

The organisation and management

Managers are appointed to run a business, although in the case of a sole proprietor or other small business, the owner will normally be intimately involved in managing daily operations. Management is responsible for making the economic decisions that are consistent with the overall objectives of the business and is accountable to the owners for the use of the business's resources. This is sometimes called **stewardship**. It is important to note that there may be a conflict of interest between the managers of a business and its owners. This relationship is explored through **agency theory**, and is one of the key factors underlying issues of corporate governance, which have recently come into considerable public prominence.

In larger businesses, management involves a **team effort** with interaction between different functional managers – production, buying, warehouse, transport, marketing, finance, personnel, research, etc. In order effectively to contribute to the team, the accountant must appreciate the objectives, methods and problems of the other business managers.



ACTIVITY 1.1: QUESTION

List the various parties, frequently called stakeholders, who are interested in the financial performance of companies and indicate what their particular concerns might be.



ACTIVITY 1.1: ANSWER

Many parties are interested in the financial performance of companies, they include:

<i>Interested parties</i>		<i>Concern</i>
Investors	<ul style="list-style-type: none">– Shareholders– Debenture holders– Other lenders	Dividends/earnings/share price Security/long-term cash flow Security/long-term cash flow
Banks		Security/cash flows
‘Traders’	<ul style="list-style-type: none">– Suppliers– Customers	Medium/long-term viability as major source of supply/customer Ability to pay to terms
Government	<ul style="list-style-type: none">– Local authorities– Tax authorities– Customs & Excise– Regulatory agencies	Levying of local taxes/rates Levying of national taxes Levying of duties, VAT, etc. Levying of other imposts, fair pricing
Employees		Wages/security of employment
Society at large		Policies of ‘good citizenship’/ equal opportunities/environment/ local economies, etc.

We can describe these parties as the stakeholders in a business. Whether they are internal or external to the operating of the business, the information they seek will be directed at answering three questions:

- How is the business doing?
- How is it placed at present? How much is it worth?
- What are its future prospects?



ACTIVITY 1.2: QUESTION

What sort of financial information do you think you would need to help answer these three questions?

- How is the business doing?
- How is it placed at present? How much is it worth?
- What are its future prospects?



ACTIVITY 1.2: ANSWER

How is the business doing?

The financial information to answer this question would include:

- published report and accounts, in particular profit and loss account
- details of profits
- cash flow and liquidity data
- growth in terms of sales
- various ratios, for example, the EPS (earnings per share)
- industry figures and figures relating to competitors.

How is it placed at present? How much is it worth?

The information required to answer this question would include:

- published report and accounts and in particular the balance sheet
- share price movements
- valuations of assets, for example, fixed assets such as property, machinery and plant, current assets such as stocks, debtors and investments
- various ratios, for example, the P/E ratio (price/earnings ratio) and gearing or leverage.

What are its future prospects?

The information required to answer this question would include:

- financial press, reports, outlook, etc.
- directors' and chairman's reports in the published report and accounts
- trends and statistics included in the published report and accounts or calculated from them
- position in the lifecycle of each of the company's products/services
- budgets, plans and forecasts – although it is very unlikely that these will be publicly available due to concerns over competition, commercial sensitivity and the natural reluctance of management to make statements about an uncertain future against which they may judged at a later date!

These items are just some of the numerous data that we could review or study to answer the three questions. Figure 1.1 reviews the different aspects of accounting within a business.

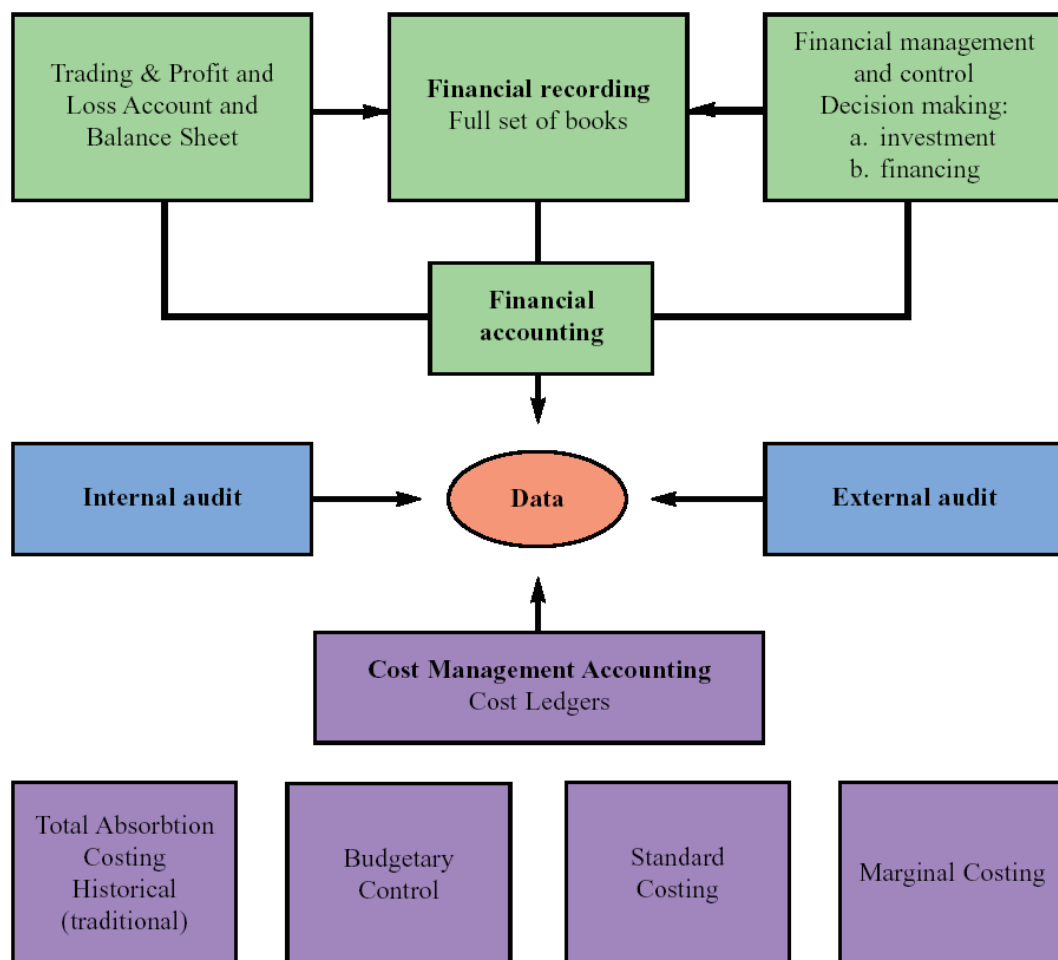


Figure 1.1: Accountancy – the overall picture



We use the terms, financial and managerial accounting, to reflect the difference in uses of accounting information. They describe the two main forms of the accounting language. The links between financial accounting and managerial accounting are shown in Figure 1.1.

- **Financial accounting** is geared towards the external users of the accounting information. To answer their needs, financial accountants draw up the **balance sheet, profit and loss account** (or in a not-for-profit organisation, the income and expenditure account) and **cash flow statement** for the enterprise as a whole. External stakeholders will ask questions such as:
 - ‘Should I invest my money in this company?’
 - ‘Should I lend money to this company?’
 - ‘What are the profits on which this company will pay tax?’

Financial accounting helps to demonstrate and explain management’s **stewardship** of the business over a period of time, and provides information useful to the external stakeholders. The statements are usually drawn up in a relatively formal and inflexible way, with disclosure (content, terminology and format) very much dictated by law and regulation – for example, by a Companies Act and authoritative Accounting Standards.

- **Managerial accounting** is aimed more at the internal users of information, for example, managers and executives. The decision makers in the organisation need more detailed information, for example, about profits of individual divisions, branches or shops and costs of (say) individual products or specific contracts or jobs. They will ask questions such as:
 - ‘Are we charging the right amount for our goods?’
 - ‘Should we invest in this new machine?’
 - ‘Are we making a profit or a loss in selling this product?’

Managerial accounting helps to provide the day-to-day information essential for good management – including adequate control – and sound decision making. Because the uses to which the information is put is, almost always, local, internal and private, the content, terminology and formats are dictated by these specific needs and are much less formal, allowing local variation and flexibility.



ACTIVITY 1.3: QUESTION

Think of four more questions that external and internal users of accounting information might ask?



ACTIVITY 1.3: ANSWER

External users might ask:

- Do I want to work for this company?
- Do we want to do business with this company – either as customer or supplier?
- Is this company acting in accordance with required regulations and standards?
- Are we getting value for money from our community charge?

Internal users might ask:

- Have we reached the targets we set for ourselves?
- Should we make this component for ourselves – or buy it in?
- Is our workforce functioning efficiently?
- How can we most effectively use this or that scarce resource?
- Are we running a ‘lean and efficient’ operation?
- What is our return on the capital employed?
- Are we managing our credit control efficiently?
- Are we tying up too much capital in stocks of raw materials, work-in-progress and finished goods?
- How much are our fixed assets really worth?
- Should we issue more ordinary shares or borrow more via long-term loans or debentures?
- Have we any bad or doubtful debts?

There are many more questions we could ask, reflecting the diverse nature of business and the diverse nature of accounting information. Some of these are more detailed and flow from the more general questions suggested above. For example, to help answer the question ‘Do we want to do business as a supplier to this company?’ we would want to ask the question ‘Can the company pay its debts as they fall due?’. Similarly, in answering the question ‘Are we running a lean and efficient operation?’ we need to question whether we are managing our credit control efficiently or perhaps tying up too much working capital in stocks of raw materials, work-in-progress or finished goods. We will examine many of these more detailed questions in Unit 3.