

# Student lecture notes

## CHAPTER 1

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### Who needs accounting?

#### Definition of accounting

*Accounting* is the process of

- i.....,
- m..... and
- c.....
- financial information about an e.....
- to permit informed j..... and
- d.....
- by u..... of the information.

#### The development of a conceptual framework

A conceptual framework for accounting is a ..... which provides generally accepted guidance for the development of new reporting practices and for challenging and evaluating the existing practices.

- Who are the u..... of financial statements?
- What are the i..... n..... of users?
- What types of f..... s..... will best satisfy their needs?
- What are the c..... of financial statements which meet these needs?
- What are the principles for d..... and r..... items in financial statements?
- What are the principles for m..... items in financial statements?

## External reporting and internal reporting

A conceptual framework is particularly important when practices are being developed for reporting to those who are not part of the day-to-day running of the business.

This is called ..... or **financial accounting**.

For those who are managing the business on a day-to-day basis, special techniques have been developed.

This is called ..... or **management accounting**.

## Types of business entity

S.....

P.....

L.....

## Sole trader

An individual may enter into business ....., either selling goods or providing a service.

If cash is not available, the sole trader may ..... to start the business.

The sole trader's business may be very much intertwined with the sole trader's personal life.

For accounting purposes, the business is regarded as a separate ....., of which the sole trader is the owner who takes the risk of the bad times and the benefit of the good times.

The owner may hardly feel any great need for accounting information because he or she .....but accounting information will be needed by:

g..... (in the form of HM Revenue and Customs) for tax collecting purposes;

the ..... for the purposes of lending money to the business; or

a person ..... when the existing owner retires.

## Partnership

One method by which the sole trader may expand is to enter into partnership with ..... persons.

This permits a pooling of skills or may allow one person with ideas to work with another who has the money to provide the resources needed to turn the ideas into a profit.

But there are real financial risks if the business is unsuccessful.

One partner may be required to meet ..... of the partnership if the other partner does not have sufficient personal property, possessions and cash. This is described in law as .....

For accounting purposes the partnership is seen as ....., owned by the partners.

### ***Need for accounting information***

- P..... wishing to be sure that they are receiving a fair share of the partnership profits.
- HM R.....and C.....
- B..... who provide finance and
- Other persons who may be .....

The major risk attached to either a sole trader or a partnership is that

.....

including the family home, if the business fails.

## Limited liability company

To encourage the development of larger business entities, owners needed the protection of ..... This meant that if the business failed then the owners might lose all the money they had put into the business but their personal wealth would be safe.

### **Forms of limited liability company**

A **private limited company** has the word ‘.....’ (abbreviated as ‘Ltd’) in its title.

A **public limited company** has the abbreviation ‘.....’ in its title.

A private limited company is prohibited by law from offering its shares to the public (appropriate to a family-controlled business). The public limited company is ..... In return, it has to satisfy more onerous regulations.

### ***Some major differences***

	<b>Partnership</b>	<b>Limited liability company</b>
<i>Formation</i>	By agreement but not necessarily in writing	
<i>Running the business</i>	All partners share in the running of the business	
<i>Accounting information</i>	Not obliged to make accounting information available to the public	
<i>Meeting obligations</i>	Partners are jointly and severally liable for money owed by the firm	

### **Users and their information needs**

Management

Owners as investors

Employees

Lenders

Suppliers or trade creditors

Customers

Governments and their agencies

Public interest

## **General purpose or specific purpose financial statements?**

Each user group has its specific information needs.

But there is a view that a ..... financial statement can be designed, which is useful to more than one user group.

Owners and long-term lenders regarded as ..... but all potential users are interested in .....

## **Agency theory**

Relationship between ..... (principal) and ..... (agents).

There is an inherent conflict between the interests of owners and managers. This conflict is partly resolved by the managers being required to provide information on a regular basis to the owners so that their decisions and behaviour can be monitored and assessed.