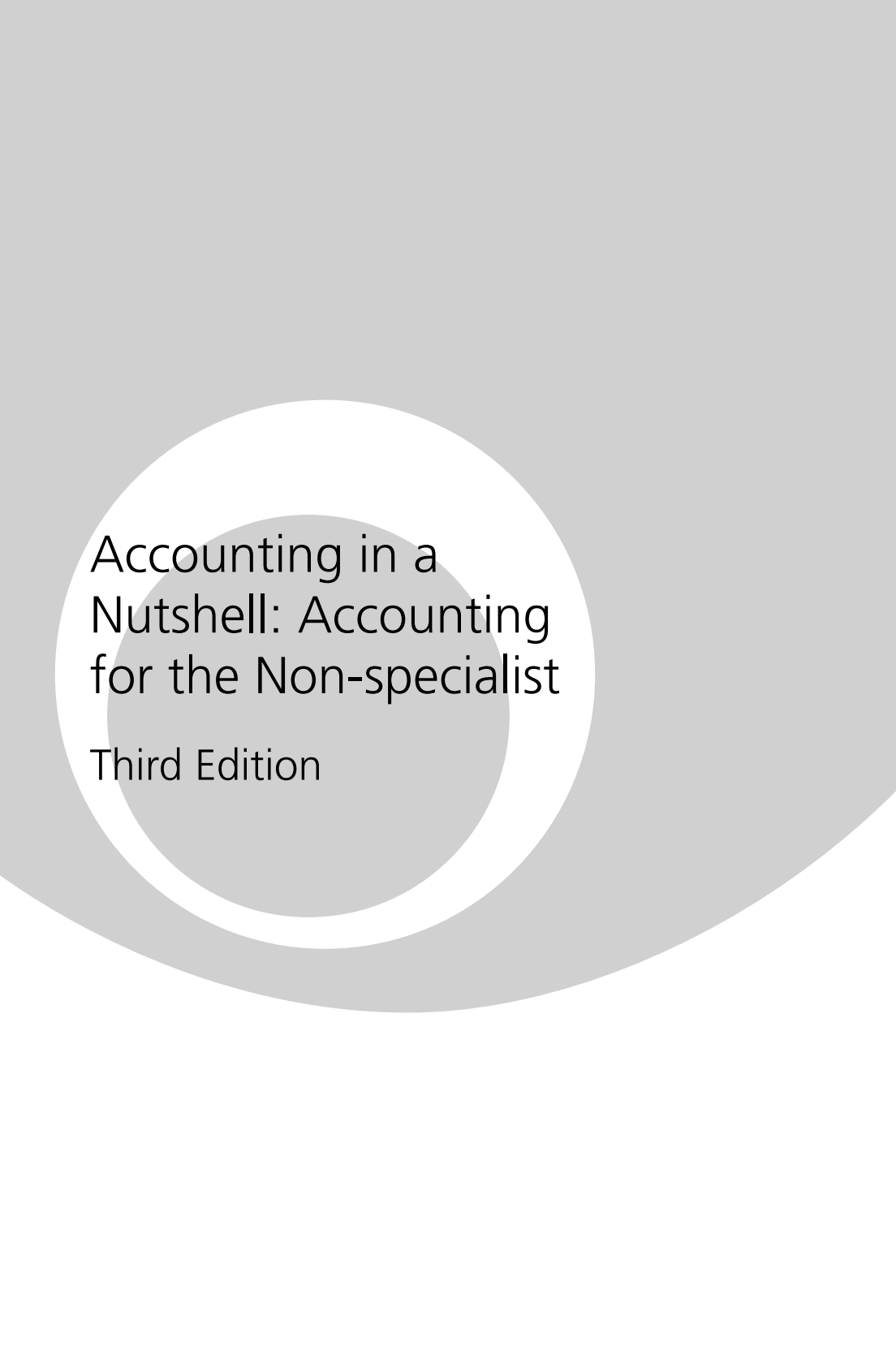
Accounting in a Nutshell

Accounting for the non-specialist



Janet Walker

Third Edition

The background of the cover is a light gray. It features two overlapping circles: a larger white circle on the left and a smaller gray circle on the right. The text is centered within the white circle.

Accounting in a
Nutshell: Accounting
for the Non-specialist

Third Edition

This page intentionally left blank

Accounting in a Nutshell: Accounting for the Non-specialist

Third Edition

Janet Walker



ELSEVIER

AMSTERDAM • BOSTON • HEIDELBERG • LONDON
NEW YORK • OXFORD • PARIS • SAN DIEGO
SAN FRANCISCO • SINGAPORE • SYDNEY • TOKYO

CIMA Publishing is an imprint of Elsevier

CIMA

PUBLISHING

CIMA Publishing is an imprint of Elsevier
Linacre House, Jordan Hill, Oxford OX2 8DP, UK
30 Corporate Drive, Suite 400, Burlington, MA 01803, USA

Copyright © 2009. Published by Elsevier Ltd.
All rights reserved.

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means electronic, mechanical, photocopying, recording or otherwise without the prior written permission of the publisher

Permissions may be sought directly from Elsevier's Science & Technology Rights Department in Oxford, UK: phone (+44) (0) 1865 843830; fax (+44) (0) 1865 853333; email: permissions@elsevier.com. Alternatively you can submit your request online by visiting the Elsevier web site at <http://elsevier.com/locate/permissions>, and selecting *Obtaining permission to use Elsevier material*

Notice

No responsibility is assumed by the publisher for any injury and/or damage to persons or property as a matter of products liability, negligence or otherwise, or from any use or operation of any methods, products, instructions or ideas contained in the material herein

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

ISBN: 978-0-7506-8738-6

For information on all CIMA publishing publications
visit our web site at books.elsevier.com

Typeset by Charon Tec Ltd., A Macmillan Company. (www.macmillansolutions.com)

Printed and bound in Hungary

09 10 11 12 10 9 8 7 6 5 4 3 2 1

Working together to grow
libraries in developing countries

www.elsevier.com | www.bookaid.org | www.sabre.org

ELSEVIER

BOOK AID
International

Sabre Foundation

Contents

Part 1	Introduction	1
Part 2	Accounting Statements	7
1	Who Needs Accounting Statements?	9
2	The Income Statement (Profit and Loss Account)	23
3	The Balance Sheet	41
4	Cash Flow Reporting	95
5	The Accounts of Not-for-Profit Organisations	131
6	Interpreting Financial Statements: Part 1	147
7	Interpreting Financial Statements: Part 2	189
Part 3	Using Financial Information to Manage a Business	219
8	Management Accounting as an Aid to Management	221
9	The Analysis of Cost	227
10	Using Costs for Decision-making	255
11	Budgetary Planning and Control	293
12	Making Long-term Investment Decisions	319
	Glossary	343
	Index	357

This page intentionally left blank



Part 1

Introduction

This page intentionally left blank

About this text

This is a basic text providing self-guided training for non-specialists who need an appreciation of the purposes and use of accounting information. It covers the basic principles of financial and management accounting for those who do not require detailed theoretical or technical knowledge. The text will provide grounding and outline understanding to enable the reader to contribute in the workplace or to progress to further financial studies.

The text demonstrates the subjectivity and limitations of financial information and explains the involvement of the non-financial manager in the accounting process. It has been written assuming no prior financial knowledge, and without the use of accounting jargon.

Who should use this text?

This text is designed primarily for the following groups of people:

- ◆ Middle and junior managers who deal with financial information without really understanding the content.
- ◆ Students who are studying accounting as a non-specialist subject, for example on a business studies or engineering course. The text will serve as a basic reference book to be used throughout the course. It will also be particularly helpful in providing the basic grounding which is required before moving on to the more technical and in-depth study of the subject that may be required on some courses.
- ◆ Students who are embarking on a course of study to become a professional accountant. The basic understanding developed in this book will serve as a valuable base on which to build future professional studies.

The content of the text

The text is suitable for those interested in the accounts of profit-making organisations or not-for-profit organisations. It also gives equal weight to manufacturing and service organisations.

The text is divided into three parts.

Part 1 explains the scope of the text, who it is for and how to use it effectively.

Part 2 begins with a review of the types of people who might use accounting statements and the sort of information that they might need.

Then, it introduces and reviews the main financial accounting statements: the income statement/profit and loss account (or income and expenditure account in not-for-profit organisations), the balance sheet and the cash flow statement. The final chapters of this part explain the basic techniques used to interpret the information contained within these financial statements.

Part 3 covers management accounting and the use of financial information to manage a business. It reviews the analysis and build-up of cost before going on to demonstrate the use of costs in short-term management decision-making. The theme of the use of financial information to manage a business is carried through the next chapter on budgetary planning and control. This part concludes with a chapter demonstrating the main techniques used in making long-term investment decisions.

The final part of the text contains a glossary of the major financial and management accounting terms used in the book, extracted from the Official Terminology of the Chartered Institute of Management Accountants.

How to use this text

The chapters are designed to be read in consecutive order. Knowledge and understanding are built in a cumulative fashion, and the material contained in each chapter builds on the material in preceding chapters.

If your attention is focused on the accounts of not-for-profit organisations, you are advised to read the earlier chapters based on the accounts of profit-making organisations. This is because the same principles apply in both sets of financial statements even though the organisations' ultimate objectives may differ. Similarly,

if you are interested primarily in the financial statements of profit-making organisations, you would benefit from working the exercises in Chapter 5.

At convenient points throughout each chapter there are short exercises. You should take the time to try these exercises and think about the solutions. They will help you to test whether you have grasped the basic principles to that stage before proceeding with the subject matter.

At the end of most chapters you will find a series of review questions and self-test questions. The review questions will test your knowledge on the content of the chapter, referring you back to the relevant section of the chapter if you are unable to answer the question. The self-test questions are followed by outline answers, so that you can check your ability to apply your knowledge to a practical situation.

Thorough and diligent use of the self-testing mechanisms will be particularly useful for those readers who are not using the book as a part of a formal course of study.

This page intentionally left blank



Part 2

Accounting Statements

This page intentionally left blank



Who Needs Accounting
Statements?

This page intentionally left blank

1.1 Introduction

In the first part of this chapter we will be reviewing the groups of people who might use financial statements and thinking about what sort of information they might need. We will also be looking at the regulatory framework within which published financial statements are prepared.

We will then obtain an overview of the three main published financial statements (the income statement/profit and loss account or income and expenditure account, the balance sheet and the cash flow statement): what they are and what general purpose they serve.

1.2 Who uses financial statements and what sort of information might they need?

The list of people who might need the information provided by financial statements seems to grow longer every day. Some of these people are directly connected with the organisation, for example its employees and managers, others are not directly connected, but they may be affected by its management of finance or by its financial stability, for example the general public.

In this part of the chapter we will look at the user groups listed below. This list is by no means exhaustive but it covers the main categories.

- ◆ The owners of the business
- ◆ Managers, employees and prospective employees
- ◆ Lenders and potential lenders
- ◆ Customers
- ◆ Suppliers
- ◆ The government
- ◆ Donors/sponsors
- ◆ The public
- ◆ Analysts and advisers

Exercise

Look at each category of the users of accounts. Think about whether you belong in that particular user group. You will probably be surprised to realise that you fit into more than just one single category.

1.2.1 The owners of the business

In many small businesses the owner or owners are likely to be those responsible for the day-to-day running of the business. These owners need information to let them know whether they are making enough profits, whether they have sufficient cash to pay their bills as they fall due, to whom they owe money, who owes money to them, etc.

As businesses begin to expand they may raise the money that they need for expansion from people who are not involved in the day-to-day running of the business. One way of doing this is to sell shares in the business and become a limited company. Shareholders are part-owners of the business. Among other things they will be concerned about the profitability of the company and how any profit is to be shared out or distributed to the shareholders. Furthermore, they will be concerned about the prospects for future returns on their investment. Potential future shareholders will also be interested in this sort of information when they are considering whether or not to purchase shares in the company.

Existing and future potential shareholders would also be interested in certain non-financial aspects of the company such as the activities it engages in and its policies, so that they can decide if this is the sort of company with which they wish to be associated.

1.2.2 Managers, employees and prospective employees

The managers of a business need financial information to help them to manage the business. They need past financial information to help them monitor the progress of the business or their part of it, current information to carry out day-to-day operational management and control, and forecast financial information to plan activities in the future.