Instructor's Manual

Accounting for Non-Accounting Students

Tenth Edition

John R. Dyson and Ellie Franklin

Tutorial questions solutions contained therein have been updated for this edition by Ellie Franklin

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PEARSON EDUCATION LIMITED
KAO Two
KAO Park
Harlow CM17 9SR
United Kingdom
Tel: +44 (0)1279 623623
Web: www.pearson.com/uk

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Preface

Non-accounting students will not normally be asked to prepare financial statements or cost analyses, but they are probably going to use them. The underlying theme behind this book is the belief that they will be in a better position to do that if they have a fairly extensive knowledge of how the information is prepared. This means that they have to have some practise in compiling cost and financial information, but it is certainly not necessary for them to do long and complex technical questions that would tax even a professionally qualified accountant. The actual depth required will vary from module to module and lecturers must use their professional judgement in determining how much material in the book their students need to cover. Experience suggests that the book is sufficient for most non-accounting modules and any wider coverage (or greater depth) would go beyond most requirements.

These are different types of questions accompanying the 10th edition of *Accounting for non-accountants* textbook:

In-chapter **'Activities'** are included throughout the test so that you can introduce an element of questions and answers or discussion during your teaching. Answers to selected activities are available in Appendix 3 to the printed text.

'Check your learning' knowledge-based questions are based on the content of the chapters and the answers could be found within the chapters themselves.

'News stories critical thinking questions' are open-ended discussion questions which do not have one set answer. They can be used to encourage your students' critical thinking as part of a seminar or a lecture discussion setting.

'Tutorial questions' test knowledge and often invite practical application of the concepts introduced in each chapter. At the time the first edition of *Accounting for Non-Accounting Students* was published, it was believed that the answers to all tutorial questions should be included in the same volume. This decision was made for two main reasons: (1) to avoid lecturers having to waste time preparing answers; and (2) to help those students who were using the book as part of a distance learning programme. When preparing later editions, ***we have been requested to include a number of tutorial questions without answers***.

To respond to such requests

- some Tutorial questions (marked with asterisk) have their answers provided in Appendix 4 to the printed edition, and
- the answers to the remaining Tutorial questions are provided in this Instructor's Manual.

The tutorial questions and answers included in the first nine editions of the book have been largely retained within this edition. The solutions contained both within the main book and within this Manual (especially those relating to the discussion-type questions) should only be treated as pointers to a possible answer. Wherever possible, students should be encouraged to question the presentation and procedures adopted in the solutions and to judge them critically.

Lecturers should stress that it is important that students should review carefully their answers to the questions and assess the usefulness of the information they contain. Once a question has been completed, students should be stopped from rushing on to the next question before the solution to the current question has been critically examined. This is perhaps best done in a tutorial but no matter how reluctant the students are to put forward their own arguments and criticisms, lecturers should resist the temptation to feed them an answer.

Most of the questions in the book contain specific information. For example, in financial accounting questions depreciation rates and inventory values are usually given. Such questions present a golden opportunity for the assumptions upon which they are based to be questioned. Students can be encouraged to do some research into what accounting policies companies adopt in practice and what difference it would make to the net profit if (say) depreciation rates or inventory valuation methods were changed. Lecturers should constantly remind students that accounting information can only be correct in an arithmetic sense. Much depends upon the assumptions adopted in its compilation: there is no such thing as the *true* profit or the *true* cost of making a product. Unless students grasp this essential fact, they will come to rely on the arithmetical accuracy of accounting information instead of using it as a reasonably sound guide to decision making.

'Case studies' are also included in the tenth edition of the book. These may be found at the end of Chapters 7, 11 and 20, respectively. This Manual gives some brief guidelines suggesting ways in which the students might attempt the cases. We shall be interested to hear from lecturers of how their students coped with all of these case studies and what other case studies might be appropriate for your students so that we could consider the ideas for future editions. Please email your comments to e.frnaklin@mdx.ac.uk or get in touch with the editorial team at Pearson.

While we are aware that lecturers would prefer a book containing a great many questions, I hope that the questions included in this one will provide sufficient material for use on most modular courses designed especially for non-accounting students. There are some **Multiple choice questions** here for lecturers to hand out if they want, and more on the CWS for the students to access.

As with previous editions, if lecturers have any suggestions for improving the book or adding to its contents and question banks, the author would be pleased to receive them. Please email your comments to e.frnaklin@mdx.ac.uk or get in touch with the editorial team at Pearson.

SECTION 1

ANSWERS TO TUTORIAL QUESTIONS

(IF NOT PRINTED IN APPENDIX 4)

Note that solutions to Tutorial Questions marked with asterisk have been included in Appendix 4 of the printed edition

PART 1

INTRODUCTION TO ACCOUNTING

CHAPTER 1

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 give a true and fair view. This common misconception is sometimes known as 'the expectations gap'. Auditors plan their work to uncover material misstatements, whether due to error or fraud, so they may indeed uncover some, but not all fraud. They are also only concerned with what impacts the financial statements (and there may be other areas of fraud in an organisation which fall completely outside their area of interest – such as identity theft, benefit fraud, etc.)

2. There is a good argument why auditors should be required to undertake this task – they have access to all the information in a business they audit. But it would be still very difficult to uncover all fraud. 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 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 maths. 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 contained 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 are 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

The law defines ‘what is a small company’ (by reference to turnover, net assets and number of employees). Companies that meet two of the three thresholds have to have any audit by law. External auditors then report to the shareholders on whether the accounts represent a true and fair view (the discovery of fraud is only incidental to this purpose). Small limited companies do not need to have an audit but they may choose to. This may be in order to give more credibility to their results, perhaps at the point of securing funding or a loan from a bank.

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, while 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 identifies schemes that it is investigating by regularly publishing schemes it has identified.

HMRC seeks to close down such schemes through legislation changes and cautions that '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. Accounting is not administration for administration's sake.

5. Provides assurance that voluntary contributions go where they are meant to go.

1.13

You would perhaps expect those at the helm of business to have higher education. Some might have gone further and completed an MBA course or obtained professional qualifications. The CFOs of companies, in particular, are most likely to have qualified as chartered accountants with one of the six accounting professional bodies mentioned in the chapter (ICAEW, ACCA, CIMA, CIPFA, ICAS and ICAI) or they may be qualified with an overseas accounting professional body (e.g. holding the CPA 'badge' in the USA and other places around the world). Having sound financial background, knowledge and experience really is of benefit. It is something that an overwhelming majority of those in high-ranking positions have. I challenge you to obtain a list of the FTSE 100 companies and their CFOs and CEOs, and to find out what their educational and professional background is. Finance and accounting is bound to be very prominent!

1.14

Leading on from the previous question – the answer is yes. An overwhelming majority of strategic decisions in business—expansion, pricing, appropriate remuneration to attract talent, research and development, etc.—involve an aspect of financial decision making.

CHAPTER 2

Accounting rules and regulations

Tutorial questions

2.1

1. It keeps changing – so how can anyone keep up with it (and therefore be compliant)?

2. Regulation tends to evolve when a scandal/problem with the existing system takes place. It does not cover all eventualities.

3. It takes a long time to pass new laws (statutory regulation); you cannot trust fully anyone to self-regulate because of the nature of humans; and the independent regulator is never 100% independent (they are paid for by the profession they regulate and staffed with people who may have worked at the institutions they now scrutinize).

4. Even when applying standards there is room for judgement.

2.2

1. This is an argument about the rule-based vs. the principle-based approaches to accounting information.

2. Principle-based systems are based on a broad legislative framework, sometimes supported by professional guidelines. Rule-based systems are based on a detailed framework of law.

3. The EU operates a principle-based system (under IASB requirements), while the USA is an example of a country that adopts a rule-based approach.

4. Principle-based systems allow considerable freedom for individual entities and their accountants to interpret the legal and professional requirements to suit individual circumstances. So even by using the same data, different accountants may produce wildly conflicting results.

5. Rule-based systems do not allow the same room for individual judgement and so the accounts may merely reflect the strict enforcement of a rigid set of rules. However, the results may not then reflect the economic actuality of an individual entity.

6. The ultimate choice depends upon whether there is a preference for a system based on fairness vs. one based on correctness.

2.3

1. The FRC is funded by the profession it regulates. Hence, it has an element of self-interest to not report problems.

2. The FRC is staffed by people who worked at the institutions they are now scrutinising.

They may have personal connections there – old friends and colleagues. How easy would it be to report them for breaches?

3. The proposal is that the new ARGE staff will not be able to work on any regulatory project involving a previous employer.

4. ARGE is also to be accountable to Parliament. This presupposes greater rigour in the system.

2.7

(a) Reliability.

The long-term services obtained from a professional footballer are highly unpredictable and, therefore, 'a degree of caution' should be exercised when accounting for transfer fees.

(b) Realisation.

Although it may appear somewhat imprudent to do so, in general the risk is usually small in taking profit prior to the receipt of cash.

(c) Entity.

The company does not have a legal title to the house.

(d) Realisation.

The profit cannot be known for some time (although in some cases a proportion may be claimed if the final outcome is reasonably certain). A degree of caution should, therefore, be exercised.

(e) Materiality.

It would be unduly pedantic to insist on matching the cost of small stocks of stationery purchased in an earlier period with the revenue of a future period.

(f) Reliability.

The improvement work may never result in a more successful revenue-earning drug, so a degree of caution should be exercised. In certain specific instances, however, earlier period costs on development work may be matched with revenues earned after the work has been completed.

2.8

Realisation rules suggest that profits are to be included in the profit and loss account when it is reasonably certain that the cash due will be received. This anticipates an accruals and prepayments system of accounting and not one based on cash flow. Profits depend on an entity selling goods or providing services. Determining the receipt of cash with 'reasonable certainty' is more restrictive than regarding a sale being made when (in the case of a trading organisation) the legal title to the goods has been transferred from the seller to the buyer. One option is that the goods can only be treated as being sold if, in addition, the seller is confident that the goods will be paid for. Like many other decisions in business, these mean that it is a matter of judgement whether the entity will be paid for the goods sold. It is obvious that an entity would not normally sell goods or provide services unless it thought that it was going to be paid for them. There has always been a risk, of course, in selling goods on credit. The traditional way of reducing this risk and of ensuring that profits are not overstated is to build into the profit and loss account a provision (i.e. an allowance) for those debts that may be doubtful. In effect, the profits are reduced by a percentage of the total of all outstanding debts. However, this procedure will not restrict entities into determining when and how much revenue falls into particular accounting periods.

The matching concept requires accruals to be accounted for in respect of expenses incurred but not paid for. In some cases, such expenses are not even invoiced yet and accountants have to make an estimate of the amount to be recorded. They tend to base that on past experience. But in any case the amount recorded is a 'best guess', an estimate. It requires a great deal of judgement. When the invoice finally comes, it may be a very different amount. When it comes to an electricity bill it is perhaps of not too great consequence (not material). But if the amount accrued for is in respect of (say) directors' bonuses to be paid after the year-end – that is likely to be a material amount. One can see how it may be possible to argue that it would be easier and more precise to record transactions when they actually happen (and there is certainty over the amounts involved).

Given below is a possible essay plan:

1. Brief explanation of the realisation and matching rules.

2. Problems associated with adopting these rules:

    - Realisation: precise point/period invalid: may not transpire, arbitrary estimates of allowance for bad and doubtful debts.
    - Matching: imprecise and insufficient information, arithmetical apportionment, under/over estimates.

3. Advantages:

    - Comparability between periods.
    - Familiar system.

4. Definition and explanation of *cash flow accounting* (CFA).

5. Problems of CFA:

    - No distinction between capital and revenue items.
    - Definition of *profit*.
    - Erratic profit levels (if defined as net cash receipts).
    - Change-over problems.

6. Advantages of CFA:

   - Avoids arbitrary assumptions (realisation, stocks, depreciation, accruals, prepayments).
   - Easy to understand.

7. Look for reasoned conclusion.

2.9

This is a general discussion question. The question may be used as a means of generating discussion around financial regulation and probity within a specific industry. The question will have a range of responses depending on the industry, which is chosen as the subject of discussion.