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## **ACCOUNTING & FINANCE IN BUSINESS & MANAGEMENT**

### **STUDY GUIDE FOR MODULE ONE**

(A full 'Study & Training Guide' will accompany the Study or Training Manual(s) you will receive soon by airmail post.)

This Study Guide - like all our Training Materials - has been written by professionals; experts in the Training of well over three million ambitious men and women in countries all over the world. It is therefore essential that you:-

- \* Read this **Study Guide** carefully and thoroughly BEFORE you start to read and study Module One, which is the first '**Study Section**' of a CIC Study or Training Manual you will receive for the Program for which you have been enrolled.
- \* Follow the **Study Guide** exactly, stage by stage and step by step - if you fail to do so, you might not succeed in your Training or pass the Examination for the CIC Diploma.

#### **\* STAGE ONE**

Learning how to **really STUDY** the College's Study or Training Manual(s) provided - including THOROUGHLY READING this **Study Guide**, and the full '**Study & Training Guide**' which you will soon receive by airmail post.

#### **\* STAGE TWO**

Studying in accordance with the professional advice and instructions given

#### **\* STAGE THREE**

Answering Self-Assessment Test Questions/Exercises

#### **\* STAGE FOUR**

Assessing - or having someone assess for you - the standard of your answers to the Self-Assessment Test

#### **\* STAGE FIVE**

Preparing for your Final Examination

#### **\* STAGE SIX**

Sitting the Final Examination

Remember: your CIC Program has been **planned** by experts. To be certain of gaining the greatest benefit from the Program, it is **essential** that you follow precisely each one of the **SIX stages** in the Program, as described above.

**STAGE ONE** is your **thorough reading of this 'Study Guide'**



CIC Member Mohamed Sarah Conteh,  
from Sierra Leone

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## **ABOUT CIC STUDY and TRAINING MANUALS**

A CIC Study or Training Manual (which comprises 4 or 6 Modules - the first Module of which follows) supplied by the College as part of your Course or Program is **NOT** simply a text book. It must therefore **not** be read simply from cover to cover like a text book or another publication. It **MUST** be **studied**, Module by Module, exactly as explained in the following pages. Each CIC Study or Training Manual has been designed and written by specialists, with wide experience of teaching people in countries all over the world to become managers, administrators, supervisors, sales and accounting personnel, business-people, and professionals in many other fields.

Therefore, it is in **your own best interests** that you use the Study or Training Manuals in the way CIC's experts recommend. By doing so, you should be able to learn easily and enjoyably, and master the contents of the Manuals in a relatively short period of time - and then sit the Final Examination with confidence. Every Study Manual and Training Manual is written in clear and easy to understand English, and the meanings of any "uncommon" words, with which you might not be familiar, are fully explained; so you should not encounter any problems in your Studies and Training.

But should you fail to fully grasp anything - after making a thorough and genuine attempt to understand the text - you will be welcome to write to the College for assistance. You must state the **exact** page number(s) in the Study or Training Manual, the paragraph(s) and line(s) which you do not understand. If you do not give full details of a problem, our Tutors will be unable to assist you, and your Training will be delayed unnecessarily.

Start now by reading **carefully** the following pages about Stages Two, Three and Four. Do **NOT**, however, start studying the first Study or Training Manual until you are **certain** you understand **how** you are to do so.

## **STAGE TWO - STUDYING A CIC MODULE**

### **STEP 1**

Once you have read page 1 of this document fully and carefully, turn to the first **study section** - called **Module One** - of **Study or Training Manual One**. (Note: In some Manuals the term "Chapter" is used instead of "Module").

Read the whole of Module One at your normal reading pace, without trying to memorise every topic covered or fact stated, but trying to get "the feel" of what is dealt with in the Module as a whole.

### **STEP 2**

Start reading the Module again from the beginning, this time reading more slowly, paragraph by paragraph and section by section. Make brief notes of any points, sentences, paragraphs or sections which you feel need your further study, consideration or thought. Try to absorb and memorise all the important topics covered in the Module.

### **STEP 3**

Start reading the Module again from its start, this time paying particular attention to - and if necessary studying more thoroughly - those parts which were the subject of your earlier notes. It is best that you do **not** pass on to other parts or topics until you are **certain** you fully understand and remember those parts you earlier noted as requiring your special attention. Try to fix everything taught firmly in your mind.

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**Note:** You may not wish to, or be able to, carry out Steps 1, 2 and 3 one after the other. You could, for instance, carry out Steps 1 and 2 and then take Step 3 after a break.

## **STAGE THREE - ANSWERING SELF-ASSESSMENT TESTS**

### **STEP 4**

When you feel that you have **fully understood and learned everything** taught in the whole Module (and if necessary after a further careful read through it) turn to the Self-Assessment Test set at the end of it, and read the Questions/Exercises in it carefully. You do not have to attempt to answer any or all of the Questions/Exercises in the Test, but it is **best** that you do so, to the best of your abilities. The reasons for this are:-

- ❁ By comparing your answers with the Recommended Answers printed in the Appendix at the end of the Module, you will be able to assess whether you **really have** mastered everything taught in the Module, or whether you need to study again any part or parts of it.
- ❁ By answering Questions/Exercises and then comparing your attempts with the Recommended Answers, you will gain experience - and confidence - in attempting Test and Final Examination Questions/Exercises in the future. Treat the Self-Assessment Tests as being “*Past Examination Papers*”.

### **Professional Advice on Answering Self-Assessment Test (and Examination) Questions and Exercises**

1. You may answer the Questions/Exercises in a Self-Assessment Test in any order you like, but it is best that you attempt **all** of them.
2. Read very carefully the first Question/Exercise you select, to be quite **certain** that you really **understand** it and what it requires **you to do**, because:
  - ★ some Questions/Exercises might require you to give full “written” answers;
  - ★ some Questions/Exercises (e.g. in English) might require you to fill in blank spaces in sentences;
  - ★ some Questions/Exercises (e.g. in bookkeeping) might require you to provide “worked” solutions;
  - ★ some Questions/Exercises (called “multiple-choice questions”) might require you only to place ticks in boxes  against correct/incorrect statements.

In your Final Examination you could **lose marks** if you attempt a Question/Exercise in the wrong way, or if you misread and/or misunderstand a Question/Exercise and write about something which is not relevant or required.

3. Try to answer the Question/Exercise under “**true Test or Examination conditions**”, that is, **WITHOUT** referring back to the relevant section or pages of the Module or to any notes you have made - and certainly **WITHOUT** referring to the Recommended Answers. Try to limit to about two hours the time you spend on answering a set of Questions/Exercises; in your Final Examination you will have **only two hours**.
4. Although you are going to check your Self-Assessment Test answers yourself (or have a friend,

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relative or colleague assess them for you) practise writing “written” answers:-

- ★ in clear, easy-to-read handwriting;

and

- ★ in good, grammatical language.

The Examiner who assesses your Final Examination answers will take into account that English might not be your national or main language. Nevertheless, to be able to assess whether you really **have** learned what we have taught you, he or she will need to be able to read and understand what you have written. You could lose marks if the Examiner cannot read or understand easily what you have written.

5. Pay particular attention to neatness and to layout, to spelling and to punctuation.
6. When “written” answers are required, make sure what you write is **relevant** to the Question/Exercise, and concentrate on **quality** - demonstrating your knowledge and understanding of facts, techniques, theories, etc. - rather than on quantity alone. Write fully and clearly, but **to the point**. If you write long, rambling Final Examination answers, you will waste time, and the Examiner will deduct marks; so practise the **right** way!
7. When you have finished writing your answer, read through what you have written to see whether you have left out anything, and whether you can spot - and correct - any errors or omissions you might have made.  
**Warning:** some Questions/Exercises comprise two or more parts; make **certain** you have answered **all** parts.
8. Attempt the next Question/Exercise in the Self-Assessment Test in the same manner as we have explained in 1 to 7 above, and so on until all the Questions/Exercises in the Test have been attempted.

**Note:** There is no limit on how much time you spend on studying a Module before answering the Self-Assessment Test set on it, and some Modules are, of course, longer than others. You will, however, normally need to spend between twelve and fifteen hours on the thorough study of each Module - and that time may be spread over a number of days if necessary - plus approximately two hours on answering the Self-Assessment Test on each Module.

## STAGE FOUR - ASSESSING YOUR ANSWERS

### STEP 5

When you have answered all the Questions/Exercises set in Self-Assessment Test One to the best of your ability, compare them (or ask a friend, relative or a colleague/senior at work to compare them) with the Recommended Answers to that Test, printed in the Appendix at the end of the Module. In any case, you should thoroughly study the Recommended Answers because:-

- ★ As already explained, they will help you to assess whether you have really understood everything taught in the Module;

and

- ★ They will teach you how the Questions/Exercises in subsequent Self-Assessment Tests and in

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your Final Examination **should** be answered: clearly, accurately and factually (with suitable examples when necessary), and how they should be laid out for maximum effect and marks.

## **MARKS AND AWARDS**

To assist in the assessment and grading of your answers, the **maximum number of marks** which can be earned for each answer to a Self-Assessment Test Question/Exercise is stated, either in brackets at the **end of each one**.

**The maximum number of marks for any one Test is 100.**

Your answers should be assessed fairly and critically. Marks should be awarded for **facts** included in your answer to a Question/Exercise, for presentation and for neatness. It is **not**, of course, to be expected that your answers will be identical to all those in the Appendix. However, your answers should contain the **same facts**, although they might be given in a different order or sequence - and any examples you give should be as appropriate to the Questions/Exercises as those given in the relevant "Recommended" Answers.

Add together the marks awarded for all your answers to the Questions/Exercises in a Self-Assessment Test, and enter the total (out of 100) in the "Award" column in the **Progress Chart** in the middle of the full '**Study & Training Guide**' when you receive it. Also enter in the "Matters Requiring Further Study" column the number(s) of any Question(s)/Exercise(s) for which you did not achieve high marks.

## **GRADES**

Here is a guide to the grade your Self-Assessment Test Work has achieved, based on the number of marks awarded for it:

50% to 59%	<b>PASS</b>	60% to 64%	<b>HIGH PASS</b>
65% to 74%	<b>MERIT</b>	75% to 84%	<b>HIGH MERIT</b>
85% to 94%	<b>DISTINCTION</b>	95% to 100%	<b>HIGH DISTINCTION</b>

## **STEP 6**

Study again **thoroughly** the section(s) of the Module relating to the Question(s)/Exercise(s) to which your answers did not merit high marks. It is important that you understand where or why you went wrong, so that you will not make the same mistake(s) again.

## **STEP 7**

When you receive the complete Study or Training Manual One\*\* from the College by airmail post, '**revise**' - study again - Module One printed in it, and then turn to **Module Two** and proceed to **study it thoroughly** in exactly the same way as explained in Steps 1, 2 and 3 in this '**Study Guide**'.

When you have completed your **thorough study**, follow steps 4, 5 and 6 for the **Self-Assessment Test on Module 2**.

Continue in the **same way with each of Modules 3, 4, 5 and 6** until you have attempted and assessed your work to Self-Assessment Test 6, and have completed the study of Study or Training Manual One. But - and this is **important** - study the Modules **one by one**; complete Steps 1 to 6 on **each** Module **before** you proceed to the next one (unless during the course of your reading you are referred to another Module).

**\*\*Note:** When you receive Study or Training Manual One by airmail post, it will be accompanied by a 20-page '**Study & Training Guide**' (containing a '**Progress Chart**') which you **MUST read very carefully** before starting your study of Module Two.

## TRAINING ON

# ACCOUNTING & FINANCE IN BUSINESS & MANAGEMENT

## Module One

### CONTENTS

<i>The Need for Complete and Accurate Accounting Information</i>	page 7
Information as the “prime resource” of managers The need for full, accurate and up to date information Transactions and monetary value Functions of accounting with regard to data: recording transactions analysing transactions presenting analyses in reports and statements, which: meet the requirements can be easily interpreted Computers in accounting Comparison between incomplete and complete financial statements in practical situations: receipts and payments income and expenditure showing the “true” picture The profit motive The responsibilities of the financial accounting function Limitations from management’s point of view of financial statements	
<i>Self-Assessment Test One</i>	page 15
<i>Recommended Answers to Self-Assessment Test One</i>	page 17
<i>What you will Learn in Modules 2 to 12</i>	page 18

# THE NEED FOR COMPLETE AND ACCURATE ACCOUNTING INFORMATION

## Introduction

In this rapidly evolving business environment, information becomes the **prime resource** of the manager. In business, “guesswork” is simply not good enough! The owners or managements of every business needs accurate and up to date **information** about the activities of their respective businesses, on which to base sound decisions, and take effective actions.

That information can come only from records kept or “maintained” about *each and every* **‘transaction’** which occurs.

In the context of accounting, a **‘transaction’** is any activity which involves the **exchange** of money or money’s worth between a business and “other parties”, whether they are people or organizations. A transaction might involve a purchase or a sale of goods or materials or services (the performance of some work); the receipt or the payment of money; the circulation of assets (possessions), the settlement of a debt, or anything else which has a **‘monetary value’**.

The main functions of the process called **accounting** are:

- \* **Recording** the financial transactions which affect an **‘enterprise’** (which might range from a small one-man business through many sizes and types of enterprises to a huge public company).
- \* **Analysing** the transactions recorded. That can involve “breaking down” data about transactions into its component parts, or collating data about related transactions (for example “sales figures”) to ascertain trends or the reasons for the results shown by the analysis.
- \* **Presenting** the analysed records of the transactions - usually in a “summarised” format or arrangement - in various **‘reports’** and **‘statements’** which should show clearly the **effects** of those transactions on the performance and financial position of the enterprise. The reports and/or statements produced should:

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- ◆ Contain the data the management of an enterprise **needs** in order to reach sound decisions.
- ◆ Arrange or “present” the data in such a way that it is capable of being **interpreted** or understood clearly, and acted upon, by those in the enterprise whose responsibility it is to make decisions and to take or to initiate action.

The recording function of accounting is called **bookkeeping**. The purpose of bookkeeping is to provide an accurate and detailed record of **each and every** transaction. We consider the principles of bookkeeping in Module 3 because - although most managers are not required to be actual “bookkeepers” - an understanding of what the activity involves is very valuable.

### **Computers in Accounting**

More and more organizations are today making use of computers to perform and maintain all or part of their accounting information needs. A computer can perform ‘**bookkeeping**’ and other accounting requirements in a fraction of the time it would take to perform often tedious and repetitive work by hand - “manually” - but that does **not** detract from the necessity for managers to have:

- \* A knowledge of what accounting **entails**.

and

- \* The ability to **interpret** accurately the accounts information produced, whether that is done by computer or manually.

A computer can be more accurate than even the most diligent human accounts clerk, bookkeeper or accountant; but if incomplete or inaccurate information - ‘**data**’ - is fed into the computer, the reports, accounts, etc, it produces will be **inaccurate**. A computer is only a **machine**, and the results of its operations are only as good as the skills of the people (a) who design the ‘**programs**’ which control its operations, and (b) who operate it - plus, of course, the “quality” of the data fed into it - or ‘**input**’ to it.

### **Practical Example of the Need for Accounting Records**

We return to a consideration of the use of computers in accounting in later Modules, but what we have stated so far emphasises the necessity for a manager to ensure that accounting information, howsoever it is compiled and maintained, is always **complete** and **accurate**, and that it is **correctly interpreted**.

This simple practical example will illustrate to you the importance of the three factors:-

A handyman decides to try to earn some extra money in his spare time by making and selling wooden tables and chairs in a shed in his back garden. He purchases timber, glue, screws, paint, etc, and sells what he makes to neighbours and friends, and to others as the result of small classified advertisements in his local newspaper. He very sensibly keeps records of all **payments**: the money he spends - his ‘**expenditure**’; and of all **receipts**: the money he receives for the tables and chairs he sells - his ‘**income**’.

After the first two months he draws up a ‘**statement**’ of his receipts and payments like that shown

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in Fig.1/1.

Note that we use the symbol \$ to indicate a sum of money; you may read the symbol \$ as being the name of or the symbol used for the currency in your own country or a currency with which you are familiar.

**Fig.1/1.** a specimen receipts and payments statement

Receipts and payments, 1st March to 30th April 20..			
Receipts	\$	Payments	\$
Received from sales of 14 tables and 12 chairs	388.00	Timber	164.50
		Screws, glue, etc	5.80
		Paint & varnish	21.00
		Adverts	8.00
<b>TOTAL</b>	<b><u>\$388.00</u></b>	<b>TOTAL</b>	<b><u>\$199.30</u></b>

If he deducts - or subtracts - the total of his payments (\$199.30) from the total of his receipts (\$388), our carpenter will discover that his '**excess of receipts over payments**' was \$188.70. He might feel well satisfied with having made such a **gain** - or '**profit**' - from his endeavour.

But has he **really** gained that sum or, indeed, any amount at all?

To arrive at the **true picture** of the financial position - which is the purpose of accounting - the following factors might have to be "**taken account of**" or "**taken into account**":-

1. As he worked in the evenings on the tables and chairs, he **might** have had to provide lighting in his shed by electricity or some other means, the cost of which is not shown in his statement (because, perhaps, it is included in his normal domestic or house electricity bill).
2. He might have had to use his own vehicle, or pay for the use of one, to transport the timber to his premises and/or to deliver some or all of the chairs and tables to his customers. No expenditure on transport is shown in his statement.
3. It is assumed that he used his own tools, e.g. saws, hammer, screwdrivers, etc, in making the furniture. But tools (and machinery and equipment) are subject to loss of value due to '**wear and tear**'; in accounting terms they '**depreciate**' in value. They also incur expense in maintenance and repair, e.g. a blunt saw blade might have to be sharpened or a paint brush might have to be replaced.
4. The statement shows that he spent \$164.50 on timber, but it is unlikely that he used every last usable piece in making the 14 tables and 12 chairs. He probably has some lengths of off-cuts of wood left which he can use in making other items; the same might apply to some screws, glue, paint and varnish. In effect, he has **stock** in hand of "raw materials", the value of which was **not** incurred (used or spent) in making the 26 items he had sold, as is shown by the statement.

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5. The statement shows that he had sold 14 tables and 12 chairs, but there might, for example, be a fifteenth table made but still **unsold**. The value of that table - and any other unsold items - should be included in the statement as "stock of goods for sale". (Note that the values of such items are usually shown "at cost", and not at the sums they would fetch if/when they are sold).
6. In between points 4 and 5, there might be some partly finished chairs and/or tables, on which expenditure has been incurred, but which are not yet ready for sale to produce or earn income. The value of any such items, again "at cost", should also be included in the statement to give a true picture. Partly finished items - which still need further work or processing before they are ready for sale - are sometimes referred to as being "work in progress".

Let us now consider Fig.1/2 and see how the statement would appear if the foregoing were all properly accounted for.

**Fig.1/2.** a specimen income and expenditure statement

<b>Income and Expenditure, 1st March to 30th April 20..</b>			
<b>Income</b>	\$	<b>Expenditure</b>	\$
Received from sales of 14 tables and 12 chairs	388.00	Timber	164.50
		Screws, glue, etc	5.80
		Paint & varnish	21.00
		Adverts	8.00
		Transport (estimated)	4.50
		Electricity (estimated)	6.00
		Depreciation, repair & maintenance of tools	<u>14.00</u>
		Total	\$223.80
		Less:	
		<b>Stocks:-</b>	
		Materials	
		1 table for sale (at cost)	6.90
		2 partly finished chairs (at cost)	14.00
		raw materials	<u>13.00</u> 33.90
<b>TOTAL</b>	<u><u>\$388.00</u></u>	<b>TOTAL</b>	<u><u>\$189.90</u></u>

This second statement gives a far more complete and accurate picture of the **'financial position'**. Properly interpreted, it tells us that:-

- ★ In actual cash terms the handyman gained the sum of \$164.20 (that is, total income of \$388 less total expenditure of \$223.80).
- ★ In addition he has stocks "in hand" worth \$33.90 at cost prices, which can earn him, or help to earn him, more income, thus increasing his overall gain.

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Other factors might also have to be “taken into account” in order to provide an accurate picture.

One of those is any money which is still **owed to** a business on the date on which a financial statement is produced. For example, our handyman might have sold 14 tables (as shown in his statement) but a customer might not actually have paid for one of them; that money owed (by a **‘debtor’**) cannot simply be ignored, as it has been **earned** and increases his **‘excess of income over expenditure’** even though he has not yet actually received the money.

Similarly, any money **owing by** a business on the date on which a financial statement is produced for it must not be overlooked, as it can have an important bearing on the “final” result. For example, although our handyman’s statement showed that he had actually paid \$164.50 for timber, there might be a timber bill “outstanding” which he still has to pay, and he has used some or all of the timber concerned in “generating” his income. The amount of the outstanding bill has been **spent** (although it has not actually been paid, and is a **debt** owing to a **‘creditor’**) and reduces his excess of income over expenditure.

**Note:** The meanings of the accounting terms “debtor” and “creditor”, and others, are explained fully in Module 2.

## Profits

Financial statements produced vary considerably in layout and content, and many are of necessity far more complex than the simple ones we have so far illustrated - others will be illustrated, examined and analysed in later Modules. However, at least once a year every enterprise in the “private sector” (and often those in the “public sector” too) requires the production of **financial** statements concerned with **profit** (or loss), as do those already illustrated. Enterprises - often called **‘businesses’** in the private sector - are started and run to make profits for their owners.

It is important for you to understand exactly what profit is, and how it arises. After all, the performance of many managers will be assessed by the profits earned by the enterprises by which they are employed. A simple practical example will help to make the concept clear to you:-

*A shoemaker sells a pair of shoes he has made, and with the money he receives for it he buys food or clothing or buys materials or pays the rent of his workshop. What he has done, is to exchange his materials and labour for the materials and labour of other people; note that money is only the medium which makes the exchange easier.*

*In order to produce his shoes, the shoemaker has to make use of three items: **land, labour, and capital**, which are called the **‘factors of production’**. Without land there would be no place or workshop for the shoemaker to work; without his labour no shoes would be made; without capital there would not be the money which he needs to pay the rent of his workshop, to buy leather, tools, nails, etc, from which to produce more shoes, and to feed and clothe himself until the next shoes are made and sold.*

*The shoemaker must be sure in advance that his production will “bring back” the money he spent on materials, on labour and on rent, and bring a **‘return’** on the capital employed; and it is that **return** which is called profit.*

A return on capital in the form of profit can be justified. For capital is nothing more than the result of previous production; if the shoemaker works so well that he sells his products for more money than his immediate needs, he can use that extra money as capital to finance more production.

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## Losses

We return to the consideration of profit in a later Module, but at this stage you should note that the opposite of making a profit is “incurring” a **‘loss’**. All business owners and managers strive to avoid making losses.

## Financial Accounting

As we explained earlier, whatever the size of an enterprise, the responsibilities of the person or people involved in **‘financial accounting’** are:

★ to record financial transactions;

★ to analyse them;

and

★ to present details of them in appropriate forms to show the effects of those transactions on the performance and financial position of the enterprise.

Such information is most valuable from the point of view of controlling the finances of the enterprise - on which its prosperity depends. However, it is often insufficient on its own to enable management to perform effectively its functions with regard to policy formulation, and planning and controlling the operations of the enterprise, which are essential for its continued prosperity and survival.

One reason is that much financial accounting information is basically **‘historical’**, showing what **has already happened** instead of what **is happening now**, or what **will or should happen in the future**. It is possible for a manager to control something whilst it is happening, and to organise control for something which is about to occur. But when something has **already** occurred without having been controlled, it is **too late** for the manager to do anything about that happening.

For example, if a financial statement shows that an enterprise made a loss in a given period, the manager might be able to use the information provided - correctly interpreted - to try to avoid subsequent losses, but it is too late for him to do anything about the original loss disclosed.

A second feature of financial accounting is that it is **not generally specific enough** for management’s needs. For example, a shop sells (a) cutlery, (b) crockery and glassware, and (c) cooking utensils. An end of financial year statement shows that the business made a profit of \$75,000. That is useful information, but gives management little clear help in planning and controlling future operations because there is no clue as to which products are the most (or least) profitable, or even unprofitable.

The permutations are, of course, endless, but the following are just a few to illustrate the point (losses are shown in brackets):-

Product	Possibility 1	Possibility 2	Possibility 3	Possibility 4
(a)	\$25,000	\$10,000	(\$5,000)	\$60,000
(b)	\$25,000	(\$30,000)	\$40,000	\$30,000
(c)	\$25,000	\$95,000	\$40,000	(\$15,000)
Total Profit	<u>\$75,000</u>	<u>\$75,000</u>	<u>\$75,000</u>	<u>\$75,000</u>

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Consider carefully each of the “possibilities” given above, remembering that in each case the basic financial statements will show the business as having made the **same overall** profit:-

**Possibility 1.** In this case each of the products has produced an identical profit, and has contributed equally to the overall profit made by the shop. (That would, of course, be most unlikely to occur in practice).

**Possibility 2.** In this case Product (a) has made a modest profit, whilst Product (c) has produced a substantial profit. However, Product (b) was most unprofitable, and made a heavy loss, so great that it effectively “wiped out” the profit made on Product (a) and a large proportion of that made on Product (c). That would be vital information for the management of the business, so that it could take urgent steps to avoid further reductions of its profits by an unprofitable “line” - there might be many reasons for the unprofitability of crockery and glassware (perhaps breakages are occurring or prices are too high, for instance) and it might even be necessary to cease trading in such items, and to concentrate on the profitable lines.

**Possibility 3.** In this case both Products (b) and (c) have shown equally good returns, but Product (a) shows a small loss. Knowing that, management can take steps to find out why Product (a) has done badly, and to remedy the situation.

**Possibility 4.** In this case Product (a) has done very well, Product (b) has done quite well, but Product (c) has greatly reduced the overall profit made by the business. Again, once that information is available to management, action can be taken to improve performances.

Of course, as we stated earlier, there are limitless other possibilities, but the foregoing emphasise that the information provided by basic financial accounting statements alone is only an ‘overview’; it does not, on its own, provide management with sufficient guidance to enable it to control effectively each individual type or group of activity.

As we have shown, losses on some lines or areas can be ‘masked’ or hidden by particularly good results by other lines or areas - and management’s aim must be to ensure, as far as is feasible, that **all** lines or areas are profitable, and that - if necessary - unprofitable lines or areas are dropped.

## **Accounting Information**

As you proceed with the study of the Manuals in this Program, you will learn various ways in which the “basic” information provided to management by financial accounting statements can be analysed and “expanded” to provide more detail about the operations of a business, and its various activities. It must never be thought that financial accounting is not important - it is, **very** much so, in order to control the finances of a business. But management’s requirements often go beyond what it is designed to provide.

The accounting information provided to management should always be **complete** and **accurate** and, where appropriate, **up to date**, if management’s decisions and actions based on that information are to be beneficial. All details must be accounted for, and the whole picture must be shown.

It would be pointless when planning, for example, to look at the balance on the bank account alone,

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without taking into account or consideration all payments which are due to suppliers and all payments which are due from customers, together with the values of stocks in hand and other possessions (assets) and debts (liabilities) of the enterprise.

Similarly, a decision based on figures relating to the income and expenditure of an enterprise two or three years ago is hardly likely to be a correct one with regard to the current financial movements.

Wherever possible managers need to know the **current** situation, and they need to know the **complete** situation, in all its aspects.

Large organizations frequently employ specialist '**management accountants**' to provide additional, analysed accounting information in the forms in which it will best aid top management in policy formulation, planning and decision-making. The average manager - running a small or medium-size business, or a department or section of a business - rarely has such a luxury, and therefore has to be able to make the greatest possible use of the information provided by those involved in financial accounting.

He therefore needs a basic understanding of financial accounting, so that he can not only interpret accurately the statements and information produced, but can also guide his accounting staff to produce the statements **best suited** to his needs, whilst also being able to **check the accuracy** of the information provided to him.

Towards those ends we devote the following two Modules to a consideration of financial accounting methods and to the principles of bookkeeping on which they are based. The intention is **not** to train you as a bookkeeper or as an accountant, but to provide you with a solid foundation on which can be built, in later Modules, an understanding of the wider applications of accounting information. It is **essential** that you grasp firmly the basic principles of double-entry bookkeeping and accounting.

### Notes:

1. In these Manuals, to avoid the repetition of the words "he or she" we refer to a manager as "he". No disrespect to women/female managers is intended.
2. You may read the sums of money and monetary values stated in these Modules as being in the currency of your own country, or the currency of a country with which you are familiar. Where there might be confusion between quantity and monetary value, we use the symbol **\$** to show which of the two is the monetary value (not the currency name).

## SELF-ASSESSMENT TEST ONE

Recommended Answers to these Questions - against which you may compare your answers - will be found on page 24. The maximum mark which may be awarded for each Question appears in brackets at the end of the Question. Do **NOT** send your answers to these Questions to the College for examination.

**No.1.** (a) What are the three essential features of accounts if they are to be of real value? (maximum 10 marks)

(b) Describe briefly what is meant by "profit". (maximum 10 marks)

**No.2.** What do you consider to be the responsibilities of those involved in financial accounting work for an enterprise? (maximum 20 marks)

**No.3.** In addition to all income actually received and all expenditure actually paid, what other items might have to be taken into account in order to produce an accurate financial statement? (maximum 25 marks)

**No.4.** In what ways might statements produced by the financial accounting function be insufficient for management's needs? (maximum 25 marks)

**No.5.** Place a tick in the box  against the **one correct** statement in each set.

(a) *In accounting, the term "expenditure" refers to:*

- 1  the amount of money received by an enterprise.
- 2  the preparation of useful financial statements.
- 3  the amount of money paid out by an enterprise.
- 4  the amount of profit made by a business during a certain period.

(b) *We say that accounting information is largely "historical" because:*

- 1  it shows the position as it will be in the foreseeable future.
- 2  it shows what has already happened, and not what is currently happening.
- 3  it is most easily interpreted by older members of management.
- 4  it gives no indication of whether a profit or a loss has been made.

(c) *The term "take into account" means that:*

- 1  a piece of information or data should be considered as relevant and included in a financial statement.
- 2  a piece of information or data should be input to a computer.
- 3  a piece of information or data is not relevant and should be excluded from a financial statement.
- 4  a piece of information or data is the responsibility of accounting staff.

(d) *The value of materials which have been purchased but have not yet been paid for:*

- 1  has not yet actually been spent, and so it should not be included as expenditure.
- 2  has no effect on whether or not a profit has been made.
- 3  is treated as a gain by the enterprise.
- 4  has effectively been spent, and so it must be included in total expenditure.



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(e) *A disadvantage of financial accounting from management's point of view may be that:*

- 1  people have to be paid to perform the work.
- 2  human accounting staff are not as accurate as are computers.
- 3  it often gives just a "general" picture and is not detailed enough.
- 4  they have not studied this Program and so do not understand it.

(2 marks for a statement correctly ticked - maximum 10 marks)

## **RECOMMENDED ANSWERS TO SELF-ASSESSMENT TEST ONE**

**No.1.** (a) It is essential that accounts are always complete and accurate and that they can be interpreted correctly.

(b) Profit is the reward for enterprise and risk, and a return on capital employed in excess of expenditure incurred on the other two factors of production - land and labour - which need to be utilized in business.

**No.2.** The responsibilities of the people involved in financial accounting work for an enterprise, are to record fully and accurately all financial transactions in which the enterprise is involved, to analyse those transactions, and to produce statements illustrating the effects of the transactions on the performance and financial position of the enterprise.

**No.3.** In addition to showing all monies actually received and paid out by a business, a financial statement might also have to take into account on or more of these:-

(a) All amounts owed to it at the date of the statement.

(b) All amounts owed by it at the date of the statement.

(c) The values of stocks of materials and other usable/saleable items and partly finished products "in hand" at the date of the statement.

(d) Any losses of value due to wear and tear or depreciation up to the date of the statement.

**No.4.** Financial accounting statements of necessity show situations as they were in the past, which might be the very near past or the distant past. They do not show what is happening at the present time, or what will or should happen in the future, which management frequently needs to know. Also, financial accounting statements frequently give only an "overview", and are not sufficiently detailed or specific to show management the positions relating to the different individual activities in which the business is involved.

**No.5.** The right statement from each of the sets selected and ticked:

(a) 3  (b) 2  (c) 1  (d) 4  (e) 3

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## **WHAT YOU WILL LEARN IN MODULES 2 TO 12 OF THE CIC ACCOUNTING & FINANCE IN BUSINESS & MANAGEMENT PROGRAM**

### **Module 2 - Accounting and Finance**

The meanings in accounting of:

- fixed assets
- current assets
- liquid assets
- liabilities:
  - capital
  - long-term
  - current
- debtors
- creditors

Capital:

- initial capital
- working capital
- funds forecasts

Financing sole-proprietor businesses

Financing business partnerships

The meaning of:

- limited liability
- private companies
- public companies
- ordinary shares
- preference shares
- dividends

Loans

Mortgages

Debentures

Bank overdrafts

Working capital:

- its importance
- calculation
- computing the capital necessary for new businesses
- why the right composition of working capital is essential

Capital income

Revenue income

Capital expenditure

Revenue expenditure

Direct expenditure

Overhead expenditure

Alternative methods of financing capital purchases:

- leasing and contract hire/rental
- hire purchase
- credit sale agreements

Depreciation:

- why it is charged
- the reducing balance method of charging
- the straight line method of charging

### **Business Finance**

Business finance and accounting

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Decisions involving finance

Investments:

- what is involved
- returns on investments
- capital investments
- working capital investments
- fixed capital investments
- investment in new technology and R & D
- investment in people

Financial assets

The roles of business finance

- factors in selecting methods of finance
- gearing

Risk in finance:

- risk and uncertainty
- the "risk factor"
- risk and the rate of return

Investment appraisal:

- business risk
- financial risk

### ***Module 3 - Principles of Bookkeeping and Books of Account***

The purpose of bookkeeping

The ledger:

- what information it records and can provide

Ledger accounts:

- what their debit side records
- what their credit side records

The basic rule of double-entry bookkeeping:

- the giving and receiving aspects of every transaction

The cash book:

- what it records
- cash and bank columns
- posting to the ledger

The sales book:

- recording credit sales made
- source documents
- posting to the ledger
- sales account

The purchases book:

- recording credit purchases made
- sources of information
- posting to the ledger
- purchases account

The returns inwards and outwards books:

- what they record
- sources of information

The journal:

- its main uses today:
  - opening entries
  - closing entries
  - correction of errors
  - unusual transactions

Balancing ledger accounts and the cash book

The trial balance:

- reason for extraction

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- agreement
- limitations
- financial statements produced from trial balance information
- Folios and their value in bookkeeping and accounting
- Abbreviations used in ledger accounts
- Entries in a cash book, sales book, purchases book and in ledger accounts examined, explained and interpreted
- A manually maintained and computerised account compared

### **Bank Accounts**

- Why bank accounts are opened
- Current accounts
- Deposit accounts
- Savings or investment accounts
- Interest receivable
- Bookkeeping for interest receivable

### **Module 4 - Final Accounts (1)**

- Accounting concepts:
  - a business as a separate entity from its owner(s)
  - accounting statements relating to a going concern
- Final accounts as historical statements
- Goodwill:
  - how it arises
  - its valuation
- Income received in advance
- Pre-payments and accrued charges
- Consistency in the preparation and presentation of final accounts and other accounting statements:
  - reasons why that is essential
- Trading accounts:
  - why they are prepared
  - information they may contain
  - the prime cost of a trading enterprise
  - how a gross profit or a gross loss arises
- Manufacturing accounts:
  - why they are prepared
  - information they may contain
  - the prime cost of a manufacturing enterprise
- Statistical and comparative percentages and ratios in:
  - trading accounts
  - manufacturing accounts
- Modification of:
  - trading accounts
  - manufacturing accounts
  - to meet the requirements of different enterprises

### **Module 5 - Final Accounts (2)**

- Profit & loss accounts:
  - why they are prepared
  - what information they contain and can provide
  - how a net profit or a net loss can arise

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Vertical layout of profit & loss accounts  
Use in profit & loss accounts of:  
    comparative figures  
    percentages  
    ratios  
    reasons why they may not be as useful  
        as those in trading accounts  
The significance of gross profit:  
    analysing gross profit made  
    practical example examined  
Rate of stock turnover:  
    meaning and value  
    methods of calculation,  
    dangers of low rates of stock turnover  
Balance sheets:  
    why they are prepared  
    what data they contain  
The importance to management of how net profit  
    is reflected in movements in the values of  
        assets and liabilities  
Vertical presentation of balance sheets:  
    comparative figures

### **Module 6 - Principles of Costing**

Purpose of cost accounting:  
    how it differs from financial accounting  
The benefits to management of a well-designed  
    costing system  
  
Why management should make full use of the  
    data provided  
Definitions of costing terms:  
    cost  
    unit  
    prime cost  
    oncost  
Different costing systems:  
    job, contract, batch or terminal  
    process  
    single unit  
    multiple unit  
    operating  
    departmental or sectional  
    types of enterprises for which each system  
        may be suitable  
Allocation of overheads:  
    sales overheads  
    production overheads  
    administration overheads  
    selling and distribution overheads  
Limitations of cost accounting  
Standards in business:  
    how and why they are set  
Standard costing:  
    its benefits to management

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Ideal standards  
Attainable standards  
Variances:  
    adverse  
    favourable  
    computing different types of variances  
Activity Based Costing:  
    analysis of activities  
    cost drivers

### ***Module 7 - Planning and Forecasting***

Setting business objectives:  
    corporate and departmental objectives  
Policy formulation:  
    interpretation and implementation  
Why planning is essential:  
    what may be involved  
    practical example examined  
    strategic planning  
    tactical planning  
    operational planning  
What forecasting involves and its importance  
The relationship between planning and forecasting:  
    practical example examined

### ***Budgets and Budgeting***

What budgets are  
Reasons why budgeting is so important for business success  
Benefits to management which can accrue from budgeting  
Budget preparation:  
    periodic and continual budgets  
Limiting factors:  
    what they may be  
Sales budgets  
Production budgets  
Purchasing budgets  
Cash budgets  
Practical examples examined  
The interrelationship and interlinking of budgets  
The master budget  
    practical example  
Budgetary control:  
    budget review statements  
    adverse and favourable variances  
    dangers of inflexible budgetary control  
Inflation:  
    its affects on businesses  
    alternative approaches to accounting for inflation

### ***Module 8 - Stock/Inventory Control***

The importance of good stock control and stores  
    management  
Costs involved in maintaining stocks  
Why stocks have to be maintained despite the cost

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Management of stocks:

- dangers of stockholding being too low
- budgets of future demand
- average stock turnover
- recording and reorder systems
- the ABC system of stock control
- economic order quantity (EOQ)
- materials requirement planning (MRP) system
- just-in-time (JIT) stock management

The importance of setting the correct stock levels

Consequences of holding:

- excess stocks
- insufficient stocks

Factors to be considered in setting stock levels

for different items:

- different types of stock levels:
  - maximum (or higher) stock level
  - minimum (or lower) stock level
  - reorder stock level
- reviews of stock levels
- variations in stock levels

Stock records:

- the need for accuracy
- what information may be contained in stock records, and why

Why stocktaking is carried out and what is involved:

- periodic stocktaking
- continuous stocktaking
- spot checks
- stocktaking by independent auditors

The treatment of:

- discrepancies
- deficiencies and surpluses
- investigating discrepancies
- writing down and writing up

Valuing stocks:

- the need for accuracy in determining profit and/or loss

Work in progress

## **Module 9 - Credit and Credit Control**

The meaning of credit

Common forms of credit:

- the monthly account
- fixed periods of credit
- budget accounts
- credit cards
- in-store credit cards

The importance of credit :

- to vendors
- to customers

Using credit for purchases as well as to boost sales

Dangers in allowing credit

Methods of credit control for various forms of credit

Bad debts:

- how they arise
- preventive measures
- accounting provisions for bad debts

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### **Discounts**

When and why:

- trade discount
  - quantity discount
  - cash discount
  - regular custom discount
  - prompt payment discount
- are offered

Dangers in the offers of discounts

Taking advantage of discounts offered as well as allowing them

Discounts allowed as an expense or loss:

- accounting treatment

Discounts received as a gain:

- accounting treatment

### **Module 10 - Partnership Accounts**

Reasons for forming business partnerships:

- possible advantages and disadvantages
- of partnership firms

Special features of business partnership accounts:

- capital
- current accounts
- drawings
- salaries
- interest on capital
- profit & loss appropriation accounts
- practical example examined

Goodwill in partnerships:

- circumstances in which its value must be ascertained various methods of dealing with it:
- in practice
- in the books of account

Formation of partnership firms

Dissolution of partnership firms

### **Departmental Accounts**

Why departmental accounting is practised:

- its purposes

The loss leader concept, and other deliberate

- management policies resulting in losses or
- reduced profits on certain products

Analysis columns in the books of account

- for departments

The apportionment of expenses between departments

- profit and loss

### **Branch Accounts**

Centralised branch accounting:

- advantages when practicable

Self-accounting branches:

- financial and operational control by head office

Consolidated trading and profit & loss accounts

The group balance sheet

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### ***Hire Purchase Accounts***

Accounting by vendors for hire purchase 'sales'  
Accounting by businesses for purchases under HP agreements

### ***Module 11 - The Interpretation of Final Accounts***

Interpretation from different points of view

Working capital:

- computing
- considering
- comparing

Cash and funds flow:

- changes which can affect it

Cash and funds flow statements:

- why they are prepared
- their values to management
- interpretation

The dangers of overtrading:

- how it arises
- step which can be taken to avoid it arising

Management control over:

- cash
- debtors
- stocks
- debts to creditors

Reasons why businesses "hold" cash:

- transactionary motive
- precautionary motive
- speculative motive

The amount of cash held:

- nature of the business
- opportunity cost of cash holding
- level of inflation
- availability of near-liquid assets
- availability of borrowing
- cost of borrowing
- economic conditions
- relationship with suppliers

Management control over debtors:

- collection policy
- average settlement period
- ageing debtors reports:
  - practical example
- pattern of credit sales receipts:
  - practical example

Cash flow and future capital expenditure

### ***Accounting ratios***

Ratio Analysis

- their values for different purposes
- profitability ratios
- liquidity ratios
- efficiency ratios
- investment ratios

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- gearing ratios
- descriptions of ratios commonly computed:
  - their formulae explained
  - practical examples
- Comparisons between accounting periods of:
  - turnover
  - gross profit percentage
  - total gross profit
  - selling and distribution costs
  - net profit
- Check list for initial study of a balance sheet:
  - cash position
  - working capital
  - stock value
  - liabilities
- Break-even analysis
  - what it seeks to ascertain
  - the break-even point
- Break-even charts:
  - their values and limitations
  - practical example with illustration examined

### ***Pricing policies***

- Factors which can determine or influence the selling prices of products
  - manufacturing costs
  - demand
  - storage
  - competition
  - long-term profit
  - government influence
  - psychology
  - strategy
- Auditors and Auditing:
  - who and what auditors are
  - external audits:
    - why the need for audits arises
    - what an audit is - and what it is not
    - the auditor's duties
    - the need for independence
    - comparison of accounting and auditing work
    - what an audit might involve
    - sequence of a balance sheet audit
  - internal auditors:
    - their duties and positions within the organization

### ***12. Computers in Accounting***

- The characteristics of computers:
  - speed
  - storage and retrieval of data
  - diligence
  - accuracy
  - their value in accounting
- Computers as machines:

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- what they can and cannot do
- viewing them only as "tools"
- Variety of business accounting applications
- How a computer works:
  - input
  - storage
  - arithmetic
  - output
  - logic
  - processing
  - control
- Comparison between a manual accounts operation and the same one performed by computer
- Software:
  - tailor-made programs
  - applications packages
  - database packages
  - what to look for in software
- The organisation of data:
  - files
  - records
  - fields
  - master data
  - movement data
- Database systems:
  - their advantages to the business and to management
- The advantages of keeping accounts by computer
- Dangers to avoid in computerising
- Converting from a manual to a computerised accounting system:
  - what areas to computerise and in what order
  - the use of a consultant
- Common accounting package modules:
  - what they can do
- Testing the new system
- The parallel run
- Going live
- Expanding, modifying or upgrading existing systems:
  - procedures
  - encouraging staff participation
  - with advice and suggestions for changes needed
- Management Information
  - statistics and reports
- Forecasting and modelling by computer
- Auditing techniques for computerised systems

### ***Glossary of Words and Terms Used in Accounting***

This Alphabetical Section is designed as a "quick reference check" to help your further understanding of many: "technical" words and terms used in accounting; words and terms which have "specialised" meanings when used in accounting; words and terms whose meanings in accounting differ from their "everyday" meanings; which are introduced and explained in Modules 1 to 12.