

## Chapter 2

# Introduction to financial accounting

In the last chapter, we outlined the objectives and purpose of financial accounting in reporting the performance of a business over a set period of time. In this chapter we show how this is done, slowly building the basics of the subject from first principles. We will start with a simple intuitive exercise looking at how a small trader, in this case a taxi driver, commenced business, and then reviewed his financial position at the end of his first month trading. From there we will show how accounts are built up using a few simple principles. These principles capture the essence of the subject and with them you will see how the accounts of a larger enterprise are constructed. These principles will also help you create a 'mental map' of the financial accounting process so that by the end of this chapter you will be able to identify how particular business decisions impact upon the financial performance of a business.

## Learning objectives

There are five outcomes we hope you can achieve in this chapter. Again we have split the chapter down into 'learning sections', which are:

### *The first principles of financial accounting*

- That you understand the principles of identity, additivity and matching and their importance in transactions-based accounting.
- That you understand the principal ways of classifying assets and liabilities.
- That you know how assets, liabilities and claims are related through the extended trial balance.
- That you can relate your understanding of the structure of accounts to the balance sheet published by a public limited company.

### *How to produce a set of simple accounts*

- That you can produce, for the first year of a business's operation, from simple transactions:
  1. An income statement
  2. A cash flow statement
  3. A balance sheet