

Introduction to financial accounting

Financial accounts are the records of the financial dealings of the business, their every day transactions.

The main role of financial accounting is to:

- ▶ **Record financial transactions;** e.g. collecting money from sales, paying suppliers, salaries and wages.
- ▶ **Help the managers to manage the business** more efficiently by preparing regular financial information e.g. monthly management accounts showing sales, costs and profits against budgets, forecasting cash flows, cost investigations.
- ▶ **Provide other stakeholders with legal/vital information** (financial accounts: trading account, profit and loss, and balance sheet).
 - Shareholders – how their investment is doing.
 - Suppliers – can they give the business trade credit.
 - Banks and lenders – can the business meet repayments of loans and risks of loaning the business money.
 - Inland revenue – tax returns.

The main accounting records kept by the business are records for keeping the details of transactions:

- ▶ **Sales ledger:** shows how much is owed by customers who have bought on credit.
- ▶ **Purchase ledger:** shows how much is owed by the business to suppliers who have provided goods and services on credit.
- ▶ **Cash book and bank statements:** shows all transactions involving cash (e.g. receipts from customers, payments to suppliers, employee wages).
- ▶ **Nominal (or “General”) ledger:** used to categorise the transactions of a business under headings e.g. sales of widgets, raw materials, electricity, and postage.

These records are used to maintain the information that is used to make up the main financial statements.

Financial Statements

Financial accounting produces the following key documents:

- ▶ **Profit and loss account** – showing how the business has traded for a specific period.
- ▶ **Balance sheet** – a statement of the assets and liabilities of a business at a particular time, and how those assets and liabilities have been financed.
- ▶ **Cash flow statement** – a statement showing how cash has come into the business and what it has been spent on.

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