

## UNIT 6: Business Accounting

**Recommended prior knowledge:** None concerning accounting but it is assumed that students will have already covered Unit 5. Students who are also following Accounting AS/A level may have an advantage in certain sections of this unit. However, this will not be great as the Business Studies course focuses not on accounting concepts and double entry bookkeeping problems but on the analysis and use of accounting information to assist managers in making business decisions. A level students should be encouraged to question the possible reasons why published accounts might not provide a complete or entirely accurate measure of company performance.

**The unit in context:** This unit provides important coverage of how accounting information – mainly in the form of final business accounts – can be of use to managers in controlling a business and in decision making for the future. Using accounts to assess the performance of the business can lead to important decisions which may well impact on the other functional areas of business such as marketing and operations management.

**Outline:** The unit does not focus on bookkeeping but on the final accounts of businesses – mainly limited companies. No specific questions will be set on sole trader or partnership accounts. The unit gives considerable weight to the interpretation and analysis of these final accounts. In addition, there are sections that cover cash flow forecasting, budgeting and investment appraisal.

Learning Outcomes	Suggested Teaching and Student Activities	Resources	Online Resources
<b>a) The need for business accounts</b>			
<p><b>Students should be able to:</b></p> <p>i.) understand the main internal and external users of accounting information</p> <p>ii.) analyse the uses to which this accounting data might be put by different users</p> <p>iii.) understand the main differences between financial and management accounting</p>	<ul style="list-style-type: none"> <li>start at the end! By using copies of plc published accounts, students can get a real feel for the depth of information available and can usually suggest who might find it useful and why. Avoid setting challenging tasks at an early stage, though.</li> <li>ask “why would these published accounts be of little use to managers of the business?” This leads to discussion of management accounting.</li> <li>if a student business was set up in Unit 5 use this opportunity for students to present simple accounts for the enterprise.</li> </ul>	<ul style="list-style-type: none"> <li>Stimpson Chapter 26 and Trinidad Tourist Flights exercise.</li> <li>Barratt and Mottershead Chapter 33</li> </ul>	<p>Use published accounts of plc’s to investigate contents and suitability for different users. Either contact web sites directly or use <a href="http://www.carol.co.uk">www.carol.co.uk</a>.</p> <p>Try to use own country examples too.</p>

<b>b) The foundations of accounting (not a core item)</b>			
<b>Students should be able to:</b>			
i.) understand the significance of the main accounting concepts and conventions (no complex or numerical questions will be set on these)	<ul style="list-style-type: none"> <li>keep this simple – straightforward examples of how each concept applies and why. Only use the simplest of numerical examples – examination questions will not test these areas numerically.</li> </ul>	<ul style="list-style-type: none"> <li>Stimpson Chapter 26</li> <li>Barratt and Mottershead Chapter 33</li> </ul>	
<b>c) What the published accounts contain</b>			
<b>Students will be expected to:</b>			
ii.) understand the purposes and structure of profit and loss accounts and balance sheets	<ul style="list-style-type: none"> <li>if published accounts have not yet been used then they should now be introduced. Careful (simple) explanations of the main accounts will be needed to avoid “information overload” especially for non-numerate students.</li> <li>show students the main section of these two main accounts – they may differ slightly from company to company so teachers should make sure they can explain the link between the textbook examples and the published accounts, if these exist.</li> <li>depreciation best taught by referring to school/college fixed assets. Ask students to discuss what would happen to the accounts if these were not “depreciated”.</li> </ul>	<ul style="list-style-type: none"> <li>Stimpson Chapter 27 and all the activities and exercises it contains.</li> <li>Barratt and Mottershead Chapters 35 and 36 and mini case studies on PP400 and 413</li> <li>Jewell Chapters 24 and 25</li> <li>9707/2 Nov 2001 Q2 a and b.</li> <li>9707/1 Nov 2002 Q4a)</li> <li>9707/1 Nov 2001 Q7</li> <li>9707/1 June 2002 Q4</li> </ul>	Use published accounts from companies’ own web sites. <a href="http://web.utk.edu/~jwachowi/wachoworld.html">http://web.utk.edu/~jwachowi/wachoworld.html</a> This is a superb site for linking to financial information, spreadsheets, OHP’s and links to most sites dealing with finance and accounting (US).
iii.) understand the main asset and liability categories on balance sheets			
iv.) understand the layout and main headings of simple profit and loss accounts			
v.) understand the purpose of depreciation provisions on accounts and calculate depreciation using the straight line method			
vi.) make simple amendments to existing balance sheets and profit and loss accounts			

<p>vii.) draw up simple balance sheets and profit and loss accounts from given data</p> <p>viii.) understand the purpose of cash flow statements and the main contents</p> <p>ix.) calculate depreciation provisions using the diminishing balance method</p> <p>x.) understand the differences between the two depreciation methods and evaluate these two methods.</p> <p>xi.) understand what goodwill is, how it arises and how it is dealt with in published accounts</p> <p>xii.) understand that valuation of stocks may be adjusted by net realizable value.</p>	<p>depreciation etc.</p> <ul style="list-style-type: none"> <li>• give simple structure to cash flow statement and discuss what it shows and how users would find it useful.</li> <li>• go back to previous depreciation examples and work through using diminishing balance method – ask students to note differences to annual depreciation charge and net book value. Students should be able to discuss when firms would use one method rather than the other.</li> <li>• simple examples of both goodwill and net realizable value – can refer back to accounting concepts and conventions.</li> </ul>		
<b>d) Analysis of published accounts</b>			
<p><b>Students should be able to:</b></p> <p>i.) recall the main profitability and liquidity ratios</p> <p>ii.) calculate these from given data</p> <p>iii.) analyse / evaluate results of these ratios and evaluate ways in which they might be improved for a given business.</p>	<ul style="list-style-type: none"> <li>• it must be made clear to students that there is no “right” or “wrong” result for ratio calculations. Interpreting results carefully is almost more important than accurate calculation. Results must be assessed in terms of past results, results of other businesses, current external environment and the objectives of the business.</li> </ul>	<ul style="list-style-type: none"> <li>• Stimpson Chapter 28 and exercises “How is my business doing?”, ICI, Habib Manufacturing and Burton Paper . Revision questions P442</li> <li>• Barratt and Mottershead Chapter 38. Mini case study on P 445.</li> </ul>	<p>Use published accounts – make comparisons between businesses in the same industry e.g. supermarkets or pharmaceutical companies such as:</p> <p>SmithKline Beecham which makes its Annual Report available in “The Company” section. Financial highlights have been clearly represented using bar charts and financial ratios look at profitability, gearing and dividend per share - <a href="http://www.sb.com">www.sb.com</a> and compare with GlaxoWellcome at</p>

<p>iv.) recall financial efficiency, gearing and investor ratios</p> <p>v.) analyse / evaluate results of these ratios and evaluate ways in which they might be improved for a given business</p> <p>vi.) analyse business performance by using trend analysis and inter firm comparisons.</p> <p>vii.) evaluate the usefulness of ratio analysis</p>	<ul style="list-style-type: none"> <li>ratio formulae need to be noted down by students and the meaning of each result made clear.</li> <li>practice at calculations is essential – but so is careful interpretation of results and suggestions for “remedial” action if needed.</li> <li>encourage students to make links between ratios e.g. how can gross profit margin be increasing yet net profit margin falling?</li> <li>the usefulness of ratio analysis should not be overstated and students should be able to judge the significance of it in different situations. Encourage discussion on why ratios do not provide a “complete picture” of a firms operations/performance.</li> </ul>	<ul style="list-style-type: none"> <li>Jewell Chapter 27 and end of chapter exercises.</li> <li>9707/3 June 2002 Qb</li> <li>9707/2 Nov 2001 Q2b.</li> </ul>	<p><a href="http://www.glaxowellcome.co.uk">www.glaxowellcome.co.uk</a></p> <p>Published accounts of UK listed companies may be ordered from <a href="http://ft.ar.wilink.com">http://ft.ar.wilink.com</a></p>
<p><b>e) Investment appraisal</b></p>			
<p><b>Students should be able to:</b></p> <p>i.) understand the meaning of investment appraisal and the need to forecast cash flows.</p> <p>ii.) recognise the difficulties involved in forecasting future cash flows</p> <p>iii.) calculate payback period and understand/analyse results</p> <p>iv.) calculate average rate of return and understand/analyse results</p>	<ul style="list-style-type: none"> <li>investment must not be confused with “savings” – it is spending money for future returns. The basic idea of profit is easy for students to grasp. Speed of return (or payback) needs to be explained carefully with the help of simple examples. Choose two projects with different cash flows – one with higher ARR and the other with quicker payback. Debate with students which is the “better” project. This is a useful way of introducing the need for <i>discounting</i> (NPV and IRR).</li> </ul>	<ul style="list-style-type: none"> <li>Stimpson Chapter 29 and all activities within the chapter plus “Investing to stay competitive”. Revision questions Page 455.</li> <li>Barratt and Mottershead Chapter 39 and mini case study P 456</li> <li>Jewell Chapter 30 and end of chapter exercises.</li> <li>9707/2 June 2003 Q2c</li> <li>9707/3 Nov 2002 Qb.</li> </ul>	<p>Use examples from the general business studies sites given at the start of the scheme of work e.g. <a href="http://www.bized.ac.uk">www.bized.ac.uk</a>.</p>

v.) understand the qualitative factors that could influence investment decisions	<ul style="list-style-type: none"> <li>• use actual examples of recent investment decisions to discuss the other factors – non financial – that could have influenced the final decision.</li> </ul>	<ul style="list-style-type: none"> <li>• 9707/2 June 2002 Q1c.</li> <li>• 9707/2 June 2001 Q1c.</li> </ul>	
vi.) <i>understand the concept of discounting future cash flows</i> vii.) <i>calculate net present value and understand/analyse results</i> viii.) <i>identify internal rate of return from a net present value graph and understand/analyse results.</i>	<ul style="list-style-type: none"> <li>• <i>allow students to gain practice at using discount factors to calculate NPV. Do not spend too long on IRR – a simple understanding is sufficient.</i></li> </ul>		
<b>f) Managing cash flows</b>			
<b>Students should be able to:</b> i.) understand the importance of cash flow to a business – and why it is not the same as profit ii.) understand the purpose and construction of cash flow forecasts iii.) understand how cash flow might be improved for a business iv.) <i>evaluate ways of improving the cash flow of a business.</i>	<ul style="list-style-type: none"> <li>• cash flow is something all students should have experience of! Stress the importance of cash/liquidity for business survival. Give simple examples to explain the difference between a profitable transaction and one that leads to a positive cash flow.</li> <li>• let students gain experience of constructing and amending simple cash flow forecasts. Ask them to debate the usefulness of these (useful to whom and how useful?)</li> <li>• ask for suggestions as to how forecast negative cash flows might be reversed and <i>discuss the possible drawbacks to all of these option in different situations..</i></li> </ul>	<ul style="list-style-type: none"> <li>• Stimpson Chapter 30 and activities “Tourist Trinkets” and “Setting up in business”. Revision questions P 467.</li> <li>• Barratt and Mottershead Chapter 34 and mini case study P 390</li> <li>• Jewell Chapter 28</li> <li>• 9707/2 Nov 2002 Q1b</li> <li>• 9707/3 June 2002 Qb</li> <li>• 9707/3 June 2003 Qc</li> </ul>	Use general business studies web sites. IGCSE CD Rom. Try <a href="http://www.osl-ltd.co.uk">www.osl-ltd.co.uk</a> and <a href="http://www.businessteacher.co.uk">www.businessteacher.co.uk</a>

<b>g) Budgets and budgeting</b>			
<p><b>Students should be able to:</b></p> <p>i.) <i>understand the purpose of budgets and the advantages of budgeting</i></p> <p>ii.) <i>analyse variances from budget in terms of adverse and favourable (not price/volume analysis).</i></p>	<ul style="list-style-type: none"> <li>• <i>stress the difference between budgets and forecasts. Why should budgets be established and what purposes do they have? Use college/school examples of cost/profit centers that could have budgets set for them. What would be the benefits of staff being involved in setting these budgets?</i></li> <li>• <i>reviewing performance – simple variance analysis should be used to identify the major reasons why actual performance differs from planned.</i></li> </ul>	<ul style="list-style-type: none"> <li>• <i>Stimpson Chapter 30 and activities West Indian Carpets and Kinibali Timber Co. Ltd.</i></li> </ul>	