

PART 1

INTRODUCTION TO ACCOUNTING

Accounting and the business world

Tutorial questions

1.1

1. This is a common perception. Accountants are an easy target, just as the computer is often blamed for almost anything that goes wrong in an organisation.
2. Accounting is a service industry concerned with the supply of information.
3. Accountants themselves do not necessarily take decisions – that is for management.
4. Managers take decisions on a whole range of issues, not all of them related to accounting or financial issues. If initiative and enterprise are stifled, that is because managers allow it to happen. Blaming accountants, therefore, is just an excuse made by incompetent managers.

1.2

1. The public perception is that it is the responsibility of auditors to detect fraud, but this is normally incidental to their main task of considering whether the accounts represent a true and fair view. This common misconception is sometimes known as ‘the expectations gap’.
2. There is no reason why auditors should not be required to undertake this task, but it would be very difficult. By its nature, fraud is normally hard to detect, and it is possible that auditors would be faced with much more litigation. So they would have to take out higher levels of insurance cover, thereby increasing the cost of an audit.

1.3

The statement made by this student that ‘I cannot understand why accountants have such a high status and why they have so much influence’ is a common assertion. It may be true of accountants in general but it may not be necessarily true of individual accountants. However, assuming that there is some validity in the assertion, a number of reasons may be posited.

1. Accountants are thought to be ‘good’ at mathematics. Since many people have convinced themselves that they are ‘hopeless at maths’, the expertise that accountants are perceived to possess creates admiration and respect.
2. The discipline of accounting is often treated as being synonymous with expertise in taxation. Like mathematics, taxation is a mystery to many people and so, once again, an assumed expert in the subject attracts some admiration.
3. It is recognised that business (and personal life) is tightly constrained by adequate and available resources. So experts who can assess the profitability of business enterprises tend

to be regarded as valuable members of a project team and of the general community. However, even accountants would accept that they provide a service and are not in the same position as those individuals who make or invent things.

4. There is a belief (which is probably true) that the education and training of an accountant is long and hard and that entrants to the profession have to be of a very high calibre.
5. Although not regarded as being particularly charismatic, accountants are thought to be dependable, reliable and absolutely trustworthy. Unfortunately, a number of financial scandals in recent years have probably damaged that image.

1.7

- (a) To keep a record of the company's day-to-day progress.
- (b) To prepare the company's annual financial statements.
- (c) To supply information to the management for decision making and control.
- (d) To operate a system of internal auditing.
- (e) To minimise the company's tax liabilities.

1.9

It is required by law. External auditors report to the shareholders on whether the accounts represent a true and fair view (the discovery of fraud is only incidental to this purpose). Note that small limited companies no longer need to have an audit.

1.10

According to HMRC, "Tax avoidance involves bending the rules of the tax system to gain a tax advantage that Parliament never intended. It often involves contrived, artificial transactions that serve little or no purpose other than to produce this advantage. It involves operating within the letter, but not the spirit, of the law".

The objective of tax avoidance schemes is therefore to reduce tax liability whilst remaining within the tax regulations. However, the hallmark of a tax avoidance scheme is that it often involves artificial and highly contrived steps which keep the scheme (just) within the law. HMRC identify schemes that they are investigating by regularly publishing schemes they have identified on their "spotlight" webpages, <https://www.gov.uk/government/collections/tax-avoidance-schemes-currently-in-the-spotlight>.

HMRC seek to close down such schemes through legislation changes and caution "most tax avoidance schemes simply do not work, and those who engage in them can find they pay more than the tax they attempted to save, once HM Revenue and Customs (HMRC) has successfully challenged them".

Tax evasion is simply the avoidance of paying tax which is legally due. This is done by such methods as manipulating profits or not declaring sources of income so that the reported level of

income is lower than it actually is. Tax evasion is not a manipulation of tax rules but a failure to declare correct income and is illegal.

Tax evasion is not justifiable due to its illegality but tax avoidance is a moot point. Those that engage in tax avoidance would probably argue that they are using the tax rules to their advantage and not actually breaking the law although their actions may not be within the spirit of the law.

1.11

In answering this question, students should be encouraged to explore in depth the nature and purpose of accounting. It is hoped that by doing so it will become obvious why it would be useful for Joseph Sykes (and other non-accountants) to study the subject.

1. The main function of accounting is to collect information and then to store, extract, summarise and report it to those parties who have a need and a use for it.
2. It is a service function: it is supposed to assist other managers who have neither the time nor the expertise to search for the information themselves.
3. Some information is necessary to satisfy various statutory and professional requirements. Such requirements cannot be ignored, no matter how irksome they may appear to non-accounting managers.
4. Information of whatever type is not always easy to understand. Accounting information is no exception. If Joseph Sykes has undertaken an accounting course, he will be much better placed to appreciate the potential usefulness of accounting information in his job because, he will have a sound understanding of where it comes from, how it has been compiled and of its inherent deficiencies.
5. When he becomes a director of the company, Joseph will be legally responsible for the company's accounting records and systems, and reporting procedures. This is a heavy burden and he will need to know the extent of his responsibilities. The 'buck' stops with the directors – *even if they are not accountants*.

1.12

The main purpose behind this question is to illustrate that accounting is not solely a product of profit-making enterprises, but that it has a use in all sectors of the economy, irrespective of which type of entity is involved.

1. Purpose of accounting: planning, control and decision making.
2. Essential that funds go to the main work of the charity and are not lost in administration.
3. If properly implemented and operated, accounting can help in the efficient use of resources.
4. Not administration for administration's sake.
5. Provides assurance that voluntary contributions go where they are meant to go.