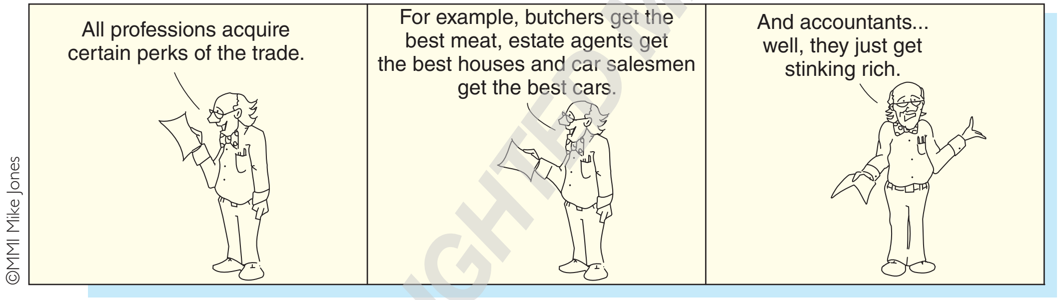
Chapter 1

Introduction to accounting

'One way to cheat death is to become an accountant, it seems. The Norfolk accountancy firm W.R. Kewley announces on its website that it was "originally established in 1982 with 2 partners, one of whom died in 1993. After a short break he re-established in 1997, offering a personal service throughout." He was, feedback presumes, dead only for tax purposes.'

New Scientist, 1 April 2000, vol. 166, no. 2232, p. 96. © Reed Business Information Ltd, England. Reproduced by permission. http:www.newscientist.com/article/mg16622327.100-feedback.html.



Learning Outcomes

After completing this chapter you should be able to:

- Explain the nature and importance of accounting.
- Outline the context which shapes accounting.
- Identify the main users of accounting and discuss their information needs.
- Distinguish between the different types of accountancy and accountant.

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Chapter Summary

- Accounting is the provision of financial information to managers or owners so that they can make business decisions.
- Accounting measures, monitors and controls business activities.
- Financial accounting supplies financial information to external users.
- Management accounting serves the needs of managers.
- Users of accounting information include shareholders and managers.
- Accounting theory and practice are affected by history, country, technology and organisation.
- Auditing, bookkeeping, financial accounting, financial management, insolvency, management accounting, taxation and management consultancy are all branches of accountancy.
- Accountants may be members of professional bodies, such as the Institute of Chartered Accountants in England and Wales.
- Although very useful, accounting has several limitations such as its historic nature and its failure to measure the non-financial aspects of business.

Introduction

The key to understanding business is to understand accounting. Accounting is central to the operation of modern business. Accounting enables businesses to keep track of their money. If businesses cannot make enough profit or generate enough cash they will go bankrupt. Often accounting is called the 'language of business'. It provides a means of effective and understandable business communication. If you understand the language you will, therefore, understand business. However, like many languages, accounting needs to be learnt. The aim of this book is to teach the language of accounting.

Nature of Accounting

At its simplest, accounting is all about recording, preparing and interpreting business transactions. Accounting provides a key source of information about a business to those who need it, such as managers or owners. This information allows managers to monitor, plan and control the activities of a business. This enables managers to answer key questions such as:

- How much profit have we made?
- Have we enough cash to pay our employees' wages?
- What level of dividends can we pay to our shareholders?
- Should we expand our product range?

PAUSE FOR THOUGHT 1.1

Some Accounting Questions

You are thinking of manufacturing a new product, the superwhizzo. What are the main accounting questions you would ask?

The principal questions would relate to sales or revenue, costs and profit. They might be:

- What price are rival products selling at?
- How much raw material will I need? How much will it cost?
- How many hours will it take to make each superwhizzo and how much is labour per hour?
- How much will it cost to make the product in terms of items such as electricity?
- How should I recover general business costs such as business rates or the cost of machinery wearing out?
- How much profit should I aim to make on each superwhizzo?

In small businesses, managers and owners will often be the same people. However, in larger businesses, such as public limited companies, managers and owners will not be the same. Managers will run the companies on behalf of the owners. In such cases, accounting information serves a particularly useful role. Managers supply the owners with financial information in the form of an income statement, a statement of financial position and a statement of cash flows. This enables the owners to see how well the business is performing. In companies, the owners of a business are called the shareholders.

Essentially, therefore, accounting is all about providing financial information to managers and owners so that they can make business decisions (see Definition 1.1). The formal definition (given below), although dating from 1966, has stood the test well as a comprehensive definition of accounting.

DEFINITION 1.1

Accounting

Working definition
The provision of information to managers and owners so that they can make business decisions.

Formal definition
'The process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.'

Source: American Accounting Association (1966), *Statement of Basic Accounting Theory*, p. 1.

Importance of Accounting

Accounting is essential to the running of any business or organisation. Organisations as diverse as Microsoft, Barclays Bank, General Electric Company, Volkswagen, The Royal Society for the Protection of Birds (RSPB) and Manchester United football club all need to keep a close check on their finances.

At its simplest, money makes the world go round and accounting keeps track of the money. Businesses depend on cash and profit. If businesses do not make enough cash or earn enough profit, they will get into financial difficulties, perhaps even go bankrupt. Accounting provides the framework by which cash and profit can be monitored, planned and controlled.

Unless you can understand accounting, you will never understand business. This does not mean everybody has to be an expert accountant. However, it is necessary to know the language of accounting and to be able to interpret accounting numbers. In some respects, there is a similarity between learning to drive a car and learning about accounting. When you are learning to drive a car you do not need to be a car mechanic. However, you have to understand the car's instruments, such as a speedometer or fuel gauge. Similarly, with accounting, you do not have to be a professional accountant. However, you do need to understand the basic terminology such as income, expenses, profit, assets, liabilities, equity and cash flow.

PAUSE FOR THOUGHT 1.2

Manchester United

What information might the board of directors of Manchester United find useful?

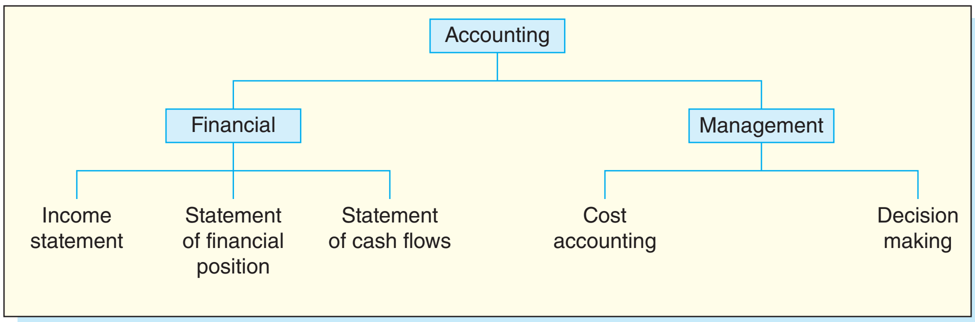
Manchester United is both a football club and a thriving business. Indeed, the two go hand in hand. Playing success generates financial success, and financial success generates playing success. Key issues for Manchester United might be:

- How much in gate receipts will we get from our league matches, cup matches and European fixtures?
- How much can we afford to pay our players?
- How much cash have we available to buy rising new stars and how much will our fading old stars bring us?
- How much will we get from television rights and commercial sponsorship?
- How much do we need to finance new capital expenditure, such as building a new stadium?

Financial Accounting and Management Accounting

There is a basic distinction between financial accounting and management accounting. Financial accounting is concerned with information on a business's performance and is targeted primarily at those outside the business (such as shareholders). However, it is also used internally by managers. By contrast, management accounting is internal to a business and used solely by managers. A brief overview is provided in Figure 1.1.

Figure 1.1 Overview of Financial and Management Accounting



Financial Accounting

Financial accounting is the provision of financial information on a business's recent financial performance targeted at external users, such as shareholders. However, internal users, such as management, may also find it useful. It is required by law. Essentially, it is backward-looking, dealing with past events. Transactions are initially recorded using double-entry bookkeeping (see Chapter 3). Three major financial statements can then be prepared: the income statement, the statement of financial position and the statement of cash flows (see Chapters 4–8). In this book, I primarily use these three terms. They are the terms used by the International Accounting Standards Board (IASB) in International Financial Reporting Standards (IFRS). IFRS are widely used worldwide, for example, by listed companies in Europe (see Chapter 14 for more details). However, there are also often national reporting rules. In the UK, for example, Generally Accepted Accounting Principles (GAAP) are often used by UK non-listed companies. Alternative terminology is used as follows: income statement (alternative profit and loss account), statement of financial position (alternative balance sheet) and statement of cash flows (alternative cash flow statement). These standards are then interpreted using ratios (see Chapter 9) by users such as shareholders and analysts.

Management Accounting

By contrast, management accounting primarily serves the internal needs of organisations. Management accounting can be divided into cost accounting and decision making. In turn, cost accounting can be split into costing (Chapter 16) and planning, control and performance:

SOUNDBITE 1.1

Investment Analysts

'Over-paid, under-qualified and inappropriately influential. That seems to be the conventional view of that rampaging beast, the city analyst.'

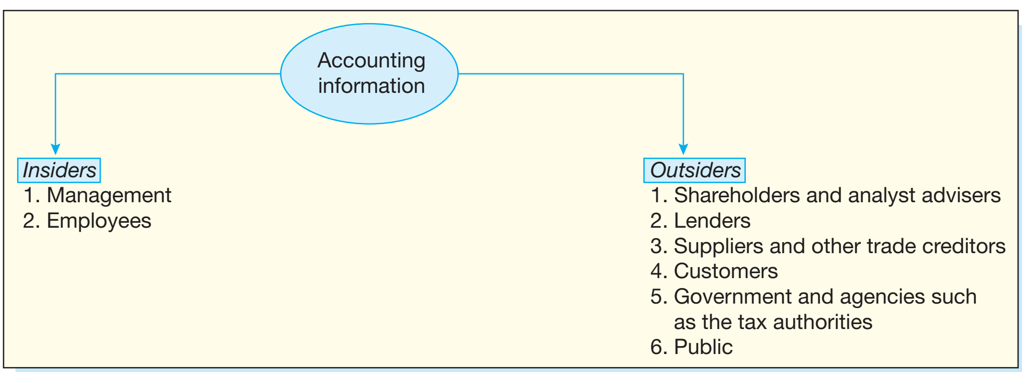
Source: Damian Wild, *Accountancy Age*, 21 October 2004, p. 14.

budgeting (Chapter 17) and standard costing (Chapter 18). Decision making is divided into short-term decisions (Chapter 19) and long-term decision making (Chapters 20–21). In Chapter 22 both short-term and long-term sources of finance are considered.

Users of Accounts

The IASB now takes a relatively narrow view of the users of accounts identifying only investors, lenders and other creditors in its 2010 conceptual framework. However, there are in fact many more.The users of accounting information may broadly be divided into insiders and outsiders (see Figure 1.2). The insiders are the management and the employees. However, employees are also outsiders in the sense that they often do not have direct access to the financial information. The primary user groups are management and shareholders. Shareholders or investors are often advised by professional financial analysts who work for stockbrokers or big city investment houses. These financial analysts help to determine the share prices of companies quoted on the stock exchange. However, sometimes, they are viewed with mistrust (see Real-World View 1.1).

Figure 1.2 Main Users of Accounting Information



REAL-WORLD VIEW 1.1

Financial Analysts

Working with analysts is a little like being a member of the Magic Circle or the freemasons – those who know how to perform these masterful sleights of hand or arcane rituals are forbidden from ever revealing them to outsiders. Of course, the alternative is that I can't reveal them because I don't understand them myself – I'll let you decide.

Source: James Montier, Showbiz values come to the City, *The Guardian*, 15 January 2000, p. 5. Guardian Newspapers Ltd 2000. Reproduced by permission of James Montier.

The influence of other users (or stakeholders) is growing in importance. Suppliers, customers and lenders have a closer relationship to the company than the government and tax authorities, or the public. These users all need accounting information to help them make business decisions. Usually, the main information requirements concern a company's profits, cash flow, assets and debt (see Figure 1.3).

Figure 1.3 User Information Requirements

User Group	*Possible Information Requirements*
Internal Users	
1. Management	Information for costing, decision making, planning and control.
2. Employees and employee organisations (Trade Unions)	Information about job security and for collective bargaining.
External Users	
1. Shareholders (current and potential)	Information for buying and selling shares.
2. Analysts advisers (brokers, dealers)	Information for buying and selling shares.
3. Lenders (bank, creditors)	Information about assets and the company's cash position.
4. Business contacts (competitors, suppliers, buyers)	Information about the long-term prospects and survival of the business and the company's cash position.
5. Government and agencies (such as tax authorities, government statistical and departments)	Information to enable governmental planning, information primarily on profits to use as a basis for calculating tax.
6. Public (e.g., individual citizens, local communities, educational groups or non-governmental organisations such as Greenpeace)	Information about the social and environmental impact of corporate activities.

Shareholders, for example, require information so that they can decide whether to buy, hold or sell their shares. The information needs of each group differ slightly and, indeed may conflict (see Pause for Thought 1.3).

PAUSE FOR THOUGHT 1.3

Conflicting Interests of User Groups

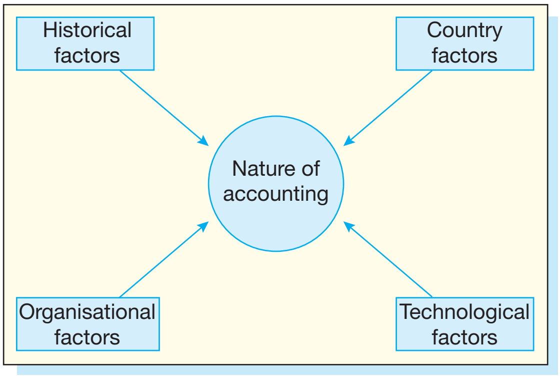
Can you think of an example where the interests of users might actually conflict?

A good example would be in the payment of dividends to shareholders. The higher the dividend, the less money is kept in the company to pay employees or suppliers. Another, more subtle, example is the interests of shareholders and analyst advisers. Shareholders own shares. However, they rely on the advice of analyst advisers such as stockbrokers. Their interests may superficially seem the same (e.g., selling underperforming shares and buying good performers). However, the analyst advisers live by the commission they make. It is in their interests to advise shareholders to buy and sell shares. Unfortunately, it costs money to buy and sell shares; therefore, this may not always be in the potential shareholders' best interests.

Accounting Context

It is important to realise that accounting is more than just a mere technical subject. Although it is true that at the heart of accounting there are many techniques. For example, as we will see in Chapter 3, double-entry bookkeeping is essential when preparing financial statements. However, accounting is also determined by the context in which it operates. Accounting changes as society changes. Accounting in medieval England and accounting today, for example, are very different. Similarly, there are major differences between accounting in Germany and in the United Kingdom. We can see the importance of context if we look briefly at the effect of history, country, technology and organisation (see Figure 1.4).

Figure 1.4 Importance of Accounting Context



History

Accounting is an integral part of human society. Early societies had accounting systems which, although appearing primitive to us today, served their needs adequately. The Incas in South America, for example, used knotted ropes, called quipus, for accounting. In medieval England notched sticks called tally sticks were used to record transactions.

PAUSE FOR THOUGHT 1.4

The Term 'Accounting'

Why is accounting so called?

It is believed that accounting derives from the old thirteenth-century word *aconter*, to count. At its simplest, therefore, accounting means counting. This makes sense as the earliest accountants would have counted sheep or pigs!

Gradually, over time, human society became more sophisticated. A form of accounting called double-entry bookkeeping (every transaction is recorded twice) arose. Emerging from Italy in the fifteenth century, at the same time that Columbus discovered America, double-entry bookkeeping is now the standard way by which accounting transactions are recorded throughout the world.

International Accounting

Double-entry bookkeeping, the income statement (the profit and loss account) and the statement of financial position (balance sheet) are now routine in most major countries. The International Accounting Standards Board (IASB) is also making great efforts to harmonise the disclosure and measurement practices of listed companies worldwide and publishes International Financial Reporting Standards (IFRS). However, there is still great diversity in the broader context in which accounting is carried out. These differences are explained more fully in Chapter 14.

SOUNDBITE 1.2

'We now operate in a global marketplace, and this is driving the need for universal professional standards and the global qualifications that can deliver them'.

Source: Chris Ward, One World, One Revision, *Accountancy Age*, 11 April 2005, p. 16.

Accounting in the UK, for example, is very different from accounting in France despite the fact that both countries are members of the European Union. Listed companies in both France and the UK, however, do have to follow IFRS. However, for non-listed companies and other enterprises, the situation is very different. The UK traditionally has been proud of a flexible and self-regulated accounting system largely free of government control. By contrast, the French system has traditionally been very standardised and largely governmentally controlled. In general, as Soundbite 1.2 shows, accounting plays an important role globally.

There are also clear differences between the UK and the US. For example, in the UK, there are Companies Acts, which apply to all UK companies whereas in the US only companies quoted on the stock exchange (i.e., listed companies) are subject to detailed and comprehensive Federal regulations. Also, US listed companies, unlike those in the UK, do not have to comply with IFRS. Unlisted companies are subject only to state regulations, which vary from state to state.

Technology

A rapid change which has affected accounting is computerisation. Up until the advent of computers, accounting was done manually. This was labour-intensive work. Each transaction was entered into the books twice using double-entry bookkeeping. The accounts were then prepared by hand. Similarly, costing, budgeting and decision making were all carried out manually.

Today, almost all businesses use computers. However, they must be used with caution. For the computer, GIGO rules. If you put garbage in, you get garbage out. To avoid GIGO, one needs to understand accounting. In fact, computerisation probably makes it more, rather than less, important to understand the basics.

Organisations

The nature of accounting will vary from business to business. It will depend on the structure of the business and the nature of the business activity.

Structure

If we take the accounts of the three types of business enterprise with which this book deals; a sole trader's accounts will normally be a lot simpler than those of either a partnership or a company. Sole traders generally run smaller, less complicated businesses (for example, a small butcher's shop). Partnerships are multi-owned businesses typically larger in size than sole traders. The sole traders' and partnerships' accounts will normally be less complicated than company accounts as they are prepared for the benefit of active owner-managers rather than for owners who do not actually run the business.

Nature of the Business

Every organisation is different. Consequently, every organisation's accounts will differ in certain respects. For example, property companies will own predominantly more land and buildings than non-property companies. Manufacturing companies will have more inventory than non-manufacturing companies.

It is clear from Figure 1.5 that the nature of revenue or sales varies from business to business. In some businesses, a service is provided (e.g., bank, football club, insurance company and plumber).

Company Snapshot 1.1 shows the sales revenue (sometimes termed turnover) of Manchester United plc, mainly gate receipts, television and merchandising, which are generated by entertaining its customers.

Figure 1.5 Nature of the Revenue

Business	***Nature of Main Revenue***
Bank	Interest received
Football club	Gate receipts
Insurance company	Premiums received
Manufacturing company	Sales of goods to retailers
Plumber	Sales of services and other goods
Shop	Sales of goods to customers

COMPANY SNAPSHOT 1.1

Turnover [i.e., revenue or sales]

Turnover, all of which arises from the Group's principal activity, can be analysed into its main components as follows:

	Year ended 30 June 2010 £'000	Year ended 30 June 2009 £'000
Match Day	100,164	108,799
Media	104,814	99,735
Commercial	81,438	69,942
	286,416	278,476

Turnover, all of which originates in the United Kingdom, can be analysed by destination as follows:

	Year ended 30 June 2010 £'000	Year ended 30 June 2009 £'000
United Kingdom	283,552	272,021
Rest of world – tour income	2,864	6,455
	286,416	278,476

Media income from European cup competitions is distributed by the Football Association and is therefore classified as being of United Kingdom origin and destination.

The Group's activities are managed as one business and, as such, the operating expenses are not separately identifiable to any particular segment. As a result, no segmental analysis of operating performance or net assets is provided.

Source: Manchester United Ltd, *Annual Report and Financial Statements for the Year Ended 30 June 2009*, p. 21.

In other businesses, the sale is more tangible as goods change hands (for example, manufacturing companies and shops).

Overall, within the UK economy, services are becoming relatively more important and manufacturing industry is declining. In particular, there is an increase in information technology and knowledge-based industries. This trend is set to continue.

Types of Accountancy

We need to distinguish between the types of accountancy and the types of accountant. Accountancy refers to the process, while accountant refers to the person. In other words, accountancy is what accountants do! In this book, we primarily focus on bookkeeping, financial accounting and management accounting. However, accountants perform other roles such as auditing, financial management, insolvency, fraud detection, taxation and management consultancy. All of these are briefly covered below. Auditors charge management audit and consultancy fees. For example, KPMG, a firm of auditors, charged HSBC Holdings £24.5 million in 2008 for auditing and £17.2 million for consultancy services. Audit fees are shown for the banking system in the UK in 2008 in Real-World View1.2.

REAL-WORLD VIEW 1.2

Audit Fees

According to *Accountancy's* most recent survey of auditors' fees, the Big Four made £36.4m in non-audit fees and £90.6m in audit fees from their FTSE 100 banking clients last year.

Bank	Auditor	Audit fee (£m)	Related fee (£m)	Other services (£m)
Barclays	PwC	25.0	4.0	15.0
HBOS	KPMG	8.0	1.0	2.4
HSBC	KPMG	24.5	9.8	7.4
Lloyds TSB	PwC	9.3	3.8	1.5
RBS	Deloitte	17.0	4.9	9.3
StanChart	KPMG	6.8	1.5	0.8

Source: Emily Beattie, Don't Bank on it, *Accountancy Magazine*, June 2009, p. 17. Copyright Wolters Kluwer (UK) Ltd.

Auditing

Auditing is carried out by teams of staff headed by qualified accountants who are independent of the business. Essentially, auditors check that the financial statements, prepared by management, give a true and fair view of the accounts. Auditing is normally associated with company accounts. However, the tax authorities or the bank may request an audit of the accounts of sole traders or partnerships. For companies, auditors issue an auditor's report annually to shareholders. Company Snapshot 1.2 provides an auditors' report for J. Sainsbury plc. This is issued after a thorough examination by the auditors of the accounting records and systems of the company.

COMPANY SNAPSHOT 1.2

Independent Auditors' report to the members of J Sainsbury plc

We have audited the financial statements of J Sainsbury plc for the 52 weeks ended 20 March 2010 which comprise the Group income statement, the Group and Company Statements of comprehensive income, the Group and Company Balance sheets, the Group and Company Cash flow statements, the Group and Company Statement of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union and, as regards the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of Directors and Auditors

As explained more fully in the Statement of Directors' responsibilities set out on page 43, the Directors are responsible for the preparation of the Annual Report, the Remuneration report and financial statements. The Directors are responsible for being satisfied that the financial statements give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Company's affairs as at 20 March 2010 and of the Group's profit and the Group's and Company's cash flows for the 52 weeks then ended;

COMPANY SNAPSHOT 1.2 (*continued*)

- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the lAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006
In our opinion:

- the part of the Remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception
We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements and the part of the Remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made: or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 28, in relation to going concern; and
- the parts of the Statement of corporate governance relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

Robert Milburn (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
12 May 2010

Source: J. Sainsbury Plc, *Annual Report and Financial Statements 2010*, p. 44. Reproduced by kind permission of Sainsbury's Supermarkets Ltd.

Bookkeeping

Bookkeeping is the preparation of the basic accounts (bookkeeping is dealt with in more depth in Chapter 3). It involves entering monetary transactions into the books of account. A trial balance is then extracted, and an income statement and statement of financial position are prepared. Nowadays, most companies use computer packages for the basic bookkeeping function which is often performed by non-qualified accountants.

Financial Accounting

Financial accounting is a wider term than bookkeeping. It deals not only with the mechanistic bookkeeping process, but the preparation and interpretation of the financial accounts. For companies, financial accounting also includes the preparation of the annual report (a document sent annually to shareholders, comprising both financial and non-financial information). In orientation, financial accounting is primarily outward-looking and aimed at providing information for external users. However, monthly financial accounts are often prepared and used internally within a business. Within a company, financial accounting is usually carried out by a company's employees. Smaller businesses, such as sole traders, may use professionally qualified independent accountants.

Financial Management

An area of growing importance for accountants is financial management. Some aspects of financial management fall under the general heading of management accounting. Financial management, as its name suggests, is about managing the sources of finance of an organisation. It may, therefore, involve managing the working capital (i.e., short-term assets and liabilities) of a company or finding the cheapest form of borrowing. These topics are briefly examined in Chapter 22. There is often a separate department of a company called the financial management or treasury department.

Insolvency

One of the main reasons for the rise to prominence of professional accountants in the UK was to wind up failed businesses. This is still part of a professional accountant's role. Professional accounting firms are often called in to manage the affairs of failed businesses, in particular to pay creditors (trade payables or banks) who are owed money by the business.

Management Accounting

Management accounting covers the internal accounting of an organisation. There are several different areas of management accounting: costing (see Chapter 16), budgeting (see Chapter 17), standard costing (see Chapter 18), short-term decision making (see Chapter 19), strategic management accounting (see Chapter 20), capital investment appraisal (see Chapter 21) and management of working capital and sources of finance (see Chapter 22). Essentially, these activities aim to monitor, control and plan the financial activities of organisations. Management uses such information for decisions such as determining a product's selling price or setting the sales budget.

Fraud Detection

Accountants who detect fraud are often called forensic accountants. The frauds they investigate may be personal or corporate and often involve large amounts of money. Real-World View 1.3 shows an interesting example.

REAL-WORLD VIEW 1.3

Forensic Accounting

Case Study: Lust, Lies and the Law

I was once involved in a divorce case, acting on behalf of the wife. We believed her husband was withholding information about assets, and had not disclosed all of his income (wives tend to remember being told these things). We had to get hold of evidence.

We knew that the husband kept a large number of documents in his garage so, accompanied by the local police, the solicitor and I conducted a 6am visit to his house.

The husband's new girlfriend opened the door. Minutes later, she was replaced by a man carrying a shotgun, which he thrust in my face. Luckily, the local sergeant was quite relaxed and talked the man round by assuring him it wasn't worth killing me as I was, after all, 'only a bean counter'. I found out later that the gun wasn't loaded – it didn't make much difference. The husband had originally made an offer of £1m, but the documents we seized proved that he held a lot of assets in Switzerland. He increased the offer to £2.5m, and eventually paid out a total of £3m.

The final ironic twist in the saga was that he dropped his girlfriend and had an inappropriate affair with his solicitor.

The shotgun man was charged with threatening behaviour with a dangerous weapon. In the long term, it all made me more determined to fight for justice.

Steven Redhead is a member of the ICAEW forensic group, interviewed by Ruth Banks

Source: Ruth Banks, CSI Accountancy, *Accountancy Magazine*, June 2010, p. 106. Copyright Wolters Kluwer (UK) Ltd.

Taxation

Taxation is a complicated area. Professional accountants advise businesses on a whole range of tax issues. Much of this involves tax planning (i.e., minimising the amount of tax that organisations have to pay by taking full advantage of the often complex tax regulations). Thus, for example, Lisa O'Carroll (*Guardian*, 14 October 2011) commented that it had been calculated that over a three year period Google had 'saved $3.1 bn in tax revenues using a subsidiary located in Bermuda where the corporate tax rate is zero'. A Google spokesperson told the *Guardian* 'we have an obligation to our shareholders to set up a tax-efficient structure, and our present structure is compliant with the tax rules in all the countries where we operate.' This tax avoidance which operates within the law should be distinguished from tax evasion

SOUNDBITE 1.3

Management Consultancy

'[Definition of management consultancy] Telling a company what it should already know.'

The Economist (12 September 1987)

Source: The Wiley Book of Business Quotations (1998), p. 359.

which is illegal. Professional accountants may also help individuals with a scourge of modern life, the preparation of their annual income tax assessment.

Management Consultancy

Management consultancy is a lucrative source of income for accountants (see Real-World View 1.4). However, as Soundbite 1.3 shows, management consultants are often viewed cynically. Management consultancy embraces a whole range of activities such as special efficiency audits, feasibility studies and tax advice. Many professional accounting firms now make more money from management consultancy than from auditing. Examples of management consultancy are investigating the feasibility of a new football stadium or the costing of a local authority's school meals proposals.

REAL-WORLD VIEW 1.4

Management Consultancy

To be fair, many of these issues were problems of success. The accountancy industry had kick-started phenomenal growth and change in the management consultancy services it offered its client base. It was natural to sell those services to its existing clients who eagerly purchased the IT, strategy and financial management consultancy on top of the bog-standard audit and tax services. Suddenly audit became the poor relation, both in terms of excitement and financial return. Audit became a commodity and we all know what happens then – the product becomes devalued and the price goes down.

Source: Peter Williams, How the Brits started the Rot, *Accountancy Age*, 11 November 2004, p. 28.

Types of Accountant

There are several types of accountant. In the UK, for example, the most high-profile are those belonging to the six professionally qualified bodies. In addition to these accountancy bodies, there are other accounting associations in the UK, the most important of which is probably the Association of Accounting Technicians. The web addresses for these institutes are listed at the end of the chapter.

Professionally Qualified Accountants

Chartered Accountants

Six institutions of professionally qualified accountants currently operate in the UK (see Figure 1.6). All jealously guard their independence and the many attempts to merge have all failed (see Real-World View 1.5). 'It's like proposing that Manchester United and Manchester City merge, suggests one indignant ICAEW member, illustrating the strength of feeling' (Michelle Perry, *Accountancy Age*, 22 July 2004, p. 6).

Figure 1.6 Main UK Professional Accountancy Bodies

Body	*Main Activities*
Institute of Chartered Accountants in England and Wales (ICAEW)	Generally auditing, financial accounting, management consultancy, insolvency and tax advice. However, many work in industry.
Chartered Accountants Ireland (CAI)	Similar to ICAEW.
Institute of Chartered Accountants of Scotland (ICAS)	Similar to ICAEW.
Association of Chartered Certified Accountants (ACCA)	Auditing, financial accounting, insolvency, management consultancy and tax advice. Many train or work in industry.
Chartered Institute of Management Accountants (CIMA)	Management accounting.
Chartered Institute of Public Finance and Accounting (CIPFA)	Accounting within the public sector and privatised industries.

REAL-WORLD VIEW 1.5

Professional Accountancy Bodies

There have been several attempts to persuade the UK's accountancy bodies to merge over the past few years, all without much success. Six accountancy bodies is rather a lot and the government understandably gets exasperated from time to time by six (and sometimes seven) different responses to a consultation paper. But the bodies' members have consistently refused merger initiatives, always citing differing training requirements as a major consideration – and not without justification.

Source: Elizabeth Mackay, Big Five Pressure Gets Results, *Accountancy Age*, 9 March 2000, p. 18.

There are three institutes of chartered accountants: the Institute of Chartered Accountants in England and Wales (ICAEW), the Chartered Accountants Ireland (CAI) and the Institute of Chartered Accountants of Scotland (ICAS). The largest of these three is the ICAEW. Its members were once mainly financial accountants and auditors, but now take part in a whole range of activities. Many leave the professional partnerships with which they train to join business organisations. In fact, qualifying as a chartered accountant is often seen as a route into a business career.

Association of Chartered Certified Accountants (ACCA)

The ACCA's members are not so easy to pigeonhole as the other professionally qualified accountants. They work both in public practice as auditors and as financial accountants. They also have an enormous number of overseas students. Many certified accountants train for their qualification in industry and never work in public practice. The ACCA qualification is very popular overseas.

Chartered Institute of Management Accountants (CIMA)

This is an important body whose members generally train and work in industry. They are found in almost every industry, ranging, for example, from coal mining to computing. They mainly perform the management accounting function.

Chartered Institute of Public Finance and Accountancy (CIPFA)

This institute is smaller than the ICAEW, ACCA or CIMA. It is also much more specialised with its members typically working in the public sector or the newly privatised industries, such as Railtrack. CIPFA members perform a wide range of financial activities within these organisations, such as budgeting in local government.

Second-Tier Bodies

The main second-tier body in the UK is the Association of Accounting Technicians. This body was set up by the major professional accountancy bodies. Accounting technicians help professional accountants, often doing the more routine bookkeeping and costing activities. Many accounting technicians go on to qualify as professional accountants. The different accountancy bodies, therefore, all perform different functions. Some work in companies, some in professional accountancy practices, some in the public sector. This diversity is highlighted in an original way in Real-World View 1.6.

REAL-WORLD VIEW 1.6

A Sideways Look at the Accounting Profession

Thus, to take parallels from the religious world, we have:

- **the lay priest:** the accountant working for a company;
- **the mendicant priest:** the professional accountant in a partnership;
- **the monastic priest:** the banker, who, while not strictly an accountant, serves much the same ends in a separate and semi-isolated unit;
- **the father confessor:** the auditing accountant to whom everything is (officially) revealed, and who then grants absolution.

Source: Graham Cleverly (1971), *Managers and Magic*, Longman Group Ltd, London, p. 47.

Limitations of Accounting

Accounting, therefore, measures business transactions in numerical terms. It thus provides useful information for managers and other users of accounts. It is, however, important to appreciate certain limitations of accounting. First, accounting tends to measure the cost of past expenditures rather than the current value of assets. There have been attempts to introduce 'fair value' or 'market prices' in some cases. However, this then brings in a great deal of subjectivity into accounting. This is dealt with in more detail in Chapter 11. Second, traditional accounting does not capture non-financial aspects of business. Thus, if an industry pollutes the air or the water this is not recorded in the conventional accounts. Nor does traditional accounting measure the human resources of a business or its knowledge and skills base. The accounts can, thus, only give a partial picture of a business's activities.

SOUNDBITE 1.4

Limitations of Traditional Accounts

'Non-financial items like business opportunities, management strategies and risks have a big effect on company performance and need to be reflected in company reports.'

Mike Starr, Chairman of American Institute of Certified Public Accountants. Committee on Enhanced Business Reporting.

Source: Nicholas Neveling, Consortium Urges Reporting Reforms, *Accountancy Age*, 17 February 2005, p. 11.

Conclusion

Accounting is a key business activity. It provides information about a business so that managers or owners (for example, shareholders) can make business decisions. Accounting provides the framework by which cash and profit can be monitored and controlled. A basic distinction is between financial accounting (accounting targeted primarily at those outside the business, but also useful to managers) and management accounting (providing information solely to managers).

Accounting changes as society changes. In particular, it is contingent upon history, country, technology and the nature and type of the organisation. There are at least eight groups which use accounting information, the main ones being managers and shareholders. These user groups require information about, amongst other things, profits, cash flow, assets and debts. There are several types of accountancy and accountant. The types of accountancy include auditing, bookkeeping, financial accounting, financial management, insolvency, management accounting, taxation and management consultancy. The six UK professional accountancy bodies are the Association of Chartered Certified Accountants, the Chartered Institute of Management Accountants, the Chartered Institute of Public Finance and Accountancy, and the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants in Ireland and the Institute of Chartered Accountants of Scotland. Although very useful, accounting has certain limitations, for example, its historic nature and its failure to measure non-financial transactions.

Websites

A list of useful websites is included below for students interested in a career in accounting and who wish to find out more information.

i) Accountancy Institutes

Association of Chartered Certified Accountants (ACCA)
www.accaglobal.com

Chartered Institute of Management Accountants (CIMA)
www.cimaglobal.com

Chartered Institute of Public Finance and Accounting (CIPFA)
www.cipfa.org.uk

Institute of Chartered Accountants in England and Wales (ICAEW)
www.icaew.co.uk

Chartered Accountants in Ireland (CAI)
www.chartered accountants.ie

Institute of Chartered Accountants of Scotland (ICAS)
www.icas.org.uk

Association of Accounting Technicians (AAT)
www.aat.co.uk

ii) Accounting Firms

PriceWaterhouseCoopers
www.pwcglobal.com

Ernst & Young
www.ey.com

KPMG
www.kpmg.com

Deloitte
www.deloitte.com

Q&A Discussion Questions

Questions with numbers in blue have answers at the back of the book.

Q1 What is the importance, if any, of accounting?

Q2 Can you think of three business decisions for which managers would need accounting information?

Q3 What do you consider to be the main differences between financial and management accounting?

Q4 Discuss the idea that as society changes so does accounting.

Q5 'Managers should only supply financial information to the "current" shareholders of companies, no other user groups have any rights at all to information, particularly not the general public or government.' Discuss.

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