An Introduction
to
Bookkeeping

Suitable for
the
AAT Accounting Qualification in

Processing Bookkeeping Transactions
Control Accounts, Journals and the Banking System
and
AAT Certificate in Bookkeeping

Study Manual
(4th EDITION)

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Introduction

This study manual will provide you with all the knowledge and skill to succeed in the AAT *Processing Bookkeeping Transactions* and *Control Accounts, Journals and the Banking Systems* examinations and the AAT *Certificate in Bookkeeping* assessments. It is suitable both for home study courses and also classroom based students. All the answers to the questions have been included at the back of the book. In addition to the Study Manual, the publishers have produced a Revision Kit containing additional questions and activities for you to further practice your bookkeeping skills. The answers to the questions in the Revision Kit are given at the end of the book.

The reasons why people take up an accountancy course are varied, but if you are interested in figures and dealing with money then you will certainly enjoy the course.

Accounting is as old as civilisation. Man always has a need to record who owns what and to record trading activities, and much of what we know about the day to day activities of ancient people comes from accounting records.

From about 4000 BC in Sumaria small clay balls were used to keep track of a person's wealth. Different sizes and different shapes were used to represent the various items such as sheep or grain.

Since it was more convenient to trade in these tokens (it's far easier to transfer a clay ball than 100 sheep) it eventually developed into what we now call money. The first coins were developed around the 7^{th} Century BC and the Ancient Greeks used silver drachmas from 5^{th} Century BC. Coinage had a legal standard now and along with that came the need to account for what coinage each person had.

The Romans are known for their building of roads, buildings and aqueducts, but Rome also had a complex finance system which included tax collections, contracts and corporations. Obviously there was even more need to keep track of transactions by a more sophisticated method of keeping records. Accountants were even more in demand.

With the Crusades, beginning about 1000 AD, a demand for exotic Eastern goods developed which demanded more complex trading relationships. A knowledge of costs and potential revenues was now needed. The businesses became larger where the owner could not do everything himself and so there was a need for better recording of transactions, and a business's wealth.

Modern bookkeeping is based on double entry (you'll find out what this is later in this book). The first evidence of double entry bookkeeping comes from Italy around 1200 but the first book to contain a detailed description was '*Summa de Arithmetica, Geometrica, Proportioni et Proportionalite' (1494)* by Luca Pacioli (1447-1517), a Franciscan monk and mathematician. (But don't worry; you don't have to be a mathematician to do accounts).

Wealth, trade and the development of technology are the reason we have a civilized world, but the need to account for it is of equal importance. The Italian merchants became successful and powerful partly through their superior financial knowledge. Understanding costs and revenues, they were better equipped than their competitors to make sound financial judgements. From this prosperity came the start of the modern world as we know it.

Chapter 1

Accounting Roles and Transactions

In this chapter we will be looking at the differing roles within an accounting system as well as the different organisations themselves. We will also look at the different transactions which may take place and the ways businesses set up their accounting systems.

Before we look at the mechanics of recording transactions we need to have a basic understanding of the different roles within an accounting system as well as the different types of business.

Bookkeeper

A bookkeeper is someone who records all the financial transactions of a business. Each type of transaction is stored in a different file called a book, hence the name bookkeeper. The most important actions of any business is buying and selling. The bookkeeper will record the details of all day to day sales and purchases in **day books**. They are called day books because daily transactions are recorded here. There will be a day book for sales and another for purchases. Obviously sales and purchases will involve the transfer of money, so the bookkeeper will also record the movement in and out of the business in a **cash book**. All books which record these transactions as they happen are called **books of prime entry**. In this case 'prime' means 'first' so these books are where the transactions are first recorded.

The bookkeeper is unlikely to be present at every transaction, so he or she will record transactions in the books of prime entry from **prime documents**. Typically a prime document is a receipt or an invoice, although we shall see later that other documents may fall into this category.

Accountant

An accountant is someone who deals with the presentation and interpretation of the figures. You will see later that there are rules and regulations covering the presentation of financial information. Financial information may include a **profit & loss statement** (also known as an **income statement** or a **statement of revenue and expense**). A profit & loss statement (or P&L) shows a business's financial performance.

Financial information may also be shown in a **balance sheet**. A balance sheet shows a business's assets, liabilities and net worth at a specific point in time.

The accountant may be responsible for advising on, and calculating taxation. Individuals and companies are all liable to taxation. Unlike employees, people with businesses are responsible for their own tax issues and the payment of amounts due. Accountants may calculate how much tax is due and complete the forms which are to be presented to **Her Majesty's Revenue and Customs** (HMRC). HMRC is the government department which deals with taxation in the UK.

An accountant may also be responsible for interpreting financial information. He or she may have to make decisions on future events in the business based on the business's past record. This may involve giving advice on the selling prices of goods, if it would be financially viable to go ahead with a new product, or whether to buy new machinery for the factory.

Accounting Technician

An Accounting Technician is someone who performs some of the duties of both the bookkeeper and the accountant. He or she may assist with the preparation of financial statements, deal with bookkeeping, look after and control budgets, monitor expenses and write reports. In many larger organisations, accounting technicians work alongside members of chartered accountancy bodies. In smaller organisations, they may be the only financially trained member of staff.

In practice the roles of the bookkeeper, accountant and accounting technician are all not as clearly defined as above, but this is a guide to the traditional duties of each.

Types of Business

There are three main types of business which will be dealt with in the AAT course.

Sole Trader

This is the business most dealt with in this Unit. The business will be owned and run by an individual. He or she will probably be responsible for most of the running of the business. He or she will be in charge of buying and selling goods or services and be in charge of hiring and firing staff. Many sole traders maintain their own books and then employ an accountant to prepare the final accounts ready for the tax calculation at the end of each financial year.

It is important to remember that a sole trader not only has the rights to all the profits a business makes, but also he or she is personally responsible for any losses. If a sole trader finds that he or she cannot pay his or her creditors from the business's income, then the money has to be found from the sole trader's personal belongings. For example, if a sole trader cannot keep up the repayments on the loan secured from the bank, the bank has the right to any or all of the sole trader's personal belongings until the debt has been repaid or the sole trader has no more belongings.

Partnerships

This is where a group of individuals come together to form a business. Typically there will be two to twenty individuals in a partnership and an agreement will have been made as to the proportion of profits to which each partner will be entitled. Partnerships are formed usually because, with more people involved in the business, there will be more expertise and money available to invest the company.

However, as with sole traders, the partners are personally responsible for any losses. In England and Wales they are 'jointly' responsible. All partners are equally responsible for all the debts of the business. They can only be sued as a group and not as an individual. In Scotland the law is slightly different. Here they are 'jointly and severally' liable, which means that in certain cases an individual partner can be sued, but if this partner doesn't have the resources to cover the suit then the other partners become liable for any amounts due.

Limited Company

A limited company is where a business is formed which is quite separate in legal terms from its 'owners'. The owners are **shareholders** but the company's finances are separate from the shareholders' personal finances. The shareholders have 'limited liability', meaning that they are only responsible for the amount of money they have invested (or guaranteed) to the company.

There are two main types of limited company. A **private limited company** may have one or more shareholders. The shares cannot be offered to the public. A **public limited company** (plc) must have at least two shareholders and must have issued shares worth at least £50,000. Both kinds of limited company must be registered at **Companies House** and each must appoint a director (at least two if it's a plc) who will manage the business. Each year a limited company must file its accounts with Companies House where the figures are open to the public. Profits are distributed to the shareholders each year (called **dividends**) in proportion to the number of shares owned. Some of the profit may be retained by the company for use within the company to pay future debts or for future investments.

Other Business Types

There are other types of businesses. So far we have only looked at the '**private sector**'. There are also '**public sector**' businesses which are owned or controlled by the Government. The public sector covers a wide range of organisations with different functions e.g.

- Central government
- Local government
- Health trusts
- Educational bodies e.g. schools and colleges
- Some corporations such as the BBC.

Then there is the '**voluntary sector**'. This includes charities or clubs. Typically they will have been established with the objective of addressing a social need, rather than simply to provide a service or generate revenue. Often they are non-profit making, or will reinvest revenue for the purpose of serving their client group or achieving their objective.

Organisational Structures

It may be becoming clear that the organisational structure of a business is dependent on the type of business. A small sole trader may do all the bookkeeping him- or herself. This is perfectly possible (although a lot of hard work) since the amount of information required will be limited. Basically all that is required in a one-man business is a list of what was sold and a list of what was bought. Taking the books to an accountant each year will be sufficient for the sole trader to see how well (or otherwise) the business is going and to satisfy HMRC regarding taxation.

In partnerships a little more work is required, although each partner will be responsible for his or her own tax liabilities. Since the company has more than one owner, a track of sales and purchases needs to be kept and the revenue and expenses created by each partner. It would be wise for a partnership to employ at least a bookkeeper to record the day to day transactions.

Limited companies will require more detailed accounting records. The format of the accounting records is regulated and more than simply what was bought and sold will need to be recorded and reported. Larger companies will have different departments for sales, purchases, wages, and **management accounts**. Management accountants assist management in decision-making, planning, and control. **Financial accountants** report the financial position and performance of a business.

Where there is more than one person in a company some sort of organisational structure will be required. The most common structure for larger businesses is the **hierarchical structure**. Responsibility passes from the director, to senior management, to middle management, and then to supervisors.

Then there is the '**tall**' structure. This has many levels of management with a long chain of responsibility.

Another structure is the '**flat**' structure.

The following pages show each structure in diagrammatic form.