

# 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.

**B**efore 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.

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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.

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### **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.

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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.

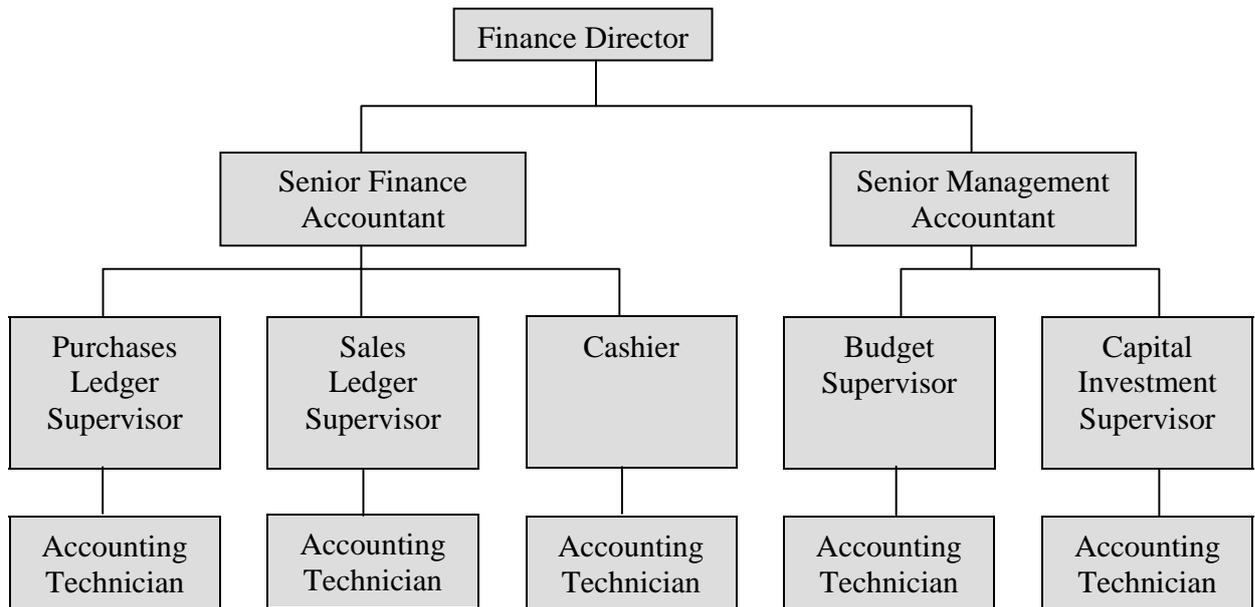
Then there is the '**tall**' structure. This has many levels of management with a long chain of responsibility.

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

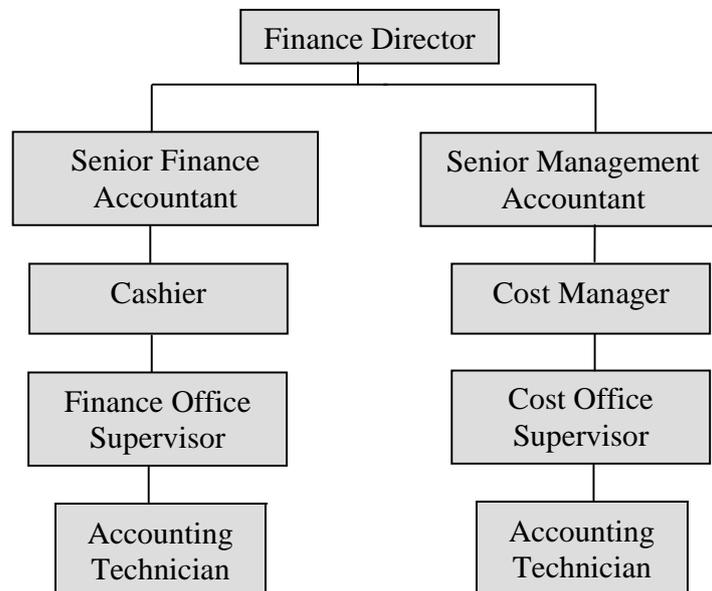
The following pages show each structure in diagrammatic form.

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**Hierarchical Structure**

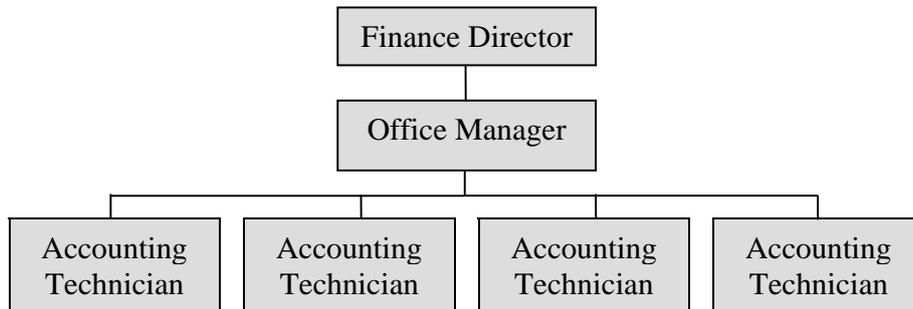


**Tall Structure**



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**Flat Structure**



Each of the above structures has been shown in a **functional format**, with each position showing what its function is. They could have been shown by **regional area** (Finance Director North and Finance Director South for example), by **product** (Finance Director Private Vehicles and Finance Director Commercial Vehicles), or a structure could be set up for individual projects.

**Accounting transactions**

No matter what the business or how it is structured all businesses carry out transactions which are common to all.

- All businesses sell goods or services
- All businesses purchase goods and services and pay expenses
- All businesses pay money into a bank account and make payments from it
- All businesses pay wages or a remuneration of some kind.

All these transactions must be recorded in some form. Some small businesses simply collect all **invoices** and **receipts** and give them to the accountant at the end of the year so that the accountant can produce financial statements from them. An invoice is a list of goods or services sold and given to the purchaser for payment. A receipt is a written acknowledgement that payment has been made for goods or services. Some small businesses record these transactions in their books as they occur, making the accountant's work easier and less time consuming (and therefore usually less expensive). A larger business will need to employ staff to look after the recording of these transactions since it will not be physically possible to do this on one's own. Books can be kept either by hand (manually) or on a computer.

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### **Retaining documents**

Legally there are differing instructions on how long accounting documents are to be kept. The **Companies Act 2006** states that a public limited company must keep records for six years from the date they are drawn up. Since the accounting records are made up for the year, some documentation from the beginning of the year will need to be kept, which in effect will make it seven years.

The **Companies Act 2006** states that private limited companies must keep similar records for three years.

The **Finance Act 1997** amended the requirement in the **Value Added Tax Act 1994** so that accounting records for VAT should be kept for six years.

**The Income Tax (Pay As You Earn) Regulations 2003** states that employers must keep payroll records for not less than three years.

The **Limitations Act 1980** requires that any action for a contract or fraud expires after six years. However, documents may be required for longer if such action is taken within the six years.

The **Taxes Management Act 1970** says that an assessment for tax can be made up to six years after the end of the period to which it relates, but personal tax documents need only be kept for 1 year and 10 months.

The **Data Protection Act** states that personal data processed for any purpose or purposes shall not be kept for longer than is necessary for that purpose or those purposes.

Other legislation requires certain documents to be retained for between 1 year and permanently.

So you can see that the legislation is confusing. If documents were never destroyed the business would accumulate a large amount of paperwork taking up space which could best be used for other purposes. It is therefore essential that the business has a policy on document retention. For most accounting documents this is often 6 years after the end of the period to which it relates. In most cases this will be sufficient to cover all possible claims made by employees, HMRC or customers. If documents are not available when they should be a fine will be imposed.

Once the retention period has elapsed the paperwork should not be simply thrown away in the general waste. It contains confidential information even though the information is old. The documents should be shredded or disposed of in a similar way so that private information does not find its way into the public domain.

In the next chapters we will look at some of the documents associated with financial transactions.

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**Chapter Summary**

- A bookkeeper records the financial transactions of a business in day books, while an accountant presents and interprets this data.
- A bookkeeper records transactions in day books and a cash book (which are books of prime entry) from prime documents.
- The data from the books of prime entry is used to produce financial statements such as a profit and loss statement and a balance sheet.
- There are three main types of business organisation: sole traders, partnerships and limited companies.
- Businesses have structures according to size and type. The three main structures are hierarchical, tall and flat. The structure may be organised according to function, region or product.
- All businesses have to record similar transactions. Businesses will record sales, purchases and bank transactions.
- It is a legal requirement that documents are retained for specific periods of time. All businesses should have a policy on document retention.

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**Practice Questions**

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**1.1**

- a) What type of business is run and owned by an individual?
- b) What type of business is owned by its shareholders?
- c) What type of business is run and owned by a group of associated people?
- d) If you bought shares from a stockbroker who traded in shares on the stock market, what kind of business would you be investing in?

**1.2**

- a) Traditionally, who records day to day transactions in books of prime entry?
  - a) Bookkeeper
  - b) Accountant
  - c) Accounting Technician
- b) Traditionally, who prepares a Profit & Loss account and a Balance Sheet?
  - a) Bookkeeper
  - b) Accountant
  - c) Accounting Technician

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**1.3**

- a) As an Accounting Technician, you work in an organisation with a long chain of command. There are many levels of management and supervision. Is this likely to be:
- a) A Hierarchical structure
  - b) A Tall structure
  - c) A Flat Structure?
- b) As an Accounting Technician, you work in an organisation with few layers of management. You are responsible to the office manager, who oversees all of your colleagues as well. The office manager is responsible directly to the Managing Director. Is this likely to be:
- a) A Hierarchical structure
  - b) A Tall structure
  - c) A Flat Structure?
- c) As an Accounting Technician, you work in an organisation where you are responsible to a manager for your area of work. Other managers are responsible for colleagues who work in other areas of accounts. There are various levels within the organisation and at each stage one person has a number of workers directly under them according to their area of work. Is this likely to be:
- a) A Hierarchical structure
  - b) A Tall structure
  - c) A Flat Structure?

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