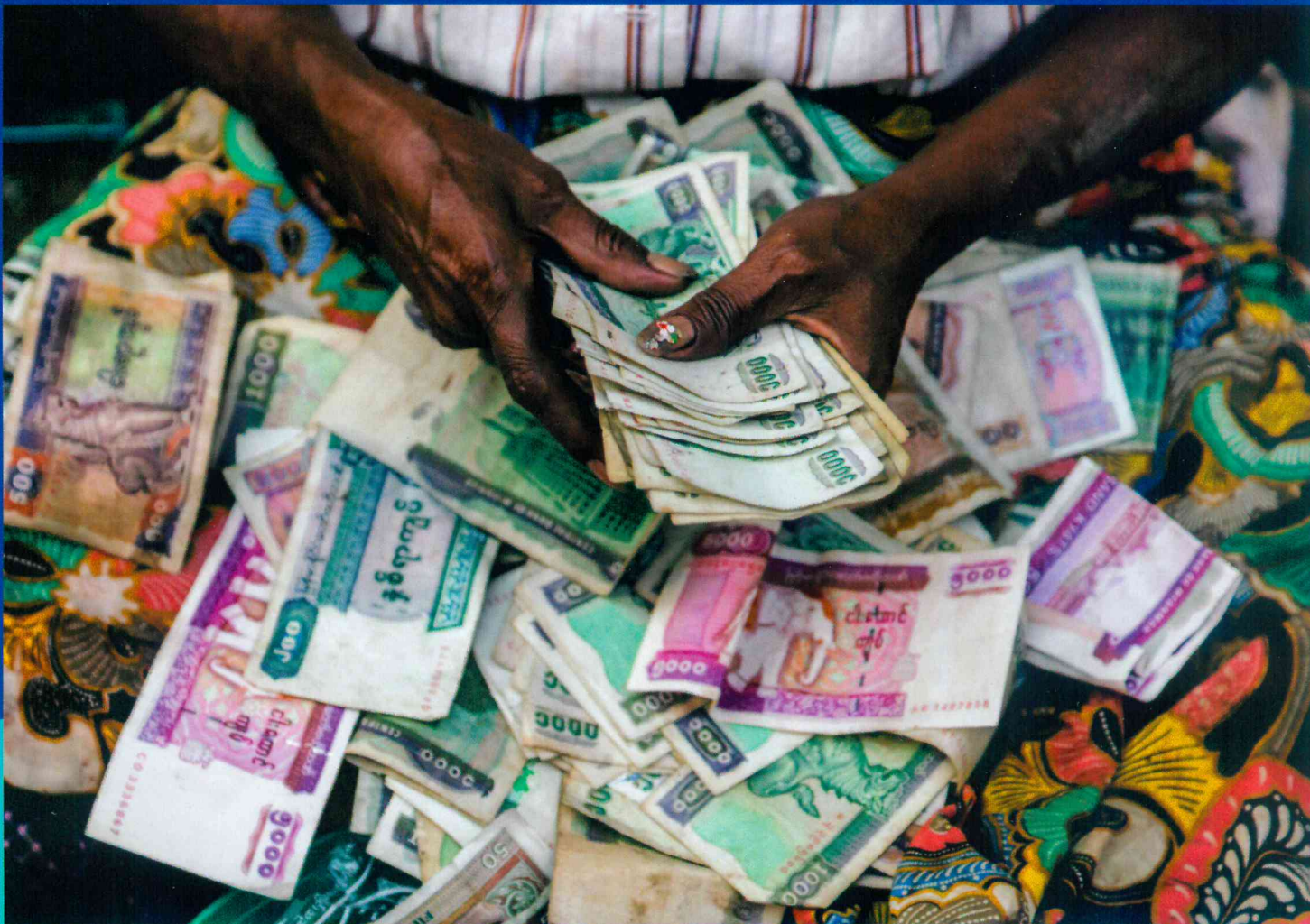


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PEARSON EDEXCEL INTERNATIONAL GCSE (9–1)

ACCOUNTING

Student Book

James Haigh

Sheila Robinson with Frank Wood



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GCSE (9–1)

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ABOUT THIS BOOK

This book is written for students following the Pearson Edexcel International GCSE (9–1) Accounting specification.

The course has been structured to support logical progression in teaching and learning, both in the classroom and in independent learning, as well as to support the exam specification. The book contains four units that cover all areas of content in the specification. The introductory text at the beginning of each unit details how students will need to apply their learning for the different parts of the exam.

Each unit is split into multiple chapters to break down content into manageable chunks and to ensure full coverage of the specification. Each chapter features a mix of learning and activities. Global case studies are embedded throughout and require students to practise a range of techniques presented in the chapter. Summary questions at the end of each chapter help to put learning into practice.

There are also exam-style questions at the end of each chapter.

A comparison of the International Finance Reporting Standards (IFRS) terminology and the UK GAAP (Generally Accepted Accounting Practice in the UK) terminology is included in the back of the book. IFRS terminology is used in the Pearson Edexcel International GCSE (9–1) Accounting qualification. Centres should be aware that these terms are also referred to as International Accounting Standards (IAS) in certain contexts within the industry. However, the definitions and meaning remain the same.

Learning objectives

These chapter-by-chapter objectives are carefully tailored to address key assessment objectives central to the course.

Getting started

An introduction to the chapter, letting you think about the concepts you will be introduced to. Activities are designed to stimulate discussion and prior knowledge. These can be tackled as individuals, pairs, groups or the whole class.

Key points

Core information is made easy to understand.

1 TYPES OF BUSINESS ORGANISATION

LEARNING OBJECTIVES

- Describe the characteristics of:
 - sole traders
 - partnerships
 - private sector organisations
 - public sector organisations
- Understand how stakeholders use the financial statements of the business
- Understand the importance of unlimited liability and unlimited liability
- Understand the relationship between stakeholders and a business
- Understand the different types of shareholder

GETTING STARTED

In this chapter, we look at the different types of business organisation. Business organisations can be small, with just one owner, or large, with over 100 owners. They may be local or multinational. To be successful, a business must meet the needs of its customers. The structure of a business organisation can have a big impact on its finances. Choosing the right business organisation is vital to the success of the business itself.

A business organisation can have many different legal forms and identities. It can be owned by just one person, or be more complicated and owned by thousands of shareholders. In this chapter, we will look at four different types of ownership:

- sole trader
- partnership
- private sector organisations
- public sector organisations

The type of business organisation you choose to set up is very important from an accounting point of view, as this can add extra financial and legal costs to the business.

ACTIVITY

- Why do you think it is important to choose the correct business organisation?
- Make a list of local businesses. Do you know what type of business organisation they are?

1.1 SOLE TRADER

Sole tradership is the earliest form of business organisation to set up. A sole trader is an individual trading alone under his or her own name, or under a trading name. The sole trader is fully responsible for the running of the business. He or she is the only financial beneficiary of its success, but he or she is also financially responsible if the business fails.

A sole trader has **unlimited liability**. This means that, in the eyes of the law, the owner and the business are the same. If the business is unable to meet its financial obligations and cannot pay its bills, a court has the authority to hand over the sole trader's personal assets to any creditors to cover these debts. The sole trader may have to sell his or her house or car, for example. If the sole trader cannot cover outstanding debts, the creditors can force the owner to be declared **bankrupt**.

There are no formal rules or guidelines to follow when setting up as a sole trader. There are also no set-up costs. As a result, sole traders are often small organisations. Sole tradership, unlike other types of business organisation, also benefits from not having any legal obligations to publish their accounts.

ADVANTAGES

- Business is easy to set up.
- Sole trader keeps all profits.
- Sole trader has complete control.
- easier to make decisions.
- Accounts do not have to be published.

DISADVANTAGES

- Sole trader may lack capital and find it difficult to raise more.
- Sole trader is personally liable for all debts.
- Sole trader may lack specialist skills.
- Making all decisions can be stressful.
- No security, as business success often relies on sole trader's skills.

SKILLS

GENERAL VOCABULARY

- draws up:** prepare formally applied to a written document, such as a list or contract
- limited liability:** limited liability is a legal agreement to begin a partnership

1.2 PARTNERSHIP

The main difference between a partnership and a sole trader is the number of owners. A partnership is defined as having between two and 20 owners. These owners have unlimited liability. A contract is usually **drawn up** to show how profits and losses are shared. This contract is called the **deed of partnership**. An accountant or solicitor normally draws up this deed of partnership to avoid potential problems. It must obey the law of the country the business is in, for example, the Partnership Act 1890 in the UK and the Partnership Act of 1902 in Bangladesh.

Activities

Each chapter includes activities to embed understanding through case studies and questions.

Subject vocabulary and General vocabulary

Useful words and phrases are colour coded within the main text and picked out in the margin with concise and simple definitions. These help understanding of key subject terms and support students whose first language is not English.

Case studies

Case studies drawn from a range of large and small businesses from around the world will help you to apply your learning to real-world contexts.

Skills
Relevant activities have been assigned the key skills that you will gain from undertaking them, allowing for a strong focus on particular academic qualities. These transferable skills are highly valued in further study and the workplace.

Exam hints

These boxes give you tips on important points to remember in your examination.

Hints

These provide aids for learning and also give notes about differences in terminology or variations in accounting standards.

End of chapter questions and checklist

Revision questions and a summary of the chapter's key points help to consolidate learning.

Assessment objectives

Questions are tagged with the relevant assessment objectives that are being examined.

UNIT 1 1 TYPES OF BUSINESS ORGANISATION 7

SKILLS **CRITICAL THINKING**

CASE STUDY: PARTNERSHIPS

Harif has been running a fruit and vegetable stall successfully in the local market in Nairobi for five years. Harif is a solo trader. He enjoys being his own boss, but he does not like the long hours he sometimes has to work. Harif wants to expand his business but has found it difficult to borrow money from banks to finance a new shop. Harif has spoken to other traders in the market. Another fruit and vegetable stall owner, Muzi, is also interested in expanding his own business. Harif and Muzi have decided to go into business together and are forming a partnership. They will share their capital and open a new store.

- 1 Why do you think Harif wants to expand his business?
- 2 What are the advantages for Harif and Muzi of going into a partnership together?
- 3 What are the disadvantages for Harif and Muzi of going into a partnership together?

OBJECT KNOWLEDGE

incorporation the official listing of a company by meeting certain legal requirements that apply in a particular country or a particular state; companies that are incorporated become corporations

limited liability the legal responsibility to pay only a limited amount of debt if something bad happens to you or your company

dividend of ownership when shareholders are owners of the business, but they are not necessarily involved in the day-to-day running of the business

auditor an independent accountant who examines the accounts of a limited company on behalf of the shareholders to see if they show a 'true and fair' view of how the business is performing

EXAM HINT

Before you read this question carefully and don't get confused between limited and unlimited liability.

1.3 PRIVATE SECTOR ORGANISATIONS

All profit-making businesses that are not run or operated by the government are private sector organisations. Solo traders and partnerships are small businesses that are part of the private sector. Companies in the private sector that want to expand can go through the process of incorporation. This allows the business organisation to create its own legal identity. In the UK, a company must be registered with the Registrar of Companies, and comply with the Companies Act 2006, to have separate legal status. This means, by law, that the owners of the business and the company are now separate.

Separate legal status allows the owner to have **limited liability**, which will make it easier for the business to raise finance. Limited liability means that the owners are not liable for the company's debts and can only lose the capital that they have invested in the business.

Separate legal status also allows for **dividend of ownership**. This means that shareholders do not have to be involved in the business and, as owners, they are separate or 'divorced' from the day-to-day running of the business. Managers are responsible for the running of the business and make the decisions on behalf of the owners.

The accounts of Limited Liability Companies must be checked and approved by an independent accountant, known as an **auditor**. An auditor acts on behalf of the owners to check that the accounts are accurate and show a 'true and fair' view of how the business is doing. This is called an **'audit'**.

There are two types of Limited Liability Company: Private Limited Companies and Public Limited Companies.

► Name three private sector organisations in your country.

1.4 PUBLIC SECTOR ORGANISATIONS

Public Sector Organisations are operated by the government. They usually provide a service rather than aiming to make a profit, unlike Private Sector Organisations. Public Sector Organisations are financed from the taxes paid by

UNIT 1 3 PROFESSIONAL ETHICS 24

3.4 INTRODUCTION TO ACCOUNTING CONCEPTS

Accountants need to be ethical. They also have to follow the rules of accounting concepts. These will be covered in more detail in Chapter 15, but it is worth having a look at them now. There are certain rules and underlying concepts that accountants have to follow when preparing financial statements. These rules ensure standardisation across all the accounts showing a 'true and fair' reflection of the business. If an accountant is involved in the business or buys goods, they want to be sure that their money will be secure.

The concepts that will feature in the exam are:

- business entity
- materiality
- consistency
- accruals
- money measurement
- prudence

END OF CHAPTER QUESTIONS

- 1 Give **three** examples of financial statements.
- 2 Give **one** example of an accountant being objective.
- 3 Explain what is meant by the term 'confidentiality' and give **one** example.
- 4 What is meant by the term 'public interest'?
- 5 How can an accountant adopt a professional manner?
- 6 Explain **three** roles of an accountant.

END OF CHAPTER CHECKLIST

- Accountants have to follow the principles of professional ethics.
- An accountant must not provide information that could mislead clients or third parties.
- All accountants must be suitably qualified and keep up to date with new accounting procedures.
- Accountants must not provide materials that could go against the public interest.

UNIT 2 4 BOOKS OF ORIGINAL ENTRY 98

EXAM PRACTICE

AD1 AD2 AD3 Answer ALL questions in this section. Questions 1-5 must be answered with a cross in the appropriate box. If you change your mind about an answer, put a line through the box and then mark your new answer with a cross.

- 1 A trader sells goods at a net price of 15000 on credit. The trader offers his customers a trade discount of 10% and a cash discount of 5%. What amount will be recorded in the trader's sales journal?

<input type="checkbox"/> A Y5100	<input type="checkbox"/> C Y5400
<input type="checkbox"/> B Y5130	<input type="checkbox"/> D Y6000

 (1 mark)
- 2 A sole trader withdraws cash from the business bank account for her personal use. How would this transaction be recorded in the ledger?

Debit	Credit
<input type="checkbox"/> A Bank	<input type="checkbox"/> Cash
<input type="checkbox"/> B Bank	<input type="checkbox"/> Drawings
<input type="checkbox"/> C Bank	<input type="checkbox"/> Capital
<input type="checkbox"/> D Drawings	<input type="checkbox"/> Bank

 (1 mark)
- 3 Which of these accounts has a credit balance?

<input type="checkbox"/> A discount allowed	<input type="checkbox"/> C purchases
<input type="checkbox"/> B discount received	<input type="checkbox"/> D sales returns

 (1 mark)
- 4 In which books of original entry should an irrecoverable debt that has been written off be entered?

<input type="checkbox"/> A cash book	<input type="checkbox"/> C purchases book
<input type="checkbox"/> B journal	<input type="checkbox"/> D sales book

 (1 mark)
- 5 In which book do we record a credit note sent to a customer?

<input type="checkbox"/> A purchases returns day book	<input type="checkbox"/> C sales returns day book
<input type="checkbox"/> B sales day book	<input type="checkbox"/> D journal

 (1 mark)
- 6 Amir Khan commenced business on 1 July 2017. On that day he:
 - purchased goods for resale, costing £5000 and fixtures and fittings for use in the business, costing £8000
 - paid £3000 into a business bank account and kept £100 to pay for petty cash expenses
 - received a £5000 loan from his brother, which he paid into the business bank account.
 Show the opening journal entry to record these transactions. (5 marks)
 (Total 10 marks)

Exam practice

These exam-style questions are found at the end of each chapter. They are tailored to the Pearson Edexcel (9-1) specification to allow for practice and development of exam technique.

ASSESSMENT OVERVIEW

The following tables give an overview of the assessment for this course. You should study this information closely to help ensure that you are fully prepared for this course and know exactly what to expect in each part of the assessment.

PAPER 1	PERCENTAGE	MARK	TIME	AVAILABILITY
INTRODUCTION TO BOOKKEEPING AND ACCOUNTING Written exam paper Paper code 4AC1/01 Externally set and assessed by Pearson Edexcel Single tier of entry	60%	100	2 hours	June exam series First assessment June 2019
PAPER 2	PERCENTAGE	MARK	TIME	AVAILABILITY
FINANCIAL STATEMENTS Written exam paper Paper code 4AC1/02 Externally set and assessed by Pearson Edexcel Single tier of entry	40%	50	1 hour 15 minutes	June exam series First assessment June 2019

ASSESSMENT OBJECTIVES AND WEIGHTINGS

ASSESSMENT OBJECTIVE	DESCRIPTION	% IN INTERNATIONAL GCSE
A01	Demonstrate a knowledge and understanding of accounting terminology, principles, procedures and techniques	35–40%
A02	Select and apply their knowledge and understanding of accounting procedures to a variety of accounting problems	41–47%
A03	Analyse, evaluate and present information in appropriate accounting formats and communicate reasoned explanations	17–20%

RELATIONSHIP OF ASSESSMENT OBJECTIVES TO UNITS

UNIT NUMBER	ASSESSMENT OBJECTIVE		
	A01	A02	A03
PAPER 1	25–28%	23–25%	9–10%
PAPER 2	11–12%	19–21%	8–9%
TOTAL FOR INTERNATIONAL GCSE	36–40%	42–46%	17–19%

ASSESSMENT SUMMARY

PAPER 1	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
INTRODUCTION TO BOOKKEEPING AND ACCOUNTING PAPER CODE 4AC1/01	Structure Paper 1 assesses 60 % of the total Accounting qualification. The examination comprises a mixture of multiple-choice, short- and long-answer questions, and is presented in two sections. Students must answer all questions. Section A comprises 10 1-mark multiple-choice questions and three short-answer questions worth 5 marks each. Section B comprises five multi-part questions worth 15 marks each.	The total number of marks available is 100	Questions will test the following Assessment Objectives: AO1 – 25–28% AO2 – 23–25% AO3 – 9–10%
	Content summary Students must study all of the following topics: Topic 1: The accounting environment Topic 2: Introduction to bookkeeping Topic 3: Introduction to control processes.		
	Assessment This is a single-tier exam paper and all questions cover the full ranges of grades from 9–1. The assessment duration is 2 hours Calculators may be used in the examination.		
PAPER 2	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
FINANCIAL STATEMENTS PAPER CODE 4AC1/02	Structure Paper 2 assesses 40 % of the total Accounting qualification. Students must answer all questions. The examination comprises two multi-part questions focusing on the preparation, analysis or evaluation of financial statements.	The total number of marks available is 50	Questions will test the following Assessment Objectives: AO1 – 11–12% AO2 – 19–21% AO3 – 8–9%
	Content summary Students must study both of the following topics: Topic 4: The preparation of financial statements Topic 5: Accounting for end of period adjustments.		
	Assessment This is a single-tier exam paper and all questions cover the full ranges of grades from 9–1. The assessment duration is 1 hour 30 minutes. Calculators may be used in the examination.		

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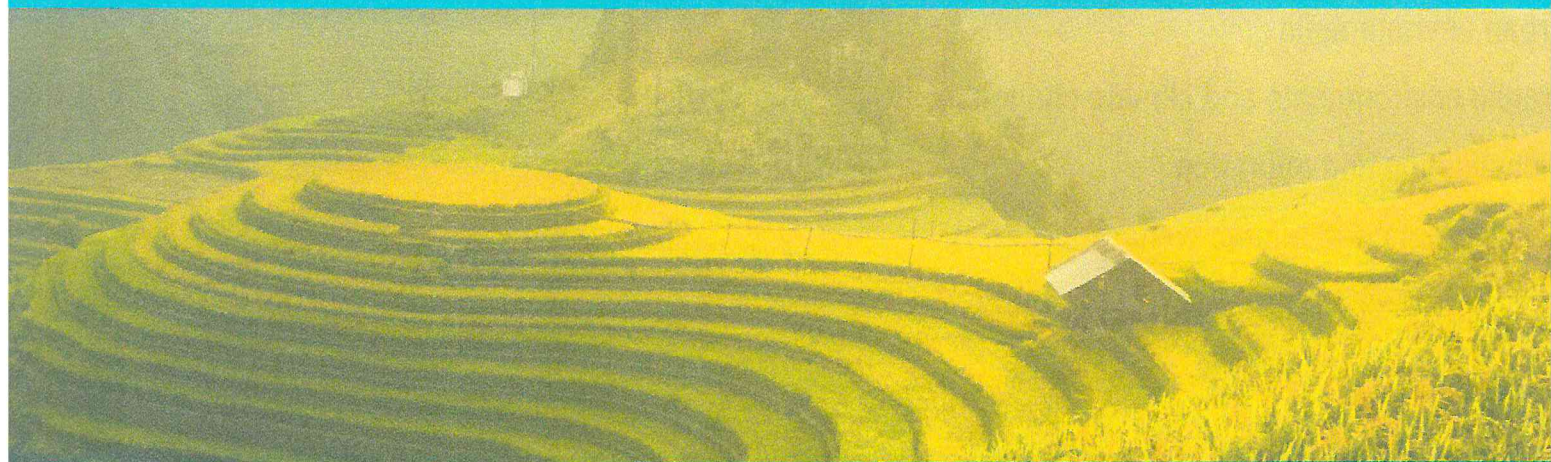
GEOGRAPHY

Student Book: Teacher Resource Pack

- Resources follow the teaching order of the Student Book and provide answers to the chapter questions.
- Easy-to-follow **lesson plans** save you valuable planning time.
- **Worksheets** give you additional ready-to-use activities.
- Guidance on the **Fieldwork** requirement of the course with exemplars.
- Sample questions and model answers in **exam practice Powerpoints** teach you and your students how to succeed in the exam.
- Prepare for exam success with **practice exam papers** and mark schemes.

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STUDENT BOOK ANSWERS

LESSON PLANS

- chapter 1: River environments
- chapter 2: Coastal environments
- chapter 3: Hazardous environments
- chapter 4: Economic activity and energy
- chapter 5: Rural environments
- chapter 6: Urban environments
- chapter 7: Fragile environments and climate change
- chapter 8: Globalisation and migration
- chapter 9: Development and human welfare

WORKSHEETS

- river environments
- coastal environments
- hazardous environments
- economic activity and energy
- rural environments
- urban environments
- fragile environments and climate change
- globalisation and migration
- development and human welfare

FIELDWORK PRACTICALS

Rural environments
Economic activity and energy
Hazardous environments
Urban environments
Coastal environments
River environments

PRACTICE EXAM PAPERS

Paper 1: Physical geography paper
Physical geography paper resource booklet
Physical geography paper mark scheme
Paper 2: Human geography paper
Human geography paper resource booklet
Human geography paper mark scheme

EXAM PRACTICE POWERPOINTS

SCHEME OF WORK



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UNIT 1

THE ACCOUNTING ENVIRONMENT

Assessment Objective A01

Demonstrate a knowledge and understanding of accounting terminology, principles, procedures and techniques

Assessment Objective A02

Select and apply their knowledge and understanding of accounting procedures to a variety of accounting problems

Assessment Objective A03

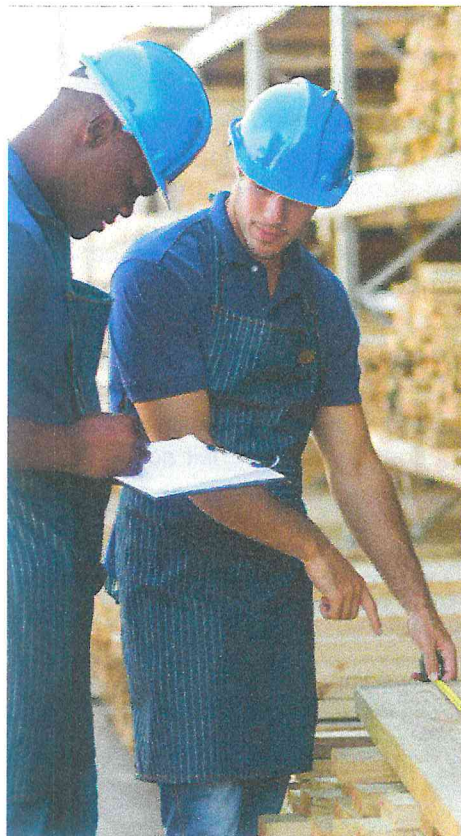
Analyse, evaluate and present information in appropriate accounting formats and communicate reasoned explanations

Unit 1 explains the different types of organisation a business can have and covers some key concepts you need to understand to work in the accounting environment. Technology is increasingly important in the field of accounting and this unit covers the benefits of technology as well as some of the main difficulties, such as data security and confidentiality.

The unit also explains the concept of professional ethics, which is vital on both an individual level and a company level.

This unit will be examined in Paper 1 of the examination, 'Introduction to Bookkeeping and Accounting'. You will need to answer a mixture of multiple choice and short- and long-answer questions. These questions will test your ability to meet the Assessment Objectives for this unit. You will also need to have a good understanding of this unit to be able to answer the questions in Paper 2.

1 TYPES OF BUSINESS ORGANISATION



▲ There are several types of business organisation to choose from when setting up a new business. ▼



LEARNING OBJECTIVES

- Describe the characteristics of:
 - sole traders
 - partnerships
 - private sector organisations
 - public sector organisations
- Explain the relationship between stakeholders and a business
- Understand how stakeholders use the financial statements of the business
- Understand the importance of unlimited liability and limited liability
- Understand the different types of stakeholder

GETTING STARTED

In this chapter, we look at the different types of business organisation. Business organisations can be small, with just one owner, or large, with over 100 owners. They may be local or multinational. To be successful, a business must meet the needs of its customers. The structure of a business organisation can have a big impact on its finances. Choosing the right business organisation is vital to the success of the business itself.

A business organisation can have many different legal forms and identities. It can be owned by just one person, or be more complicated and owned by thousands of owners. In this chapter, we will look at four different types of ownership:

- sole trader
- partnership
- private sector organisations
- public sector organisations.

The type of business organisation you choose to set up is very important from an accounting point of view, as this can add extra financial and legal costs to the business.

ACTIVITY

- 1 Why do you think it is important to choose the correct business organisation?
- 2 Make a list of local businesses. Do you know what type of business organisation they are?

HINT

A sole trader is sometimes called a sole proprietor.

GENERAL VOCABULARY

beneficiary someone who gets advantages from an action or change

SUBJECT VOCABULARY

sole trader an individual who owns his or her own business

unlimited liability full responsibility for the debts of the business

bankruptcy when someone is judged to be unable to pay their liabilities by a court of law

capital or equity money invested in the business by the owner(s)

KEY POINT

In the UK, sole traders must complete an annual tax return. However, they do not have to make details of their accounts available to the public.

Typical sole traders include plumbers, window cleaners and shopkeepers. ►

SKILLS

INTERPRETATION

GENERAL VOCABULARY

drawn up prepare (usually applied to a written document, such as a list or contract)

SUBJECT VOCABULARY

deed of partnership a formal agreement to begin a partnership

1.1 SOLE TRADER

Sole tradership is the easiest form of business organisation to set up. A **sole trader** is an individual trading alone under his or her own name, or under a trading name. The sole trader is fully responsible for the running of the business. He or she is the only financial **beneficiary** of its success, but he or she is also financially responsible if the business fails.

A sole trader has **unlimited liability**. This means that, in the eyes of the law, the owner and the business are the same. If the business is unable to meet its financial obligations and cannot pay its bills, a court has the authority to hand over the sole trader's personal assets to cover these debts. The sole trader may have to sell his or her home or car, for example. If the sole trader cannot cover all outstanding debts, the sole trader may be forced to declare him or herself **bankrupt**.

There are no formal rules or guidelines to follow when setting up as a sole trader. There are also no set-up costs. As a result, sole traders are often small organisations. Sole traderships, unlike other types of business organisation, also benefit from not having any legal obligations to publish their accounts.

▼ ADVANTAGES	▼ DISADVANTAGES
Business is easy to set up.	Sole trader may lack capital or equity and find it difficult to raise more.
Sole trader keeps all profits.	Sole trader is personally liable for all debts.
Sole trader has complete control.	Sole trader may lack appropriate skills.
Easier to make decisions.	Making all decisions can be stressful.
Accounts do not have to be published.	No continuity, as business ceases when sole trader dies.



- How do you think an accountant can help a sole trader run their business?
- What businesses in your local area may be sole traders? Make a list and compare with your classmates.

1.2 PARTNERSHIP

The main difference between a partnership and a sole trader is the number of owners. A partnership is defined as having between two and 20 owners. These owners have unlimited liability. A contract is usually **drawn up** to show how profits and losses are shared. This contract is called the **deed of partnership**. An accountant or solicitor normally draws up this deed of partnership to avoid potential problems. It must obey the law of the country the business is in, for example, the Partnership Act 1890 in the UK and the Partnership Act of 1932 in Bangladesh.

SUBJECT VOCABULARY

limited partnership a type of partnership where partners are responsible for the partnership's debts only up to the amount they originally invested

▼ ADVANTAGES	▼ DISADVANTAGES
More capital or equity can be raised through additional partners.	The partners have unlimited liability. This means they will have to cover the debts of each partner. For example, if one of the partners steals money from the business, the other partners will have to cover these debts and may have to sell their personal assets to do so (note: this excludes limited partners , see below).
Losses can be shared between partners.	A partnership is dissolved on the death of a partner.
Additional partners may bring more skills and expertise to the business.	It is difficult to liquidate or transfer partnerships.
The responsibility of management can be shared between the partners.	A partnership may still find it difficult to raise capital or equity for expansion, as increased unlimited liability could act as a deterrent.
Partnerships are ideal organisations for professional practices such as medicine, law and accounting.	Profits have to be shared between the partners.
Profits from a partnership are taxed as the personal income of the partnership.	There could be conflict between the partners.
Financial information is not published.	

SKILLS COMMUNICATION

- Give examples of businesses in your local area that are partnerships. Why do you think they are partnerships?

LIMITED PARTNERS

A partnership may be unlimited or limited. In a limited partnership, there must be at least one partner who is not limited. Limited partners are not liable for the debts of the business. They can only lose the capital or equity they have invested in the business. All limited partners must be registered with the Registrar of Companies.

DEED OF PARTNERSHIP

A Deed of Partnership is a contract between partners that can be either written or verbal. A Deed of Partnership has no specific requirements by law, so it can contain as much or as little as the partners wish. In fact, by law you do not need a Deed of Partnership, but it can help to solve any arguments later. It normally includes:

- the capital or equity contributed by each partner
- the ratio at which profits and losses are to be shared
- salaries to be paid to partners
- interest, if any, to be paid on capital or equity
- interest, if any, to be charged on partners' **drawings**.

SUBJECT VOCABULARY

drawings money taken (withdrawn) from the business by the owner(s)

SKILLS CRITICAL THINKING



CASE STUDY: PARTNERSHIPS

Hanif has been running a fruit and vegetable stall successfully in the local market in Nairobi for five years. Hanif is a sole trader. He enjoys being his own boss, but he does not like the long hours he sometimes has to work. Hanif wants to expand his business but has found it difficult to borrow money from banks to finance a new shop. Hanif has spoken to other traders in the market. Another fruit and vegetable stall owner, Mzuzi, is also interested in expanding his own business. Hanif and Mzuzi have decided to go into business together and are forming a partnership. They will share their capital or equity and open a new store.

- 1 Why do you think Hanif wants to expand his business?
- 2 What are the advantages for Hanif and Mzuzi of going into a partnership together?
- 3 What are the disadvantages for Hanif and Mzuzi of going into a partnership together?

SUBJECT VOCABULARY

incorporation the official listing of a company by meeting certain legal requirements that apply in a particular country or a particular state; companies that are incorporated become corporations

limited liability the legal responsibility to pay only a limited amount of debt if something bad happens to you or your company

divorce of ownership when shareholders are owners of the business, but they are not necessarily involved in the day-to-day running of the business

auditor an independent accountant who examines the accounts of a limited company on behalf of the owners to see if they show a 'true and fair' view of how the business is performing

EXAM HINT

Make sure you read the question carefully and don't get confused between limited and unlimited liability.

1.3 PRIVATE SECTOR ORGANISATIONS

All profit-making businesses that are not run or operated by the government are private sector organisations. Sole traders and partnerships are small businesses that are part of the private sector. Companies in the private sector that want to expand can go through the process of **incorporation**. This allows the business organisation to create its own legal identity. In the UK, a company must be registered with the Registrar of Companies, and comply with the Companies Act 2006, to have separate legal status. This means, by law, that the owners of the business and the company are now separate.

Separate legal status allows the owner to have **limited liability**, which will make it easier for the business to raise finance. Limited liability means that the owners, are not liable for the company's debts and can only lose the capital or equity that they have invested in the business.

Separate legal status also allows for **divorce of ownership**. This means that owners do not have to be involved in the business and, as owners, they are separate or 'divorced' from the day-to-day running of the business. Managers are responsible for the running of the business and make the decisions on behalf of the owners.

The accounts of Limited Liability Companies need to be checked and approved by an independent accountant, known as an **auditor**. An auditor acts on behalf of the owners to check that the accounts are accurate and show a 'true and fair' view of how the business is doing. This is called an 'audit'.

There are two types of Limited Liability Company: Private Limited Companies and Public Limited Companies.

► Name three private sector organisations in your country.

1.4 PUBLIC SECTOR ORGANISATIONS

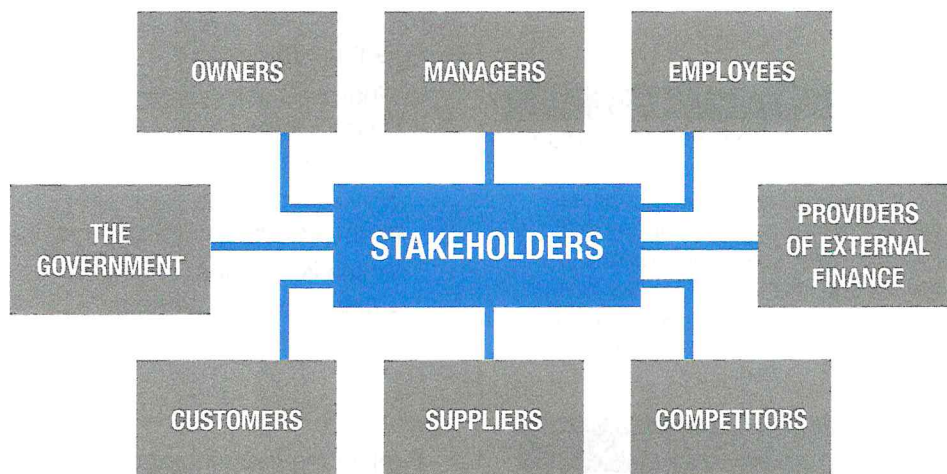
Public Sector Organisations are operated by the government. They usually provide a service rather than aiming to make a profit, unlike Private Sector Organisations. Public Sector Organisations are financed from the taxes paid by

companies and individuals. Some of the services provided by the government in the UK are free, including hospitals, libraries and education up to the age of 18. Other public services, such as travelling by bus, are paid services.

► Name three public sector organisations in your country.

THE CONNECTION BETWEEN STAKEHOLDERS AND A BUSINESS

A stakeholder is any person or business who is affected by the actions of that business. These include: owners, managers, employees, customers, suppliers, competitors, providers of external finance and the government.



▲ Figure 1.1 Different types of stakeholder

SUBJECT VOCABULARY

Income Statement a statement of all income and expenses recognised during a specified period

The **owners** look at the overall profitability of the business. They monitor how the business traded over the previous financial year. They compare the business performance with the previous year to judge how safe their capital or equity is and whether they would get a return on their investment. The owners look at the **Income Statement** to assess if they will receive any share of profit.

Managers run the business on behalf of the owners. They monitor the accounts to see how the business is performing. They make decisions based on the financial data available.

Employees may want to look at the accounts to see how well the business is performing and whether they have job security. The employees would look at the Income Statement to assess the overall profitability of the business. They could also use the accounts to try to secure a pay rise.

Customers may want to see how financially stable the company is. They can then assess whether the supply of goods and services is secure, and whether they should trade with the company.

Suppliers look at the company accounts to see how stable the business is. The supplier can then assess what credit terms to give and how much interest to charge.

Providers of external finance assess the company's ability to pay back any money that they lend the business, such as loans. They would look at the **Statement of Financial Position** to assess the **liquidity** of the business.

The **government** looks at the profits of the business to monitor whether the business is paying enough tax.

GENERAL VOCABULARY

liquidity the ability of a business to pay its debts

SUBJECT VOCABULARY

Statement of Financial Position shows the value of a business on a specific date, including the assets, liabilities and capital or equity

SKILLS CRITICAL THINKING

HINT

If a company name is followed by 'Ltd', this means that it is a Private Limited Company. This is not to be confused with a Public Limited Company (plc). Plcs are known as incorporations in the US (Inc). Public and Private limited companies are both types of limited liability private sector organisation.

CASE STUDY: DYSON LTD

Dyson Ltd was founded in 1991 by Sir James Dyson. His most famous invention is the dual-cyclone vacuum cleaner, also known as the 'bagless' vacuum cleaner. Dyson Ltd also manufactures the bladeless fan, hand dryers and hairdryers. It employs more than 9000 people and sells products in more than 65 countries.

- 1 What are the advantages for Dyson Ltd of being a private sector organisation?
- 2 Why do you think Dyson Ltd is not a public sector organisation?
- 3 Which is the most important stakeholder in a company like Dyson Ltd?



▲ The Dyson Ltd range of fans is called Dyson Cool™.

END OF CHAPTER QUESTIONS

- 1 Explain the meaning of the term 'unlimited liability'.
- 2 Explain briefly what is meant by the phrase 'divorce of ownership'.
- 3 Give **two** examples of businesses that would typically be sole traders.
- 4 What are the **two** types of partnership?
- 5 Explain the role of an auditor in producing financial statements.
- 6 Briefly explain what is meant by a Public Sector Organisation.
- 7 Identify **five** stakeholders and explain how they are affected by the business.
- 8 State **two** differences between sole trader business and partnership business.
- 9 Two partners decide to form a Limited Liability Company. Evaluate their decision.

END OF CHAPTER CHECKLIST

- A sole trader is set up to make a profit and has only one owner. The owner has unlimited liability and is personally responsible for the debts of that business.
- A partnership is made up of between two and 20 partners. The partners have unlimited liability and are responsible for the actions of the other partners.
- Limited companies have a separate legal identity to the owner and can **sue** or be sued in their own name.
- Limited companies have limited liability. This means the owners can only lose the capital or equity they have invested in the business.
- In the UK, limited companies have to publish their accounts at Companies House.
- A stakeholder is anybody who has an interest in, or is affected by, a company.

GENERAL VOCABULARY

sue make a legal claim against someone, especially for money, because they have harmed you in some way

EXAM PRACTICE

A01 Answer ALL questions in this section. Questions 1–10 must be answered with a cross in the box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

- 1** Which of the following is not a stakeholder for a business?
- ☐ A doctor
 - ☐ B competitor
 - ☐ C supplier
 - ☐ D government
- (1 mark)

- 2** Which of the following is a disadvantage of becoming a sole trader?
- ☐ A you keep all the profit
 - ☐ B you have unlimited liability
 - ☐ C you have full control over your business
 - ☐ D the business is easy to set up
- (1 mark)

- 3** Which of these is most likely to be a Public Sector Organisation?
- ☐ A a car manufacturer
 - ☐ B a biscuit factory
 - ☐ C the Police
 - ☐ D a restaurant
- (1 mark)

- 4** What does the word 'limited' after a business name indicate?
- ☐ A the number of owners is limited
 - ☐ B there is a limit to the number of loans that can be issued
 - ☐ C the owners' liability for the debts of the business is limited
 - ☐ D there is a limit to the number of businesses of this type
- (1 mark)

- 5** A limited company must have which of the following?
- ☐ A unlimited liability
 - ☐ B the ability to sell shares to friends and family
 - ☐ C an auditor check on its financial statements
 - ☐ D a government-run business
- (1 mark)

- 6** Which of the following is the best definition of a stakeholder?
- ☐ A someone who is affected by a business
 - ☐ B someone who has control over a business
 - ☐ C someone who is paid by a business
 - ☐ D someone who sponsors a business
- (1 mark)

- 7** Why should a sole trader record all the financial information about her business?
- ☐ A because she is required to do so by law
 - ☐ B so that she knows how much to pay her suppliers
 - ☐ C so that she can prepare financial statements
 - ☐ D so that she knows how much her customers owe her
- (1 mark)

- 8** Which best describes the term 'limited liability'?
- ☐ A the owner is responsible for all the debts of the business
 - ☐ B the owner is only responsible for the assets of the business
 - ☐ C the owner is only liable for the money they have invested in the business
 - ☐ D the owner is only liable for the taxes that are paid by the business
- (1 mark)

- 9** Which of the following is a disadvantage of a partnership?
- ☐ A increased capital or equity
 - ☐ B increased workload
 - ☐ C increased knowledge
 - ☐ D increased arguments
- (1 mark)

- 10** Why might a government department be interested in the financial statements of a company?
- ☐ A to check that the company is paying the correct amount of tax
 - ☐ B to decide whether to invest in the company
 - ☐ C to ensure that the company continues to receive supplies
 - ☐ D to see if the company could repay a loan
- (1 mark)

(Total 10 marks)

2 USE OF TECHNOLOGY IN ACCOUNTING



▲ IT is now an essential part of the accounting environment.

LEARNING OBJECTIVES

- Explain the benefits of using the following technology in the accounting environment:
 - accounting software
 - spreadsheets
- Explain the issues regarding the security of data in terms of:
 - data loss
 - access
 - confidentiality
- Explain the methods of protecting data through:
 - hardware
 - software

GETTING STARTED

Information technology (IT) has become an integral part of business and accounting. There are many different types of specialist equipment you can use. Relying on technology can lead to other issues, however, such as the safety and security of important and confidential data. In this chapter, we look at the ways businesses use IT in the accounting environment.

ACTIVITY

Find information on the internet about specific IT software packages for accounting. Make notes on the types of services they offer and the types of accounts they can help you with.

GENERAL VOCABULARY

off-the-shelf already made and available in shops rather than being designed for a specific customer

SUBJECT VOCABULARY

double entry the accounting system in which each transaction is recorded twice, as a debit in one account and as a credit in another

2.1 INTRODUCTION TO TECHNOLOGY IN ACCOUNTING

Today, computers are very widely used to operate accounting systems. Sophisticated technology is now available at a reasonable cost. Large to medium-sized businesses have used specially written IT software for many years, working with IT companies such as Adobe and Sage to tailor IT software to their individual needs. Most large companies also have IT departments who monitor their financial systems 24 hours a day, 7 days a week. Until recently, most smaller enterprises did not set up their own systems because of the cost of such software. Now, however, even small businesses can afford to use computerised systems with **off-the-shelf** packages such as Sage or QuickBooks. These packages carry out the same **double entry** functions of data processing and recording financial information as manual systems, and also offer other features such as management information.

INTERNET ACCESS

Internet access enables such things as online banking, and the payment of suppliers and employees. An organisation that has its own website can advertise its products and services and offer online ordering systems. In addition, the internet is a useful source of information and data that an organisation may need to access. It also allows customers to deal directly with businesses, with more and more transactions carried out online. Some businesses have become internet only in their business plans, for example Amazon, Alibaba and eBay.

KEY POINT

Accurate inputting of data ensures reliable output.

Today, so much accounting information is sent via the internet, and so many transactions are processed online, that businesses without computer facilities may struggle to succeed.

COMPUTER HARDWARE AND SOFTWARE

Computer hardware is the physical aspects of the computer. These include the monitor, keyboard, mouse, data storage area (hard drive), graphics card, sound card and mother board. These can be password protected to stop access.

Computer software is the data and instructions that are sent to the hardware that allows the computer to act in the way you want it to. This includes the operating system and the computer programs that you want to use. These can be password protected to restrict access to only certain members of staff.

2.2 FUNCTIONS OF ACCOUNTING SOFTWARE

A computerised accounting system offers similar functions as a manual system. However, it also provides useful reports and management information. The system is integrated, so basic data that is entered is processed and automatically posted to supplier and customer accounts. The nominal (general) ledger, and the inventory records, are also automatically updated. In some instances, automatic re-ordering systems are in place. The main functions of a computerised accounting package are described below.

Accounting software allows financial statements to be produced more quickly than traditional hand-written methods. The use of pre-programmed formulae and layouts means that financial data only needs to be entered once. The software can then make various uses of this information, and can store it in different ways. The software can use data provided to complete all aspects of a transaction, such as generating documentation (once programmed by the user) and providing reporting functions.

REVENUE

This involves preparation and printing of revenue invoices, credit notes and month end statements. Data from these documents is entered, processed and recorded:

- in the customer accounts in the receivables ledger
- by automatic update of the inventory records.

PURCHASES

Data from purchase invoices and credit notes is entered, processed and recorded:

- in the supplier accounts in the payables ledger
- by automatic update of the inventory records
- via a print-out of **remittance**.

SUBJECT VOCABULARY

remittance an amount of money that you send to pay for something

ONLINE BANK ACCOUNT AND APPS

Accounting systems record data such as customer receipts, supplier payments, other payments and receipts.

Many banks offer online banking facilities. These mean the organisation's bank account is always up to date.

All receipts and payments are linked to the personal accounts of the trade receivables and trade payables. The system allows for such transactions to automatically update these accounts.

SUBJECT VOCABULARY

payroll packages a software package that allows a firm to organise its staff wages and income tax

Many banks now offer apps (applications) that you can download for your phone. They allow you to access your account anywhere, as long as you have internet access. This is known as mobile banking.

Accounting systems automatically update the ledger.

WAGES/SALARIES**EXAM HINT**

Questions on payroll will not be asked in the exam.

Organisations have the option of using a combined computerised accounting and wages/salary package. Alternatively, they may use a separate **payroll package**. Such packages perform all the necessary payroll functions.

INVENTORY CONTROL**HINT**

An inventory check is when you physically count all your inventory in your business. This is usually carried out monthly, but will depend on the size of the business. This is sometimes known as a 'stock-take'.

Inventory control includes raw materials and ordinary goods purchased for resale. This means that inventory records are automatically updated after each revenue invoice or purchase invoice is entered into the system. This ensures an accurate figure of inventory is held in the system at all times.

At the end of the financial year when an organisation undertakes an inventory check, it is crucial to have an up-to-date inventory list. A computerised accounting system ensures this list is available. Inventory lists are used in the physical inventory check and allow variances to be identified and amended.

MANAGEMENT REPORTS**HINT**

The receivables ledger contains all sales of goods and/or raw materials on credit. The receivables ledger used to be called the receivables ledger. The payables ledger contains all purchases of goods and/or raw materials on credit.

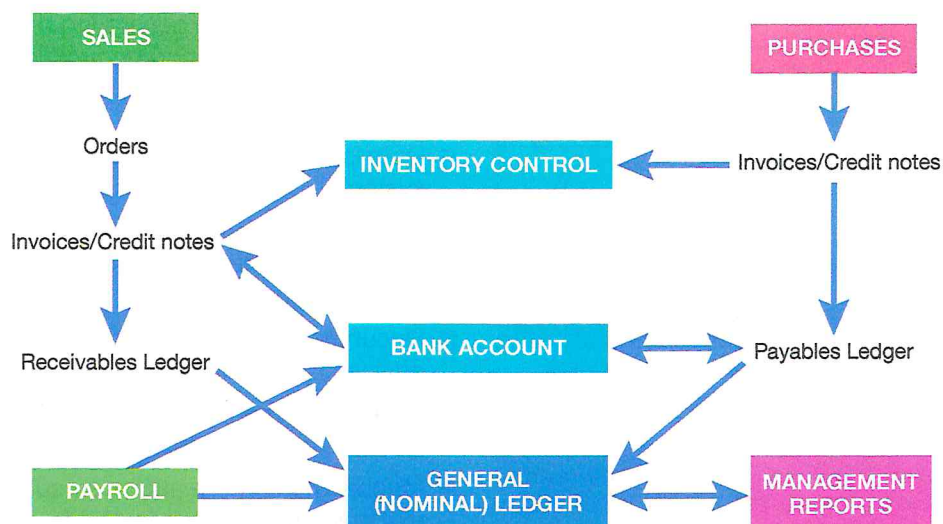
One of the main features of a computerised accounting system is the facility to provide the owners and/or managers of the business with useful financial data and reports. At the end of each month or specific accounting period, certain 'month end/year end' functions are carried out to provide the following information:

- day books for customers and suppliers
- general (nominal) ledger and bank account transactions
- activity reports on all ledger transactions
- an audit trail
- analysis reports for aged trade receivables and trade payables
- financial statements including the trial balance, income statement, statement of financial position
- ratio analysis
- reports (such as on staff attendance etc.) for human resources and payroll.

DID YOU KNOW?

VisiCalc was the first accounting program. It was launched in 1979. It was the first program to automatically update cells on a spreadsheet.

The functions are summarised in **Figure 2.1**.



▲ **Figure 2.1** Functions of accounting software.

SPREADSHEETS

GENERAL VOCABULARY

cell an individual box on a spreadsheet that holds information

formula a calculation that allows two or more cells to be calculated together.

	A	B	C	D	E
1					
2					
3					
4					

▲ **Figure 2.2** Getting to know your spreadsheet

Spreadsheets are used to provide financial budgets or cash-flow budgets, and non-current asset registers. They are also used to calculate loan interest payments, and many other sums.

A computer software spreadsheet allows data to be presented in a tabular format. The electronic document can be saved and updated when necessary. Examples of spreadsheet programs include Microsoft® Excel®, Apple® Numbers®¹ from Apple Office Suite and Google® Sheets™².

A spreadsheet is a series of cells presented in rows and columns. Numerical data or words can be entered into the sheet. For example, row 3, column D and cell B2 are highlighted in **Figure 2.2** (left).

When the details have been input into the spreadsheet, users can add calculations using set **formulae**. This speeds up the process of inputting data as the spreadsheet can automatically total columns or rows as needed, for example. It can also be used as a planning tool for different scenarios such as increases or decreases in revenue and how this impacts profit.

For example, cell C4 could have a formula inserted so it automatically subtracts cell C3 from cell C2.

Spreadsheets have speeded up the accounting process as they allow data to be presented in a number of different ways and can be easily adapted and changed.

2.3 ADVANTAGES AND DISADVANTAGES OF ACCOUNTING SOFTWARE

There are many advantages and disadvantages of using accounting packages. The following are particularly important.

Accounting software allows financial statements to be produced more quickly than traditional hand-written methods. The use of pre-programmed formulae and layouts means that financial data only needs to be entered once. The

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 GOOGLE® SHEETS™ IS A TRADEMARK OF GOOGLE INC

	A	B	C
1			£
2		Revenue	2000
3		Costs	600
4		Profit or Loss	
5			

This can be automatically calculated by the spreadsheet software

▲ Figure 2.3 Spreadsheet software can be programmed to make calculations

SUBJECT VOCABULARY

back up to make a copy of information stored on a computer

DID YOU KNOW?

Data must be **backed up** regularly based on the needs of the business.

software can then make various uses of this information, and can store it in different ways. The software can use data provided to complete all aspects of a transaction, such as generating documentation (once programmed by the user) and providing reporting functions.

ADVANTAGES

- Data is entered and processed very rapidly, much faster than in a manual system.
- Accuracy is improved since data is only entered once and documents are updated automatically. In a manual system, data may have to be entered twice or more.
- Documents such as invoices, credit notes, statements and remittance advices can be produced easily and quickly.
- Accounting records are updated in real time, so they accurately reflect customers' accounts. This enables remedial action to be taken if necessary.
- Management information can quickly be made available in report form, for example, aged trade receivables and trade payables analysis reports.
- A system connected to the internet can make financial transactions electronically.
- Resources can be used more efficiently, for example, by needing fewer accounting staff.
- Documents can be shared online, or scanned and saved, reducing filing space.

DISADVANTAGES

- Installation can be expensive. Ongoing maintenance and updating costs can also be high.
- The introduction of the system will affect most other areas of the business, which may lead to considerable disruption. Staff may also be resentful of a new system.
- Staff will need to be trained to use the system. There will be training costs.
- System downtime can be very disruptive.
- Data back-up at regular intervals is essential.
- Fraudulent access can seriously affect the business's operation and its profitability.
- Security measures are vital. For example, passwords for staff and protection against viruses and hacking.
- There are health risks associated with the use of computer keyboards and screens. These include eyestrain, back problems due to poor posture, and muscular fatigue in the arms and wrists from keyboard use. Regular rest intervals away from workstations are essential.

SKILLS PROBLEM SOLVING

CASE STUDY: MONITORING INVENTORY USING IT



▲ This business imports motorcycle components to make up and sell as motorcycles.

Ahmed owns a small manufacturing business in Colombo, Sri Lanka. The business imports motorcycle components from all over China and India. Ahmed then manufactures the motorcycles to sell in Sri Lanka. Ahmed sometimes struggles to keep up to date with all his inventory as he can receive up to 10 deliveries a day and the boxes aren't clearly labelled. Ahmed doesn't employ a lot of staff so these boxes of components may not be opened for days and are not organised in a specific order. Ahmed needs to monitor his inventory levels as he sometimes encounters problems when he runs out of parts or cannot locate the components he needs. Produce a presentation to show Ahmed why he should introduce an IT inventory system to monitor his inventory levels.

2.4 DATA LOSS

Protection of data is vitally important to any business for reasons of record maintenance as well as access and security.

It is important that data held on a computer is saved regularly, and protected against data loss. Electronic data can be stored by different methods; for example, on a hard drive or a memory stick. Both of these types of storage devices can be encrypted or password protected. This would stop access to the data if the devices were lost or stolen.

It is also vital to back up data held on the system. Most operating systems offer an option to automatically back up material at regular intervals. This means that a temporary copy of your document is held, for example on the hard drive. If you do lose material, or forget to save it, a back up means that you can recover the information. Operating systems also include the option to 'restore' data, either to the last saved version, or to a specified back-up version. If you don't back up your data, and make sure that you have activated the 'restore' functionality, you risk having to start your accounts from scratch.

2.5 SECURITY

All organisations regard their financial information as sensitive. Most want their financial information to remain confidential, except when legislation demands that certain information is made available to external bodies. Preventing unauthorised access to electronic accounting data is vital.

KEY POINT

When a system uses internet connections, there is the constant threat of fraudulent access and corruption.

Staff working on computerised accounting systems are allocated passwords that restrict access to their area of work. Passwords should be changed regularly to help prevent the possibility of non-authorised persons accessing the system. Most computer systems have packages to resist viruses and attack by hacking. These systems must be constantly reviewed and updated.

Most medium-sized or large organisations will use computer networks rather than standalone computers. This calls for extra security measures, such as ensuring that the network is not public.

To protect your hardware and software it is worth taking the following actions.

▼ ACTION	▼ BENEFIT
Install a firewall	This helps to control the information that goes to and from your computer. It can block internet traffic based on the security features you select.
Install antivirus software	This will search for, detect and remove any possible viruses on your computer and prevent new viruses from damaging your files.
Install anti-spyware software	This stops programs such as malware from being installed on your computer. Malware allows other users to look at your work and may allow someone else to take control of your computer.
Use complex and secure passwords	Always make sure your password contains upper and lowercase letters, numbers and symbols. Never write down your passwords. You must change your password regularly.
Check the security settings on your internet browsers	You can set your internet zone security to high or medium.

SKILLS REASONING

CASE STUDY: ACCOUNTING SOFTWARE



▲ Chefs don't only cook, they also need to organise their accounts.

EXAM HINT

Always relate your answers on IT to accounting. If you don't you will lose important marks as you haven't applied your knowledge.

Anson Lau owns several restaurants in Macau. Each restaurant runs its own paper-based accounting system.

It is therefore difficult for Mr Lau to manage his business. He visits each restaurant at least once a week, and has to file accounts for each outlet separately. This is both expensive and time-consuming.

Explain the benefits to Mr Lau of using (an) accounting software (package).

END OF CHAPTER QUESTIONS

- 1 Explain the different ways in which you can protect your financial information on a computer.
- 2 Explain **two** ways that you may be able to send financial data electronically.
- 3 Give **three** advantages of using ICT in accounting.
- 4 Give **three** disadvantages of using ICT in accounting.

END OF CHAPTER CHECKLIST

- Computers are widely used in organisations for operating accounting systems.
- Most computerised accounting software packages are integrated systems and communicate with each other.
- It is essential that users of computerised systems regularly back up their data to stop potential catastrophic loss of data.
- There are many advantages to using computer accounting software. These include speed, accuracy, cost effectiveness and the ease of producing financial reports.
- The disadvantages include the cost of software and hardware, the training of staff and potential security concerns.

EXAM PRACTICE

A01 Answer ALL questions in this section. Questions 1–4 must be answered with a cross in the appropriate box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

1 Which software is an accountant most likely to use for recording customers' addresses?

- ☐ A spreadsheets
- ☐ B databases
- ☐ C word processing programs
- ☐ D internet (1 mark)

2 What is electronic mail used for?

- ☐ A to send and receive messages over a network
- ☐ B to send and receive messages via the internet
- ☐ C to send and receive messages via radio waves
- ☐ D all of the above (1 mark)

3 In spreadsheets, what are values, formulae and labels stored in?

- ☐ A ranges
- ☐ B functions
- ☐ C labels
- ☐ D cells (1 mark)

4 What is computer hardware?

- ☐ A a medium for data communications
- ☐ B a physical device driven by data
- ☐ C a physical device driven by software
- ☐ D all of the above (1 mark)

(Total 4 marks)

3.4 PROFESSIONAL ETHICS



▲ Certain standards of behaviour are expected in corporate life.

SKILLS INTERPRETATION

LEARNING OBJECTIVES

- Describe the principles of professional ethics
- Apply the principles of professional ethics to accounting roles and functions
- Explain the concept of public interest and how it is applied to accounting roles and functions

GETTING STARTED

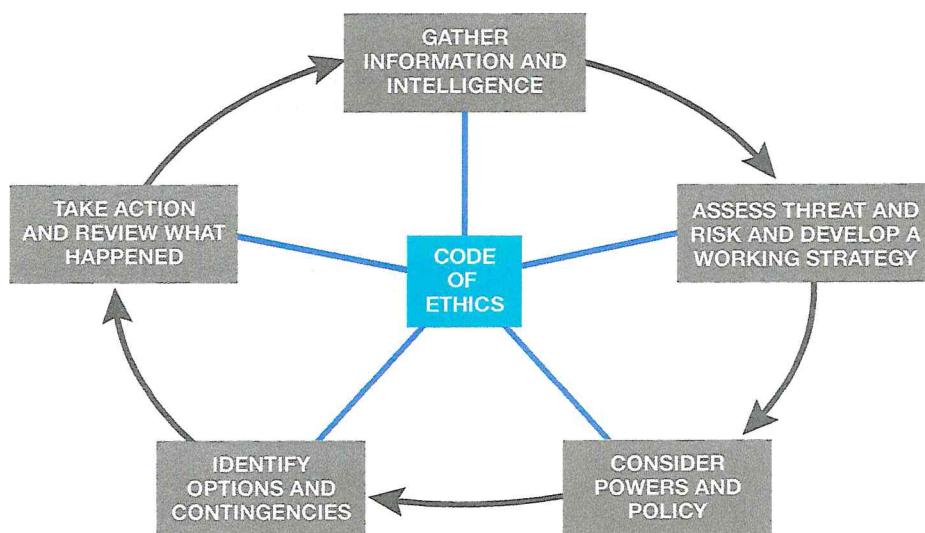
In this chapter, we will explore the importance of ethics in accounting and learn about some of the different roles in accounting. We will also look at what is meant by the term 'public interest'.

ACTIVITY

Why do you think accountants have to have a code of ethics? Use the internet to research some news stories about accounting fraud and see how many examples you can find of accountants being unethical.

3.1 THE PRINCIPLES OF PROFESSIONAL ETHICS

Professional ethics are the personal and corporate rules that govern behaviour within a particular organisation or profession. They are professionally accepted standards of personal and business behaviour. Sometimes they are called codes of practice. Professionals use these rules as a guide to perform their jobs based on sound and consistent ethical principles.



▲ Figure 3.1 Code of ethics

Professional ethics in accounting has five main aspects:

1 INTEGRITY

This refers to fair dealing and trustworthiness. An accountant must be straightforward and honest in all professional and business relationships. An accountant must not knowingly produce financial statements or financial reports that contain false or misleading information. In addition, they must not produce financial statements or financial reports that deliberately omit any data that could lead to misunderstandings. Behaving with integrity also includes not taking bribes to change the data they are presenting.

Example 1 A business must not overstate its profits by implying that its costs are lower than they are. For example, underestimating the depreciation figure for non-current assets is comparable to stating that these assets will last longer than they will. If depreciation is entered as £4,000 instead of £10,000, profit and the net assets of the business will be inflated by £6,000.

Example 2 A business must not overstate the value of its assets. If closing inventories are valued at £20,000, rather than the correct figure of £16,000, profit will increase by £4,000 and the net assets will also increase by £4,000.

2 OBJECTIVITY

All accountants must make their own judgements on the accounts. Accountants must be free from bias or conflict of interest and must not be under the influence of others. Behaving with integrity includes not preparing the accounts of a family member or for a company that they have shares in.

Example 1 A business owner's personal expenses should not be put through the books of the business. These expenses should be recorded as 'drawings' instead. If a business owner put his or her personal motor expenses through the business, this would be an example of not being objective. It would mislead stakeholders of the business and would lower the business' overall profit.

Example 2 If you prepare accounts of a family member you may not be objective or unbiased when valuing assets or calculating profit, and therefore may show the business to be in a better financial position than it actually is.

DID YOU KNOW?

The International Federation of Accountants represents over 3 million accountants in over 130 countries: www.ifac.org

3 PROFESSIONAL COMPETENCE AND DUE CARE

This rule requires all accountants to keep up to date with any changes in accounting policies and regulations. Accountants' knowledge and skills must be relevant so their clients receive a professional service. This includes becoming qualified to the appropriate level and maintaining the standard expected of a professional accountant.

Example 1 Accountants must keep up to date with all the latest terminology and regulatory framework.

Example 2 Accounting firm managers should carry out skills analysis of the work force and make sure that only competent and fully qualified staff are producing the financial documents. Staff must also act in a professional manner at all times and produce work in a timely manner.

4 CONFIDENTIALITY

Accountants have a legal obligation to maintain the confidentiality of materials they have been given. This includes not giving key information to third parties such as competitors or investors, as this could break confidentiality agreements. However, there are some cases where accountants may have to

SUBJECT VOCABULARY

money laundering hiding illegally obtained money in a business, e.g. exchanging good money (notes and coins) for stolen money through normal day-to-day business transactions

break confidentiality to be able to comply with the law. One example of this would be a client trying to deceive the government by paying less tax. Another example would be when an accountant finds evidence of **money laundering**.

Example 1 An accountant should not give out financial information to third parties without the permission of the business. If a competitor is given access to a company's revenue and costs, this would give them an advantage, for example regarding pricing.

Example 2 If an investor is given access to confidential financial information, they might decide not to invest and could prevent the expansion of that business.

5 ADOPT PROFESSIONAL BEHAVIOUR

This imposes an obligation on all accountants to comply with all relevant laws and regulations so as not to bring the accounting profession into disrepute. An example would be exaggerating your accounting skills or making unprofessional comments about colleagues or other accounting professionals.

Example 1 An accountant should never overestimate their accounting skills when trying to attract new clients. For example, it is unprofessional to claim that you are a specialist in tax accounting when this is not the case.

6 PUBLIC INTEREST

Accountants need to behave in the public interest, i.e. in a manner so that the public can have confidence that profits stated are true and fair. They must not mislead the public with overstated figures when producing accounts for a firm.

Example 1 If the public believe that financial accounts are biased they may start to lose faith in all financial reports and will stop investing their money. This would mean that firms wouldn't grow and expand.

CASE STUDY: THE SATYAM SCANDAL

Satyam Computer Services was an Indian IT services company. In 2009, they were charged with falsifying their books of accounts. B. Ramalinga Raju, the company's former chairman, admitted that 95% of the cash in the business was false. Due to this acknowledgement, investors in Satyam lost around Rs14 000 crore (\$2.2 billion) as Satyam's shares fell. B. Ramalinga Raju was arrested and sentenced to seven years in jail.

Why must companies behave in an ethical manner?

3.2 ACCOUNTING ROLES AND FUNCTIONS

There are many different roles within an accounting department. Departments are organised in different ways and the way they operate can vary greatly. However, most accounting roles usually cover the same five areas:

- 1 Accounts payable.** This role is responsible for keeping a check on the money that goes out of the business to pay for bills and expenses. Payments have to go out on time. The role also involves maintaining good relationships with trade payables and checking the business is getting the best deals, for example by seeing if any discounts are available. In this role, it is important to ensure no costs are incurred for late payments and no interest is incurred.

- 2 Accounts receivable.** This role involves checking that the business has received all the money it is entitled to. This includes tracking invoices to make sure they are paid on time. A 'friendly' reminder service can be set up for customers to make sure no irrecoverable debts occur.
- 3 Payroll.** This is a critical part of an accountancy department, ensuring that all staff are paid on time and the government receives the correct amount of tax.
- 4 Reporting and financial statements.** This role involves preparing financial reports for internal and external use. This could include budgets and forecasting to check the viability of a new product or store. The Income Statement, Statement of Financial Position and Statement of Cash Flow for the company's Annual Report, may also need to be provided, as well as information for possible investors, banks and other professionals who are involved in the development of the company.
- 5 Checking the accounts.** This role is responsible for controlling the finances of the business, for example, ensuring that the correct procedures are followed and the correct accounting standards are adhered to. This role also involves putting systems in place to show compliance and to protect against fraud and theft. This is sometimes called the internal audit.

3.3 PUBLIC INTEREST

To understand the term **public interest**, it is easier to look at what is meant by the term 'public' and what is meant by the term 'interest'.

For accountants, the term 'public' includes the following.

- **Investors, owners and business owners of public sector and private sector organisations.** These parties require good financial information that is free from bias. They need to base their actions and decisions on the most reliable data.
- **Customers and competitors.** These parties rely on sound financial information as decisions based on this data could have significant impacts on the costs and benefits to them.
- **Taxpayers.** Any financial information that may have a detrimental impact on taxpayers is of significant interest to these parties.

The term 'interest' can be defined as all things that are valued by society. This includes economic wellbeing and certainty in the business environment. Sound financial information must be given to stakeholders so that they are not misled. Comparing the financial information from two different companies allows investors to make the best decisions. Sound financial data can improve the efficiency and lower the costs of government and private organisations. The term 'interest' also includes financial information that leads to the protection of the environment and reduces the depletion of natural resources.

To act in the 'public interest', accountants must work towards the highest levels of ethical and professional standards. Accountants are required to produce high quality financial statements that are audited to ensure accuracy. There is an international code of conduct for all accountants across the globe. They also need to guarantee that there are rigorous checking systems. Accountants who behave in an unethical manner are dealt with through strict structures of disciplinary measures and sanctions.

DID YOU KNOW?

The International Ethics Standards Board for Accountants® (IESBA®) is an independent standard-setting body that serves the public interest by setting robust, internationally appropriate ethics standards, including auditor independence requirements, for professional accountants worldwide: www.ethicsboard.org

INTRODUCTION TO ACCOUNTING CONCEPTS

At the end of a financial year organisations prepare their financial statements, i.e. Income Statement and Statement of Financial Position. There are, however, other issues to consider with the preparation of the financial statements which are known as 'accounting concepts' or 'rules of accounting'. These concepts or rules have evolved over the years for practical as much as theoretical reasons. As a consequence, this has made the preparation of the financial statements more standardised enabling the information to be more easily understood and reliable, and to enable clearer comparisons between different businesses. Accountants need to be ethical. They also have to follow the rules of accounting concepts. These will be covered in more detail in Chapter 13, but it is worth having a look at them now. There are certain rules and underlying concepts that accountants have to follow when preparing financial statements. These rules ensure stakeholders have faith in the accounts showing a 'true and fair' reflection of the business. If stakeholders invest in the business or buy goods, they want to be sure that their money will be secure.

HINT

Try to remember the **acronym** BMCAMP.

GENERAL VOCABULARY

acronym a word made up from the first letters of the name of something such as an organisation

The concepts that will feature in the exam are:

- **business entity**
- **materiality**
- **consistency**
- **accruals**
- **money measurement**
- **prudence.**

END OF CHAPTER QUESTIONS

- 1 Give **three** examples of financial statements.
- 2 Give **one** example of an accountant being objective.
- 3 Explain what is meant by the term confidentiality and give **one** example.
- 4 What is meant by the term 'public interest'?
- 5 How can an accountant adopt a professional manner?
- 6 Explain **three** roles of an accountant.

END OF CHAPTER CHECKLIST

- Accountants have to follow the principles of professional ethics.
- An accountant must not provide information that could mislead clients or third parties.
- All accountants must be suitably qualified and keep up to date with new accounting procedures.
- Accountants must not provide materials that could go against the public interest.

EXAM PRACTICE

A01 Answer ALL questions in this section. Questions 1–5 must be answered with a cross in the box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

1 Which accounting objective states that the information in financial statements must be free from error and bias?

- ☐ A comparability
 - ☐ B relevance
 - ☐ C reliability
 - ☐ D confidentiality
- (1 mark)

2 What are accounts produced to show?

- ☐ A an accurate and fair view of the business
 - ☐ B a true and fair view of the business
 - ☐ C a true and honest view of the business
 - ☐ D a fair and honest view of the business
- (1 mark)

3 Who does the term 'public' refer to when used in accountancy?

- ☐ A owners
 - ☐ B employees
 - ☐ C customers
 - ☐ D suppliers
- (1 mark)

4 Which of the following is not an accounting concept?

- ☐ A materiality
 - ☐ B auditory
 - ☐ C objectivity
 - ☐ D consistency
- (1 mark)

5 Which of the following is not one of the main aspects of professional ethics?

- ☐ A identity
 - ☐ B integrity
 - ☐ C objectivity
 - ☐ D confidentiality
- (1 mark)

(Total 5 marks)