Voorwoord

Dit is het overzicht van de studiestof Accounting. Het betreft hier een overzicht van de verplichte literatuur. Hoofdstuk A tot en met N bestaat uit de verplichte literatuur van het hoofdboek.

Dit overzicht is geschreven naar eigen inzicht van de auteur. Bij het maken van deze overzichten wordt geprobeerd de kwaliteit zo veel mogelijk te waarborgen. SlimStuderen.nl kan echter geen verantwoordelijkheid aanvaarden voor het gebruik ervan. Dit overzicht dient als aanvulling/hulpmiddel en niet ter vervanging van de verplichte leerstof.

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Inhoudsopgave

A. Introduction to Accounting

What are accounting and finance?
Accounting is concerned with collecting, analysing and communicating information about finance. The ultimate aim of the accountant's work is to give users better financial information on which to base their decisions. Finance is concerned with the ways in which funds for a business are raised and invested. The way in which funds are raised must fit with the particular needs of the business. Finance should help identifying:

- The role of financial markets in supplying finance;
- The risks associated with each form of finance;
- The costs, benefits and risks of each form of finance;
- The main forms of finance available.

The funds must be invested in a way that will provide the business with a worthwhile return. Understanding finance should also help evaluating the risks and returns associated with an investment.

Who are the users of accounting information?
For accounting information to be useful, it must be clear for whom the information is being prepared and for what purpose the information will be used.
The main users of financial information are:

- Owners;
- Managers;
- Lenders;
- Suppliers;
- Investment analysts;
- Community representatives;
- Government;
- Employees and their representatives;
- Competitors;
- Customers.

The conflict of interests of users
Accounting can play an important role at the distribution of business wealth. Accounting plays an important role in monitoring and reporting how various groups benefit from the business. This information tells whether pay and benefits received are appropriate and accord with agreed policies.

How useful is accounting information?
The information accounting is providing should reduce uncertainty about the financial position and performance of the business.

Providing a service
Another way of viewing accounting is as a form of service. The value of the service can be judged according to whether the accounting information meets their needs. To be useful, the information provided must possess two qualities:

- **Relevance**;
  Accounting information should make a difference. It must help to predict future events, help to confirm past events or do both.
- **Faithful representation**.
  The information provided should be complete, neutral and free from error.

Accounting information must contain both of these fundamental qualities to be useful.

Further qualities
There are other qualities that enhance the usefulness of the information:

- Comparability. Better comparisons can be made when items that are basically the same, are threated in the same way;
- Verifiability. This provides assurance that the information provided faithfully represents what it is supposed to represent;
- Timeliness. The later accounting information is produced, the less useful is becomes;
- Understandability. The information provided should be set out as clearly and concisely as possible.

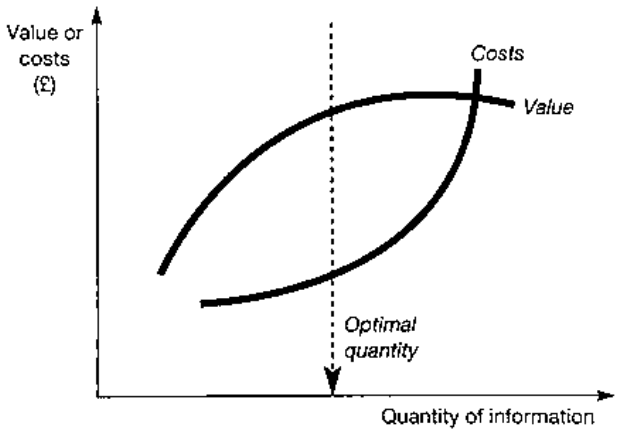
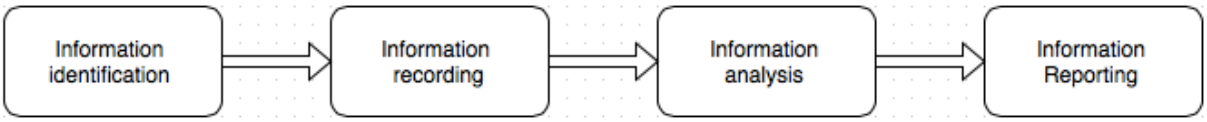


Figure 1. Relationship between costs and the value of providing additional accounting information; McLayney, E & Atrill, P (1999); Accounting and finance an introduction:

Weighing up the costs and benefits
A particular item of accounting information should only be produced if the costs of providing it are less than the benefits derived from its use.

Accounting as an information system
A different way of viewing accounting is as a part of the business's total information system. The accounting information system should have certain features that are common to all information systems:

- Reporting the information in a manner that suits the needs of users;
- Analysing and interpreting the information collected;
- Recording, in a systematic way, the information collected;
- Identifying and capturing relevant information.



Management accounting and financial accounting
Accounting has two distinct strands:

- **Management accounting;**
- **Financial accounting.**

The differences between these areas are:

- Nature of the reports produced. Management accounting reports are often specific purpose reports and financial accounting reports tend to be general-purpose;
- Level of detail. Management accounting reports provide managers with considerable detail while financial accounting reports provide users with a broad overview;
- Regulations. Management accounting is for internal use only so there are no regulations. Financial accounting reports are subjected to accounting regulations;
- Reporting interval. Management accounting reports are produced as frequently as required by managers. Financial accounting reports are produced on an annual basis;
- Time orientation. Management accounting reports provide information concerning future performance as well as past performance and financial accounting reports reflect only the performance and position of the business for the past period;
- Range and quality of information. Management accounting reports are likely to contain information of a non-financial nature while financial accounting reports concentrate on information that can be quantified in monetary terms.

The changing face of accounting

The environment within which businesses operate has become increasingly turbulent and competitive. This change has brought new challenges for managers and other users of accounting information. Management accounting has changed by becoming more outward-looking in its focus and to stay competitive, businesses developed more sophisticated methods of measuring and controlling costs. Businesses have become more customer-driven, as Peter Drucker argued; 'the purpose of business is to create and keep a customer.

What kind of business ownership exist?

The particular form of business ownership has certain implications for financial accounting. There are three arrangements for private-sector businesses;

- **Sole proprietorship;**
- **Partnership;**
- **Limited company**.

Sole proprietorship

Sole proprietorship is where an individual is the sole owner of a business. These businesses are quite small in terms of size but the number of such businesses is very large. These kinds of businesses are very easy to set up and the law does not recognise the sole-proprietor business as being separate from the owner. There is no legal requirement to produce accounting information relating to the business for other user groups.

Partnership

When two or more individuals carry on a business together with the intention of making a profit, there is a partnership. They are not recognised in law as separate entities, so contracts with third parties must be entered into the name of individual partners, and they have unlimited liability.

Limited company

Limited companies can range in size from quite small to very large. The liability of owners is limited. This means that the individuals subscribing capital to the company are liable only for debts incurred by the company up to the amount that they invested or agreed to invest. For these kind of businesses a framework of regulations exists. A part of this regulatory framework requires annual financial reports.

A hybrid form of business ownership is a Limited Liability Partnership (LLP). These businesses have many of the attributes of a normal partnership but is different in that the business is responsible for any debts incurred.

How are businesses organised?
Finance will come from the owners in different ways:

- In the form of a direct cash investment to buy shares;
- Through the shareholders allowing past profits to be reinvested in the business;
- Lenders;
- Suppliers of goods and services being prepared to supply on credit.

In large limited companies the shareholders appoint a board of directors to manage the business on their behalf. This board is charged with three major tasks:

- Communicate with shareholders and others connected with the business;
- Monitoring and controlling the activities of the business;
- Setting the overall direction and strategy for the business.

The directors elect a chairman who is responsible for running the board in an efficient manner. Each board has a chief executive officer (CEO) who is responsible for running the business on a day-to-day basis. The board represents the most senior level of management.

The operations within a business can be divided in different ways. Separate departments are often created where each department is responsible for a particular function. Large businesses often create separate divisions for each geographic area and/ or major product group. Divisional structures need not to be permanent.

How are businesses managed?
The effect of environmental changes has been to make the role of managers more complex and demanding, which has led to the introduction of **strategic management**. This kind of management seeks to provide a business with a clear sense of purpose and to ensure that appropriate action is taken to achieve that purpose.

What is the financial objective of a business?
A business is created to enhance the wealth of its owners. Satisfying the needs of other groups is consistent with increasing the wealth of the owners over the longer term.

Balancing risk and return
Risk and return are related. Managers must find the appropriate balance between risk and return when setting objectives and pursuing particular courses of action.

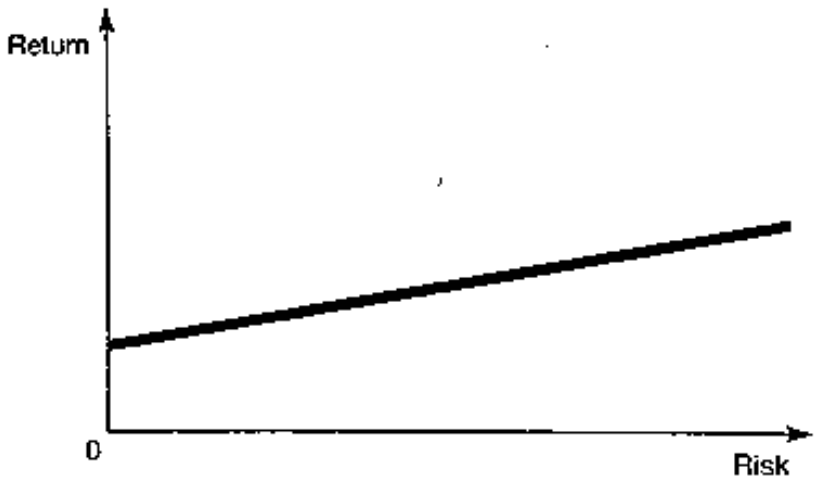


Figure 2: Relationship between risk and return; McLayney, E & Atrill, P (1999); Accounting and finance an introduction: seventh edition.

Not-for-profit organisations
Some organisations do not exist mainly for the pursuit of profit. These organisations still need accounting information for decision-making purposes.

B. Measuring and Reporting Financial Position

The major financial statements – an overview
There are three kinds of financial statements:
- The statement of cash flows;
- The income statement;
- The statement of financial position.

When put together, they provide an overall picture of the financial health of the business. The income statements and statement of cash flows are both concerned with measuring flows during a particular period. The statements of financial position is concerned with the financial position at a particular moment in time. The statements are often referred to as the **final accounts** of the business.

The statement of financial position
This statement shows the forms in which the wealth of a business is held and how much wealth is held in each form. It sets out the assets of a business and the claims against the business.

Assets
Assets are resources held by a business. Assets should have the following characteristics:
- The assets must be capable of measurement in monetary terms;
- The business must have the right to control the resource;
- The benefit must arise from some past transaction or event;
- A probable future economic benefit must exist.

All four condition must apply will the item be treated as an asset for accounting purposes. An asset does not have to be a physical item; there are **tangible assets** and **intangible assets**.

Claims
Claims are obligations of the business to provide cash, or some other form of benefit, to an outside party. There are two types of claim:
- **Equity**, which represents the claim of the owner(s) against the business;
- **Liabilities**, which represent the claims of all individuals and organisations, apart from the owners.

$$Assets = Equity + Liabilities$$
$$Assets = Equity + Profit(or\ loss) + Liabilities$$

Classifying assets
Current assets
Current assets are assets that are held for the short term. Current assets are assets that meet the following conditions:
- They are cash, or near cash;
- They are held principally for trading;
- They are expected to be sold within a year;
- They are held for sale or consumption during the business's normal operating cycle.

The operating cycle of a business is the time between buying and/or creating a product or service and receiving the cash on its sale.

Non-current assets
Non-current assets are assets that do not meet the definition of current assets. They are sometimes called fixed assets. Tangible non-current asset can consist of property, plant and equipment.

Classifying claims
Liabilities can further be classified as either current or non-current.

Current liabilities
Current liabilities are amounts due for settlement in the short term. They are liabilities that meet any of the following conditions:

- There is no right to defer settlement beyond a year after the date of the relevant statement of financial position;
- They are due to be settled within a year after the date of the relevant statements of financial position;
- They are held principally for trading purposes;
- They are expected to be settled within the business's normal operating cycle.

Non-current liabilities
Non-current liabilities represent amounts that do not meet the definition of current liabilities. Non-current liabilities represent longer-term liabilities. It is common for non-current liabilities to become current liabilities.

Statement layouts
Within each category of assets, the items are listed in reverse order of liquidity. Liquidity means nearness to cash.

$$Assets - Liabilities = Equity$$

The role of accounting conventions
Business entity convention
The business and its owner(s) are treated as being separate and distinct for accounting purposes. The law does not make any distinction between the business and its owner(s) for sole proprietorships and partnerships, but for limited companies there is a clear legal distinction.

Historic cost convention
The historic cost convention holds that the value of assets shown on the statement of financial position should be based on their historic cost. Some argue that the current value would give a more realistic view, but current value can be defined in different ways. It can be defined as either current replacement cost or the current realisable value of an asset.

Prudence convention
The prudence convention involves recording all losses at once and in full. Profits are recognised only when they actually arise.

Going concern convention
The going concern convention holds that the financial statements should be prepared on the assumption that a business will continue operations for the foreseeable future.

Dual aspects convention
The dual aspects convention tells us that each transaction has two aspects, which will affect the statement of financial position.

Goodwill and brands
Goodwill is often used to cover various attributes such as the quality of the products, the skills of employees and the relationship with customers. To agree a price for acquiring product brands or goodwill means that some form of valuation must take place and this raises the question as to how it is done.

Human resources
Monetary measurement of the human resources is very difficult. There are certain limited circumstances where it is measured, for example at an arm's-length transaction arises and the amounts paid provide a reliable basis for measurement.

Monetary stability
Inflation has been a real problem because the value of money has declined in relation to other assets. This raises the question on how to measure assets values on the statement of financial position.

Valuing assets
Large businesses adhere to asset valuation rules set out in International Financial Reporting Standards. Some key valuation rules are:

Non-current assets
Non-current assets have lives that are either indefinite or finite. This distinction applies to both tangible and intangible assets. Non-current assets are recorded at their historic cost, which will include any amount spent on getting them ready for use.

Non-current assets with finite lives
Benefits from assets with finite lives will be used up over time. The amount used up is called depreciation and must be measured for each reporting period for which the assets are held. The total depreciation that has accumulated over the period since the asset was acquired must be deducted from its cost and this net figure is called the carrying amount.

Non-current assets with indefinite lives
Benefits from these kinds of assets may or may not be used up over time. These assets are not subject to annual depreciation over time.

Fair values
In an arm's-length transaction the fair value is the current market value. Fair values give up-to-date information; assets such as property may have increased significantly in value over time. The frequency of revaluation is an important issue. These revaluations should be frequent enough to ensure that the carrying amount of the revalued asset does not differ materially from its true fair value at the statement of financial position date.

The impairment of non-current assets
Non-current assets are at risk of suffering a significant fall in value. This fall in value may lead to the carrying amount of the asset being higher than the amount that could be recovered from the asset through its continued use or through its sale. The asset value is said to be impaired. The rule is to reduce the value of the statement of financial position to the recoverable amount and unless this is done, the asset value will be overstated. The impairment loss is the amount by which the asset value is reduced.

Inventories
Inventories of a business could also run the risk of a significant fall in value. When the amount likely to be recovered from the sale of the inventories will be lower than their cost, this loss must be reflected in the statement of financial position.