

The purpose of accounting and its role in the management of a business



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Introduction

Understanding how a business operates and what makes it successful requires knowledge of the accounting process. This unit introduces you to the purpose of accounting and its role in the management of a business organisation.

Accounting involves the recording of business transactions, and this in turn, leads to the generation of financial information, which can be used as the basis of good financial control and planning. Inadequate record-keeping and a lack of effective planning ultimately lead to poor financial results. It is vital that owners and managers of businesses are able to recognise the indications of potential difficulties. Remedial action can then be taken. This unit should give you the skills and knowledge needed to understand and manage finances.

The unit is divided into two distinct parts. The first is an understanding of the accounting processes necessary to provide accurate and relevant financial information. The second part is the practical aspect of carrying out those accounting activities.

You will be introduced to accounting terminology as they study the purpose and function of accounting and consider the various categories of business income and expenditure. It is important to know the sources of an organisation's income and the nature of its expenditure as this clarifies the basis of its profitability and enables more effective control of the business.

This control begins with the planning process and learners will study the use of a cash flow forecast which requires managers to set cash flow targets that <https://assignbuster.com/the-purpose-of-accounting-and-its-role-in-the-management-of-a-busienss/>

can be monitored and adjusted on a regular basis. You will consider the effective management of cash flow and the implications of cash flow problems. The link between business failures and cash flow problems will be highlighted.

The measurement of an organisation's financial performance and position requires an understanding of a basic profit and loss account and balance sheet. This understanding permits the analysis of profitability, liquidity and efficiency of the organisation through the application of ratio analysis.

Analysis will always require comparison of current figures with those from a previous accounting period or those of a similar business organisation. You will discover the method of carrying out ratio analysis as well as the meaning and implication of the figures.

General information

Making the grade

Each of the elements that make up a " part" of the assignment has been graded to show their level of difficulty. As you complete each element successfully you will have achieved the grade indicated for that particular element. There are four elements that have been graded as a Pass (P), two graded as a Merit (M) and two graded as a Distinction (D). It is important to remember that you must successfully complete all 4 Pass elements before you can be awarded a " Pass" mark for the assignment. Only when all 4 elements have been achieved can you be considered for a Merit grade. Equally, you must complete both Merit elements before you can be considered for a Distinction mark.

Completing your assignment

Here are a few tips to help you be successful;

Begin your research straight away

Keep a file with all your work, from rough research to final reports

Keep a record of where all your research information came from and list them in your bibliography.

Use the Assessment Evidence sheet in the assignment and the detailed explanations of each “ part” to make sure you complete everything you are required to and keep all the evidence required to achieve PASS, MERIT and DISTINCTION marks. You will find that ticking each one off as you complete them will be really helpful.

It is strongly recommended that you meet the interim deadlines shown in this document as your lecturer will have the opportunity to ensure you are making good progress and to help with suggestions for the next part of the assignment.

Only work handed in by the interim deadline dates will be marked at that stage. It goes without saying that you must complete and hand in your final version of the Assignment on or before the final deadline date.

Part One (relating to P1)

Understand the purpose of accounting

Scenario

You have been recruited to helping your uncle's family set up and run a clothing shop called DessiDesigns on the Broadway. In the past they set up and ran smaller scale businesses, but have muddled up their finances. Your knowledge and guidance regarding financial aspects will be essential to build this into a successful venture.

Task 1

Prepare a short report (500 – 600 words) for your uncle and aunt explaining the purpose of accounting. Explain why it is important to record transactions.
(P1)

Hints from the syllabus

Purpose: record transactions; monitor activity; control; management of the business (planning, monitoring, controlling); measurement of financial performance (gross profit, net profit, value owed to and by the business).

Grade criteria

P1 Describe the purpose of accounting.

How you will be marked

To achieve P1, learners will describe clearly the main purpose of accounting for an organisation. The description may be brief but it should be accurate and should incorporate the recording of historical data to be able to check on financial performance and position, as well as the planning aspect of management accounting.

Part 2 relating to P2

Understand the categorisation of business income and expenditure

Task 2

Write a short (200 words) explanation regarding the difference between capital and revenue items of expenditure and income. Use examples to help you so that your uncle understands each.

Task 3

Complete the exercise (overleaf) putting various examples of income and expenditure into the revenue and capital categories.

Task 3 relating to P2

Name.....

Put each of the following into the correct category below

Advertising paid

Investment from owner

Purchase of stock

Bank charges paid

Investment from partner

Rent paid

Buildings bought

Issuance of shares

Rent received

Business rates paid

Land bought

Salaries paid

Cash sales received

Lighting bill paid

Sales commissions paid

Commissions received

Loan from bank

Stationary bought

Credit sales received

Machinery bought

Telephone bill paid

Fittings bought

Mortgage from bank

Trademarks bought

Furniture bought

Office equipment bought

Training paid for staff

Goodwill bought

Patent bought

Transportation of goods

Heating bill

Pensions paid

Vehicles bought

Insurance premium paid

Postage paid

Wages paid

Interest on loans payable

Printing paid

Revenue income

Capital Expenditure

Revenue expenditure

Capital income

Grade criteria

P2 Explain the difference between capital and revenue items of expenditure and income.

How you will be marked

For P2, learners will be expected to identify the different categories of capital income, capital expenditure, revenue income and revenue expenditure as listed in the unit content. This may be achieved in a number of ways. For example, learners could examine a specific type of organisation, identifying the likely income and revenue and indicating in each case whether it is of a capital or revenue nature. They should also describe clearly what is meant by each category. At this stage, learners are not expected to calculate profit or to know the impact of the income and expenditure items on profit.

Hints from the syllabus

Capital income: sole traders; partners; shares; loans; mortgages.

Revenue income: sales (cash and credit transactions); rent received; commission received.

Capital expenditure: fixed assets (land and buildings; office equipment; machinery; furniture and fittings; motor vehicles); intangibles, eg goodwill, patents, trademarks.

Revenue expenditure: premises costs, eg rent, rates, heating and lighting, insurance; administrative costs, eg telephone charges, postage, printing, stationery; staff costs, eg salaries, wages, training, insurance, pensions; selling and distribution costs, eg sales staff salaries, carriage on sales, marketing; finance costs, eg bank charges, loan and mortgage interest; purchase of stock (cash and credit transactions).

Part 3 relating to (P3, M1, D1)

Be able to prepare a cash flow forecast

Task 4

To achieve P3 you must prepare and complete accurately a cash flow forecast for DessiDesigns. The scenario will be given to you to complete in class.

Grade criteria

P3 Prepare a twelve-month cash flow forecast to enable an organisation to manage its cash.

How you will be marked.

For P3, learners should construct a twelve-month cash flow forecast from the information given in a scenario, accurately calculating each month's receipts, payments, opening and closing balances.

Hints from the syllabus

Cash flow forecast: structure; timescale; credit periods; receipts (cash sales, debtors, capital, loans, other income); payments (cash purchases, trade

creditors, revenue expenditure, capital expenditure, Value Added Tax (VAT)); opening and closing cash/bank balances.

Once you have accurately completed and passed the task 4 cash flow exercise, you will use the information for tasks 5 and 6 where you will analyse the cash flow forecast you have completed and identify potential problems of the business and move further to suggest possible solutions.

Task 5

Analyse the cash flow for DessiDesigns and discuss problems the business might experience (M1). Use the figures you have prepared. (As a guide you should identify at least 3 issues and describe why this are problems for the business based on the cash flow forecast. In order to pass this section you must make your report relevant to your uncles business.)

Grade criteria

M1 Analyse the cash flow problems a business might experience.

How you will be marked

For M1, learners should comment on the cash flow, highlighting any problems that are evident, such as a shortage of cash as a result of costly capital expenditure in one month.

Hints from the syllabus

Cash flow management: problems within the cash flow forecast, eg insufficient cash to meet payments that are due.

Task 6

Based on your uncles business DessiDesigns recommend and justify actions for them to help them improve the cash flow and overcome the cash flow problems identified in task 5. (D1) (As a guide your report should be approximately 1000 words and should give reasons for your recommendations. In order to pass this section you must make your report relevant to your uncles business). Be prepared for a viva of your work. (This will be in the form of a few questions to assess your understanding – you will be given an appointment time to enable you to prepare for this).

Grade criteria

D1 Recommend and justify actions a business might take when experiencing cash flow problems.

How you will be marked

For D1, learners will make appropriate recommendations to solve the cash flow problems, such as retiming large payments or arranging an overdraft. Learners should show awareness of the dangers and costs of poor financial planning.

Hints from the syllabus

Solutions, eg overdraft arrangements, negotiating terms with creditors, reviewing and rescheduling capital expenditure

Part 4 relating to P4

Understand profit and loss accounts and balance sheets

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Task 7

Explain the component parts of a profit and loss account and balance sheet provided for DessiDesigns. Describe the purpose and use of the trading, profit and loss account and balance sheet. Explain how gross profit and net profit are calculated. You will be given a sample P&L statement and a Sample Balance Sheet for DessiDesigns to comment on.

Grade criteria

P4 Explain the component parts of a profit and loss account and balance sheet in a given organisation.

How you will be marked

For P4, learners will describe the purpose and use of the trading, profit and loss account and balance sheet. They will also explain how gross profit and net profit are calculated by indicating the kinds of income and expenditure that are included.

Learners will be presented with a trading and profit and loss account and a balance sheet for a business organisation, which should be set out using the vertical style.

Learners will label the 'cost of goods sold' section and the 'overheads' section of the profit and loss account.

Hints from the syllabus

Profit and loss account: purpose and use; trading account and calculation of gross profit (sales, purchases, opening and closing stocks); calculation of net

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profit (overheads, other revenue income, eg discounts received); commission received; transfer of net profit to balance sheet.

Balance sheet: purpose and use; vertical presentation; order of permanence; fixed assets; current assets; intangible assets; long-term liabilities; current liabilities; working capital; net assets; transfer of net profit from profit and loss account; capital employed.

Part 5 relating to P5, M2, D2

Be able to review business performance using simple ratio analysis

Task 8

P5 Perform ratio analysis to measure the profitability, liquidity and efficiency of DessiDesigns.

Calculate the following ratios for the business given show the formulas and all the working out. Explain what each ratio tells us about your uncles business.

Profitability

Liquidity

Efficiency

Gross profit % of sales

Current ratio

Debtors' payment period

Net profit % of sales

Acid test ratio

Creditors' payment period

Return on capital employed

Rate of stock turnover

Grade criteria

P5 Perform ratio analysis to measure the profitability, liquidity and efficiency of a given organisation.

How you will be marked

For P5, learners will outline clearly what is meant by the terms profitability, liquidity and efficiency. That description will include the meaning and relevance of each ratio.

Hints from the syllabus

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Profitability: gross profit percentage of sales; net profit percentage of sales; return on capital employed (ROCE).

Liquidity: current ratio; acid test ratio/liquidity ratio.

Efficiency: debtors' payment period; creditors' payment period; rate of stock turnover.

Task 9 (M2)

Analyse the following ratios for the DesiDesigns and explain what each means for your uncle. Relate these to the strengths and weaknesses of the business.

Profitability

Liquidity

Efficiency

Gross profit % of sales

Current ratio

Debtors' payment period

Net profit % of sales

Acid test ratio

Creditors' payment period

Return on capital employed

Rate of stock turnover

Grade criteria

M2 Analyse the performance of a business using suitable ratios.

How you will be marked

For M2, learners will identify the accounting ratios they will use to measure profitability, liquidity and efficiency and will calculate these accurately, based on the trading and profit and loss account and the balance sheet. The relevant accounting ratios from the previous year, or from another similar type of business organisation, will be given to the learners.

Hints from the syllabus

Profitability: gross profit percentage of sales; net profit percentage of sales; return on capital employed (ROCE).

Liquidity: current ratio; acid test ratio/liquidity ratio.

Efficiency: debtors' payment period; creditors' payment period; rate of stock turnover.

Task 10 (D2)

Prepare a power point presentation to evaluate the financial performance of your uncles business using ratio analysis. You will be given a second set of ratios to compare your first set of businesses ratios with. Look for trends. Is the business doing better or worse? Make suggestions on what can be done about this. Make sure you give appropriate evidence for your conclusions and recommendations. The presentation will be done individually and will be followed by a few questions by the lecturer or fellow classmates.

Grade criteria

D2 Evaluate the financial performance and position of a business using ratio analysis.

How you will be marked

For D2, learners will demonstrate a good understanding of the meaning of the accounting ratios used by comparing the figures calculated with those given. Learners will work in groups to evaluate the performance and position of the business organisation, based on the ratio analysis, giving appropriate evidence for any conclusion made. Learners could present their evidence and findings as part of a group using a PowerPoint presentation or OHTs.

Assignment Part 1

Task No

Criteria

Interim date

1

P1 describe the purpose of accounting

P1

Assignment Part 2

Task No

Criteria

Interim

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date

2

3

explain the difference between capital and revenue items of expenditure and income

P2a

P2b

Assignment Part 3

Task No

Criteria

Interim

date

4

prepare a twelve-month cash flow forecast to enable an organisation to manage its cash

P3

5

analyse the cash flow problems a business might experience

M1

6

recommend and justify actions a business might take when experiencing cash flow problems

D1

Assignment Part 4

Task No

Criteria

Interim

date

7

explain the component parts of a profit and loss account and balance sheet in a given organisation

P4

Assignment Part 5

Task No

Criteria

Interim

date

8

Perform ratio analysis to measure the profitability, liquidity and efficiency of a given organisation.

P5

9

Analyse the performance of a business using suitable ratios.

M2

10

Evaluate the financial performance and position of a business using ratio analysis.

D2

Part 1

P1 describe the purpose of accounting

Part 2

P2 explain the difference between capital and revenue items of expenditure and income

Part 3

P3 prepare a twelve-month cash flow forecast to enable an organisation to manage its cash

M1 analyse the cash flow problems a business might experience

D1 recommend and justify actions a business might take when experiencing cash flow problems

Part 4

P4 explain the component parts of a profit and loss account and balance sheet in a given organisation

Part 5

P5 perform ratio analysis to measure the profitability, liquidity and efficiency of a given organisation.

M2 analyse the performance of a business using suitable ratios.

D2 evaluate the financial performance and position of a business using ratio analysis.