

SOLUTIONS TO END OF CHAPTER QUESTIONS

CHAPTER 1

► RECALL AND REVIEW

► Question 1.1

- An oil exploration company will set itself up as a public limited company. It will need a lot of investment from a substantial number of shareholders to provide the necessary cash to purchase oil exploration equipment, to hire skilled employees and to buy exploration licences around the world. This size of investment would not be available to sole traders, partnerships or private limited companies. Investors will also want to limit their liability for the debts of the organisation. There is always a risk that no oil will be discovered so that the company does not survive.
- A taxi driver would set up as a sole trader as driving a taxi is a straightforward operation that will require no major financing or present any other difficulties that might be overcome by adopting a different business format. The taxi driver just needs to buy a car and a hackney carriage licence, all of which expenditure can be met from personal savings. Day to day expenditure, such as petrol and repairs, can be paid for from the receipts from fares.
- A family-run knitwear manufacturing business would adopt the private limited company format. As this is a family business, the family will want to maintain control of day to day operations, which would be lost if the business were to set up as a public limited company. The private limited company will be able to borrow money to buy specialised knitwear machinery and equipment while affording the family business limited liability if the business venture were to fail. As a private limited company, the family will be able to concentrate on ensuring that the business will be a commercial success without being distracted by the demands of many outside shareholders.
- The business format most suited to the two friends setting up a dance school will be the partnership. Each of the two friends will want to have an equal share in running the school and in contributing to its success. Additionally, both friends will be entitled to share profits in the venture equally. The operations of the dance school will be straightforward with no complexities that would make a different format more suitable.

► Question 1.2

Your answers should have included the following points, among others. You may well have been able to think of more points than are given here. In all four cases, figures should be compared with previous years' figures to determine whether current year figures are higher or lower than in the past.

Information required by the trustees of a charity:

- Donations received
- Legacies received
- Money received from fund-raising campaigns

- Ability of the charity to continue to attract financial support
- Expenditure on charitable purposes
- Expenditure on administration
- Expenditure on administration as a percentage of total expenditure/income
- Number of beneficiaries assisted
- Whether the charity made a surplus this year or whether a deficit arose from expenditure being higher than income
- Spare funds to use in an emergency or in the case of a natural disaster

Information required by the managers of a secondary school:

- Number of pupils on roll
- Number of teachers
- Pupils per teacher
- GCSE and A level results
- Average GCSE and A level points per pupil
- Number of applications received for new entrants into year 7 next year
- Whether numbers of pupils are rising or falling
- Reputation of the school among parents, pupils and local residents
- Whether the secondary school is staying within its budget or not
- Pupil and parent satisfaction scores with the educational experience delivered

Information required by the managers of a university:

- Number of applications per course
- Number of offers per course
- Number of students enrolling each year
- Average A level points or equivalent of students enrolling on courses
- Degree classifications gained by students at the end of their course
- Starting salaries of students entering employment at the end of their course
- Employment rate of students at the end of their course as a percentage of those graduating
- Graduating students still unemployed six months after the end of their course
- Satisfaction ratings from employers with graduates of the university
- Student satisfaction ratings for each course
- Staff/student ratios
- Drop-out rates
- Completion rates
- Surplus or loss generated each year
- Research papers published by staff
- Research grants awarded to staff

- The value of research grants awarded to staff
- Research awards gained by staff

Information required by the managers of a manufacturing business:

- Profit or loss for the year
- Number of products produced and sold in the year
- Selling prices for products whether these are rising or falling
- Demand for products whether this is rising or falling
- Investment in new machinery/facilities
- Number of new/improved products developed this year
- Productivity of employees, products produced per employee
- Number of customer complaints about products
- Health and safety record, number of employees injured while at work
- Financial stability of the business
- Whether the budget for the year was met or not

► Question 1.3

Your chart should include the following details (though you may have thought of more points than are given here):

1. Costs

- Transfer fee demanded by potential targets' current clubs
- Weekly wages that new striker is likely to demand
- Signing on fee for new striker
- Agent's fees for handling the transfer
- Length of proposed contract in years

2. On-pitch performance

- Number of career goals
- Number of goals in the last 12 months (to determine current scoring record)
- Goals per game
- Number of yellow and red cards received over career
- Number of yellow and red cards received in the last 12 months (to determine current disciplinary record)
- Number of games missed through suspension in the last 12 months
- Number of minor injuries suffered in the last 12 months
- Number of serious injuries suffered over career
- Number of games missed through injury in the last 12 months

3. Off-pitch performance

- Number of charitable activities undertaken in the last 12 months

- Number of clubs played for during career (to gauge loyalty to past clubs)
- Diet
- Alcohol consumption
- Age (to assess the number of playing years left)
- Fitness levels
- Number of non-football related stories in the press about the player in the last 12 months (to gauge the likelihood that the player will get into trouble and damage the reputation of the club)
- Reputation among fellow professionals (scores out of 10)

» DEVELOP YOUR UNDERSTANDING

» Question 1.4

Managers make decisions and implement strategies but underpinning all these decisions and strategies is accounting information. Accounting information is a useful tool which enables managers in the performance of their job as it helps managers understand, direct and control businesses. Accounting information provides a basis for decision making. It is used to determine what went well and what did not turn out as expected. Businesses would be lost without accounting information as there would be no information relating to costs, no indication of past performance as a point of comparison for current performance, no figures on which to base taxation assessments, no proof that the results are as companies claim they are.

» Question 1.5

The size of the amount stolen is not material in terms of the overall size of the company and its operations, but the nature of the item is material. This is because the theft was committed by a top manager. This suggests that James' investment might not be safe if a top manager is willing to steal even small amounts of money from the company.

» Question 1.6

- Objectives: The objective of financial accounting is to provide information for use in investing and lending decisions while the objective of management accounting is to provide information to assist managers in running the business and its activities.
- Main users: The main users of financial accounting information are external users including existing and potential investors, lenders and other creditors, employees, customers, government and the general public. On the other hand, the main users of management accounting information are the internal managers of the business.
- Obligation to produce information: Producing financial accounting information is obligatory while there is no obligation to produce management accounting information.
- Use of standards: Financial accounting information is prepared according to strict accounting standards, but there is no standard at all for producing management accounting information.
- Type of information produced: Financial accounting produces only financial information while management accounting produces both financial and non-financial information.

» Question 1.7

- (a) Qualified accountants prepare financial statements and reports, audit financial statements and provide advice on the taxation rules and business management.
- (b) Professional accounting bodies are responsible for admitting individuals to membership and for the regulation and oversight of their conduct as qualified accountants.
- (c) If a qualified accountant breaches the ethical rules of conduct, their professional bodies will take action to discipline them with warnings, fines and, in the most serious cases, excluding them from membership.

» Question 1.8

Accounting has the following limitations:

- Accounting does not provide measures of performance quality. The quality of what an entity produces is measured by its customers and their level of satisfaction with goods and services delivered. Similarly, while accounting indicates the profit made by an entity, it does not indicate the time, effort and thought dedicated to delivering the products and services to generate that profit.
- Accounting does not present details of the pollution and environmental or social damage the entity causes.
- Accounting does not provide any valuation or measure of the skills base and knowledge of an entity.

»» TAKE IT FURTHER

»» Question 1.9

- (a) The directors of the company are accountable for their actions to the shareholders, the people who have placed them in positions of power and trust. Accounting information is provided by the directors to render an account of what they have done with the resources provided by the shareholders and how they have used those resources to generate income for the shareholders.
- (b) If shareholders are not content with the performance of the company, they can replace the directors in the expectation that the new directors will manage their investment more carefully and profitably. Alternatively, they can sell their shares and invest their money in companies that provide them with higher profits and higher dividends.

»» Question 1.10

- (a) The head of the accounting department has a key role in facilitating the expansion plan. The decisions made by other departments of the company require accounting input. Therefore, the accounting department must be represented at this key meeting.
- (b) Although the marketing department can use reports from sales personnel and consumer evaluations to advise on current demand for the product, it is up to the accounting department to advise on product costs and what the selling price should be in order to generate a profit on each unit sold. The human resources department will provide advice on the recruitment of

new staff, the legal obligations incurred in doing so, the training required and the salary rates for new employees, but it is the accounting department that will advise on the level of productivity the new employees will need to achieve in order to generate additional profit.

»» Question 1.11

- **Relevance:** Accounting information must be relevant. To be relevant, information must be capable of making a difference in the decisions made by users.
- **Faithful representation:** Accounting information must not only represent relevant economic transactions and events, it must also faithfully represent the substance of the transactions and events that it purports to represent. To do this, accounting information must be complete, neutral and free from error.
- **Comparability:** Accounting information should be comparable over time. The usefulness of accounting information is enhanced if it can be compared with similar information about other entities for the same reporting period and with similar information about the same entity for other reporting periods.
- **Verifiability:** Accounting information should be verifiable. Verifiability provides users with assurance that information is faithfully presented and reports the economic phenomena it purports to represent.
- **Timeliness:** The decision usefulness of information is enhanced if it is available to users in time for it to be capable of influencing their decisions.
- **Understandability:** Users of accounting information are assumed to have a reasonable knowledge of business and economic activities in order to make sense of what they are presented with.