

## Chapter 1

# The role of accounting and finance in business

## Introduction

Accounting and finance lie at the heart of business. It is possible to survive, for a while at least, without an effective marketing plan, poor human resource management and indeed a poorly designed business strategy. However, if there are serious faults with the management and control of the business's financial systems, it will fail. On the positive side, good accounting and financial management helps keep the business under control; it also provides the owners, management and others with the information and the confidence to make the bold decisions and take the opportunities to help the enterprise grow. So for any student of business, accounting and finance are 'need to know' subjects. In this chapter we set the scene by exploring some of the basic ideas behind accounting and finance as well as some of the extensive history of the subject within its business context.

## Learning objectives

The learning objectives in this chapter will provide the context for developing your understanding of accounting and finance.

### *The context and history of accounting and finance*

- To give an overview of the role that accounting and finance play in business.
- To inform that overview with a wider understanding of the history and development of accounting and the financial markets.

### *Different types of business organisation*

- That you can classify business firms by business type (distinguishing the four generic types of merchant, extractor, manufacturer and service), size and legal form.
- That you understand the concept of limited liability, and the rights and duties of the directors.

*Business objectives and the decision-oriented approach*

- That you understand the principal financial objectives of a firm from both a shareholder and a stakeholder perspective.
- That you understand the purpose of financial accounting information and the implications of the decision-oriented approach.

*The purpose and characteristics of accounting information*

- That you can describe the five quality criteria for accounting information and can rank them in order of precedence.
- That you understand the fundamental difference between financial and management accounting.

## The context and history of accounting and finance

Accounting is concerned with the recording and provision of financial information to the individuals who run firms and to outsiders. We can classify these ‘users’ of accounting in the following way: the owners of the business (its shareholders), management, other employees, suppliers and customers, lenders and agencies of government such as the tax authorities and various regulatory bodies. Of these the most important have traditionally been those who provide the cash the firm requires for investment (its capital requirements) and for managing the peaks and troughs in its cash balances caused by trading (its working or ‘operating’ capital requirements). Finance is concerned with the process of raising capital from the financial markets and covers subjects such as the operation of the market for short- and long-term finance, sourcing the most appropriate form of capital, making good investment decisions within the firm and calculating the cost of the capital the firm employs.

## The role of accounting

At its simplest level accounting is still about summarising and totalling up the financial values and transactions associated with a business or some other enterprise. However, accounting and the role of accountants has developed far beyond this simple idea. The modern accountant extracts meaning from a firm’s financial data: partly to help control its activities, partly to determine what resources are available for future development and partly to satisfy the needs of a wide range of different groups who need financial information for their own purposes.

Accounting within firms has developed in two principal directions: first in fulfilling the information needs of external stakeholders and, second, in providing information to management to assist them in their decision-making and other activities. The externally oriented branch of the subject is called ‘financial accounting’ where statements of financial performance over a period of time are produced – the income statement (formerly the profit and loss account), the balance sheet and the cash flow statement. ‘Management accounting’ is concerned with producing internal information for the management of the firm. The range