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| Name: Date: |

# Learning Aim C: Understand the purpose of accounting

# Purpose of accounting

Do now activity:

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| **Question:** | **Your answer:** |
| State 3 organisations you can go to to get financial advice |  |
| State 3 organisations which protect consumers in terms of personal finance |  |
| Explain what a price comparison website is |  |
| Give three ways to pay |  |

**Purpose of accounting**

Anyone who wants to understand how a business is performing is likely to turn straight to its accounts. Owners need to keep a careful eye on accounts or it is almost certain to be doomed for failure.

Accounting involves financial transactions, planned or actual, and the use of these figures to produce financial information.

**Why is accounting important? (**read the following information and annotate as a class)

1. **Record transactions:**

Keeping business records accurate and up to date is important for the smooth running of a business/ the business owner must record all the money coming in and out of the business. If a business fails to do this it may find itself not chasing payments, forgetting to pay bills or it may get in trouble with HM Revenue and Customs (HMRC).

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| Summarise in one sentence why it is important to record transactions: |

1. **Management of the business**

A manager is responsible for the planning, monitoring and controlling of the resources for which they are responsible. A manager who clearly understands the business’ accounts will be better able to make informed decisions and plan for the future. Management of a business involves careful coordination of resources including staff, pay wages, stock and money. The manager must ensure there are sufficient funds to pay wages, order new stock, pay bills and meet other demands for cash outflows by balancing this with the money coming in from sales.

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| Summarise in one sentence accounting is important for the management of the business: |

1. **Compliance**

Financial reporting is governed by laws and regulations. This is to ensure that any financial records give a fair and accurate picture of the business. It is important that businesses comply with these laws and regulations in order to ensure that investors and other stakeholders are not misinformed. Compliance will also help protect against fraud.

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| Why do you think it is important for financial reporting to be regulated? |

1. **Measuring performance**

Without financial records it would be impossible to know if the business was making a profit or a loss, or whether the business was owed money or was in debt to others.

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| Profit |  |
| Loss |  |

Key indicators of financial performance include:

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| Sales revenue |  |
| Gross profit |  |
| Net profit |  |

1. **Control**

Accounting will control the flow of money into and out of the business by maintaining accurate records and monitoring performance. This should mean that any unusual (what could this be?) activity is spotted helping to prevent fraud. It will also, therefore, track the amount of money the business is owed: trade receivables, from the sale of goods. It will also track the amount the business owes to others: trade payables. This will help ensure that the business can meet its day-to-day expenses. If trade receivables and payables are not carefully controlled, there is a danger that the business may not be able to survive. This will also involve credit control which aims to ensure that all money owed to the business is paid on time.

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| Trade receivables |  |
| Trade payables |  |

**Knowledge check**

1. Why is accounting important for the management of a business?

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1. Why is it important to keep investors accurately informed about accounts?

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1. What is the term used to describe money coming into the business?

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1. What is the term used to describe money going out of the business?

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1. In your own words, explain what is meant by ‘accounting’.

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