Chapter 3 Introduction to Accounting

Section I Purposes and the Role of Accounting

1. A	2. A	3. C	4. D	5. B	6. A	7. A	8. A

1. **A**

   (1) is correct. The primary purpose of financial accounting is to provide information to external parties. Creditors need the financial information of a company to assess its liquidity and solvency.

   (2) is correct. Management accounting provides information to internal parties like managers for decision-making.

   (3) is incorrect. Accounting is not used to window-dress the financial statements to attract investors but to provide accurate and true information for economic decision-making.

2. **A**

   (1) is correct. Accounting summarises financial information about the business by preparing financial statements in each financial period.

   (2) is correct. Accounting records the transactions of the firm with other entities, in order to provide raw data that will be further processed into information useful to decision-making.

   (3) is incorrect. Cost controlling is a function of operations management rather than accounting.

3. **C**

   Posting is the process of transferring the amounts from journals to ledger accounts.

   A is incorrect. Balancing off is the process of finding the balance of an account and carrying down the amount to the next period.

   B is incorrect. 'Transferring' is not a specific term in accounting.

   D is incorrect. Closing refers to the process of transferring the balances from nominal accounts to the income statement.

4. **D**

   Recording is the process of entering transactions into the books of original entries.

5. **B**

   Transactions are firstly recorded in books of original entry. Classifying is then carried out. Accounting transactions are identified and those transactions are assigned to assets, liabilities, equity, revenue and expenses. These transactions are summarised afterwards and all together presented in the financial statements. After that, the accounting information will be communicated and presented to both external and internal users.

6. **A**

   (1) is correct. Accounting gives production information that is valuable for evaluating the performance of production. If the performance is unsatisfactory, managers will take corrective actions to control the performance.

   (2) is correct. Accounting information depicts the situation of the business, which is useful for plan development. For example, financial managers can decide on the actions to be taken based on the solvency position of the business; marketing managers noticing a drop in the sales figure can initiate promotional campaigns to boost sales.

   (3) is incorrect. One of the limitations of accounting is that it lacks qualitative information.

7. **A**

   Business transactions are first realised by the issuance of source documents (such as sales invoices, debit notes, and receipts). Then, they are (1) recorded in the books of original entry (such as sales journal and cash book). After that, the records will be (4) posted to relevant accounts in ledgers. After (3) period-end adjustments in accounts, (2) financial statements for the accounting period can be prepared. Please note that a trial balance should be prepared before compiling the financial statements as account balances in the trial balance is needed for computing the figures.

8. **A**

   (1) is correct. Comparison of performance should be based on accounting ratios. As no record is available to compile the ratios, we can hardly compare the performance with others.

   (2) is incorrect. Though Victor does not have accurate information about his financial position and income flow, he can still consider doing market research and carrying out product positioning. Information gathered can be used to plan his marketing strategies.

   (3) is incorrect. Employment of staff can be done without accounting information.