

PROFESSIONAL DIPLOMA IN ACCOUNTING

SYNOPTIC ASSESSMENT

STUDY TEXT

Qualifications and Credit Framework

AQ2016

The Study Text supports study for the following AAT qualifications:

AAT Professional Diploma in Accounting – Level 4

AAT Level 4 Diploma in Business Skills

AAT Professional Diploma in Accounting at SCQF – Level 8

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CONTENTS

	<i>Page number</i>
Introduction	P.5
Synoptic guide	P.9
The assessment	P.14
Unit guide for Accounting systems and Controls	P.15
Study skills	P.23

STUDY TEXT

PART A – ACCOUNTING SYSTEMS AND CONTROL

Chapter

1	The accounting function	1
2	The use of key financial reports	23
3	Internal controls and weaknesses in accounting systems	43
4	Internal controls in a computerised environment	73
5	Ratio analysis	103
6	Preventing and detecting fraud	133
7	Improving the accounting system	167
8	Ethics and sustainability	191

PART B – SYNOPTIC ASSESSMENT QUESTIONS

9	AAT Sample assessment 1 – Questions	209
10	AAT Sample assessment 1 – Walkthrough and answers	233
11	AAT Sample assessment 2 – Questions	255
12	AAT Sample assessment 2 – Answers	273
13	Mock assessment – Questions	289
14	Mock assessment – Answers	305

**PART C – RECAPS OF CORE KNOWLEDGE FROM UNDERLYING
UNITS THAT HAVE SEPARATE UNIT ASSESSMENTS**

Appendix

A1	Financial Statements of Limited Companies	A1:1
A2	Management accounting: Budgeting	A2:1
A3	Management accounting: Decision and Control	A3:1
Index		I.1

INTRODUCTION

HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

STUDY TEXT

This study text has been specially prepared for the revised AAT qualification introduced in September 2016.

It is written in a practical and interactive style:

- key terms and concepts are clearly defined
- all topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style
- frequent activities throughout the chapters ensure that what you have learnt is regularly reinforced
- 'pitfalls' and 'examination tips' help you avoid commonly made mistakes and help you focus on what is required to perform well in your examination.

ICONS

The chapters include the following icons throughout.

They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained.



Definition

These sections explain important areas of Knowledge which must be understood and reproduced in an assessment.



Example

The illustrative examples can be used to help develop an understanding of topics before attempting the activity exercises.



Test your understanding

These are exercises which give the opportunity to assess your understanding of all the assessment areas.

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Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

Progression

There are two elements of progression that we can measure: first how quickly students move through individual topics within a subject; and second how quickly they move from one course to the next. We know that there is an optimum for both, but it can vary from subject to subject and from student to student. However, using data and our experience of student performance over many years, we can make some generalisations.

A fixed period of study set out at the start of a course with key milestones is important. This can be within a subject, for example 'I will finish this topic by 30 June', or for overall achievement, such as 'I want to be qualified by the end of next year'.

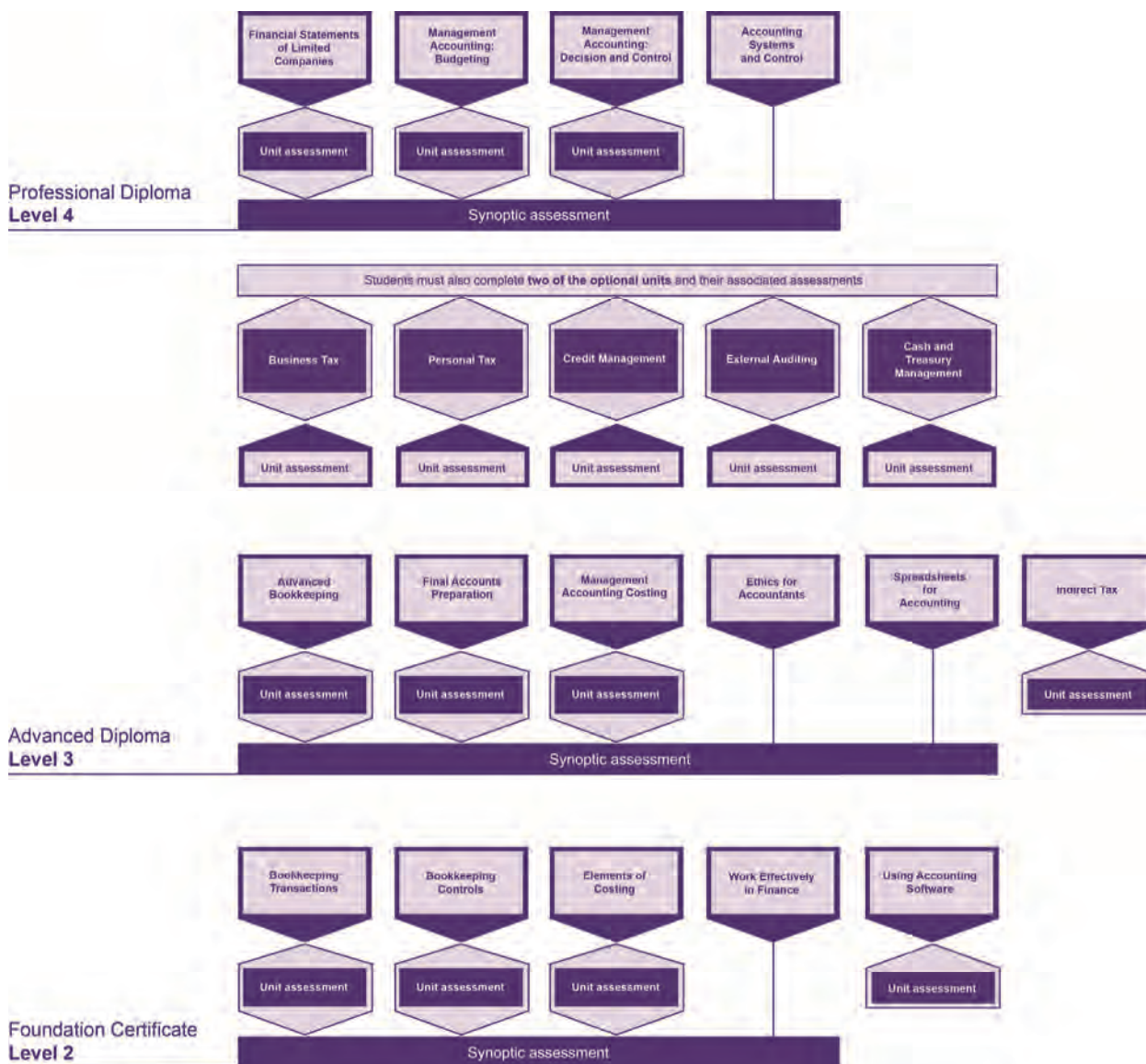
Your qualification is cumulative, as earlier papers provide a foundation for your subsequent studies, so do not allow there to be too big a gap between one subject and another.

We know that exams encourage techniques that lead to some degree of short term retention, the result being that you will simply forget much of what you have already learned unless it is refreshed (look up Ebbinghaus Forgetting Curve for more details on this). This makes it more difficult as you move from one subject to another: not only will you have to learn the new subject, you will also have to relearn all the underpinning knowledge as well. This is very inefficient and slows down your overall progression which makes it more likely you may not succeed at all.

In addition, delaying your studies slows your path to qualification which can have negative impacts on your career, postponing the opportunity to apply for higher level positions and therefore higher pay.

You can use the following diagram showing the whole structure of your qualification to help you keep track of your progress.

PROFESSIONAL DIPLOMA SYNOPTIC ASSESSMENT



SYNOPTIC GUIDE

Introduction

AAT AQ16 introduces a Synoptic Assessment, which students must complete if they are to achieve the appropriate qualification upon completion of a qualification. In the case of the Advanced Diploma in Accounting, students must pass all of the mandatory assessments and the Synoptic Assessment to achieve the qualification.

As a Synoptic Assessment is attempted following completion of individual units, it draws upon knowledge and understanding from those units. It may be appropriate for students to retain their study materials for individual units until they have successfully completed the Synoptic Assessment for that qualification.

Four units within the Professional Diploma in Accounting are mandatory. Of these, three are assessed individually in end of unit assessments, but this qualification also includes a synoptic assessment, sat towards the end of the qualification, which draws on and assesses knowledge and understanding from all four mandatory units:

- Financial statements of Limited Companies – end of unit assessment
- Management Accounting: Budgeting – end of unit assessment
- Management Accounting: Decision and Control – end of unit assessment
- Accounting Systems and Controls – assessed within the synoptic assessment only.

Scope of content

To perform this synoptic test effectively you will need to know and understand the following:

Assessment objective 1	Demonstrate an understanding of the roles and responsibilities of the accounting function within an organisation and examine ways of preventing and detecting fraud and systemic weaknesses
Related learning objectives	<p>Accounting Systems and Controls</p> <p>LO1 Demonstrate an understanding of the role and responsibilities of the accounting function within an organisation</p> <p>LO2 Evaluate internal control systems</p>
Assessment objective 2	Evaluate budgetary reporting; its effectiveness in controlling and improving organisational performance
Related learning objectives	<p>Accounting Systems and Controls</p> <p>LO1 Demonstrate an understanding of the role and responsibilities of the accounting function within an organisation</p> <p>LO2 Evaluate internal control systems</p> <p>LO3 Evaluate an organisation's accounting system and underpinning procedures</p> <p>Management Accounting: Budgeting</p> <p>LO3 Demonstrate how budgeting can improve organisational performance</p> <p>Management Accounting: Decision and Control</p> <p>LO1 Analyse a range of costing techniques to support the management accounting function of an organisation</p> <p>LO2 Calculate and use standard costing to improve performance</p>

THE ASSESSMENT

Test specification for this synoptic assessment

Assessment type	Marking type	Duration of exam
Computer based synoptic assessment	Partially computer/ partially human marked	3 hours

Assessment objective	Weighting
A01 Demonstrate an understanding of the roles and responsibilities of the accounting function within an organisation and examine ways of preventing and detecting fraud and systemic weaknesses	20%
A02 Evaluate budgetary reporting; its effectiveness in controlling and improving organisational performance	15%
A03 Evaluate an organisation's accounting control systems and procedures	15%
A04 Analyse an organisation's decision making and control using management accounting tools	15%
A05 Analyse an organisation's decision making and control using ratio analysis	20%
A06 Analyse the internal controls of an organisation and make recommendations	15%
Total	100%

UNIT GUIDE FOR ACCOUNTING SYSTEMS AND CONTROLS

Introduction

The purpose of the unit is to enable students to demonstrate their understanding of the role of the accounting function in an organisation and the importance of internal controls in minimising the risk of loss. Students will undertake an evaluation of an accounting system to identify weaknesses and assess the impact of those weaknesses on the operation of the organisation.

They will then make recommendations to address the weaknesses having regard for cost/benefit, sustainability and the impact of those recommendations on users of the accounting system. This unit enables students to consolidate and apply the knowledge and understanding gained from the mandatory Level 4 units of Financial Statements of Limited Companies, Management Accounting: Budgeting and Management Accounting: Decision and Control to the analysis of an accounting system.

When organisations have a planned change in policy there will be a transition period, which will present its own challenges. Students need to be able to review a planned change in policy, identify potential problem areas while one system is being changed to another and make suitable recommendations to ensure that the integrity of the accounting system is maintained.

The accounting system affects all areas of an organisation and should be capable of producing information to assist management with decision making, monitoring and control, as well as producing financial information to meet statutory obligations. In this unit, students will demonstrate analytical and problem-solving skills, exercising judgement to make informed recommendations. These are practical skills that are essential to the accounting technician.

Accounting Systems and Controls is a mandatory unit and requires students to have a sound understanding of management accounting and financial accounting information requirements, and the way that the accounting function needs to support both areas.

Learning outcomes

On completion of these units the learner will be able to:

- Demonstrate an understanding of the role and responsibilities of the accounting function within an organisation
- Evaluate internal control systems
- Evaluate an organisation's accounting system and underpinning procedures
- Analyse recommendations made to improve an organisation's accounting system

Scope of content

To perform this unit effectively you will need to know and understand the following:

	Chapter
1 Demonstrate an understanding of the role and responsibilities of the accounting function within an organisation	
1.1 Discuss the purpose, structure and organisation of the accounting function	1,8
Students need to know:	
<ul style="list-style-type: none"> • the difference between financial and management accounting • the importance of accuracy and cost-effectiveness within the accounting system • the importance of ethics and sustainability within the accounting function • why different types and sizes of organisation, or departments within an organisation, will require different accounting information and systems • the different accounting team staffing structures that will be required by different types or sizes of organisation 	

STUDY SKILLS

Preparing to study

Devise a study plan

Determine which times of the week you will study.

Split these times into sessions of at least one hour for study of new material. Any shorter periods could be used for revision or practice.

Put the times you plan to study onto a study plan for the weeks from now until the assessment and set yourself targets for each period of study – in your sessions make sure you cover the whole course, activities and the associated Test your knowledge activities.

If you are studying more than one unit at a time, try to vary your subjects as this can help to keep you interested and see subjects as part of wider knowledge.

When working through your course, compare your progress with your plan and, if necessary, re-plan your work (perhaps including extra sessions) or, if you are ahead, do some extra revision/practice questions.

Effective studying

Active reading

You are not expected to learn the text by rote, rather, you must understand what you are reading and be able to use it to pass the assessment and develop good practice.

A good technique is to use SQ3Rs – Survey, Question, Read, Recall, Review:

1 Survey the chapter

Look at the headings and read the introduction, knowledge, skills and content, so as to get an overview of what the chapter deals with.

2 Question

Whilst undertaking the survey ask yourself the questions you hope the chapter will answer for you.

The accounting function

1

Introduction

The accounting function is an important part of any organisation. It needs to reflect the organisation's needs at all times.

PERFORMANCE CRITERIA

- 1.1 Discuss the purpose, structure and organisation of the accounting function
- 1.3 Examine the impact of relevant regulations affecting the accounting function
- 1.4 Demonstrate an understanding of the impact of management information requirements on the accounting function
- 3.1 Examine an organisation's accounting system and its effectiveness

CONTENTS

- 1 Introduction
- 2 The accounting/finance function
- 3 Understanding systems

1 Introduction

1.1 Organisations and the need for control

There are many different types of organisations but they all share the following key characteristics:



Definition

'Organisations are social arrangements for the controlled performance of collective goals'.

The key aspects of this definition are:

- **Collective goals** – organisations are defined primarily by their goals. A school has the main goal of educating pupils and will be organised differently from a company where the main objectives are to make profits and pay dividends to shareholders.
- **Social arrangements** – someone working on his own does not constitute an organisation. Organisations have structure to enable people to work together towards common goals.
- **Controlled performance** – organisations have systems or procedures to ensure goals are achieved.

The key emphasis of the Accounting Systems and Control unit (and the Professional Diploma Synoptic Assessment) is the third of these:

- How do organisations ensure that they achieve their objectives?
- What control mechanisms can they introduce to help managers and other employees work in such a way that the organisation is successful?

1.2 Control mechanisms

There are a wide number of ways that control can be used within an organisation, including the following:

- **Organisational structure** – breaking the organisation down into smaller units, such as having a dedicated accounts department, with clearly defined roles, responsibilities and authority. This can be reflected in many ways, such as insisting that all capital expenditure over £1,000 must be authorised by the Finance Director, for example.
- **Target setting and budgeting** – so staff know what is expected of them.

- Direct **supervision** of staff by managers.
- The **culture** of the organisation – for example, where mistakes are not tolerated.
- **Self-control** where employees are encouraged to work independently and take responsibility for their own results.
- Control **systems** – for example where actual results are compared to the budget each month and variances produced. These allow managers to identify, and focus on, areas where performance is not as expected and take corrective action.
- Specific control **processes** – for example, Creditors Ledger Control Account reconciliations may identify errors in processing purchase invoices.



Test your understanding 1

Jersey Ltd is a small business that manufactures high quality portable loudspeakers. The business is small and has only twenty members of staff, with one supervisor. The work is highly skilled and complex, with staff divided into four teams – each with very different sets of required skills.

Currently there are no control procedures or any work guidance for employees, meaning that each member of staff often works in the way they individually feel is best. The twenty employees are moderately well paid, though there are few, if any, real promotion prospects and several employees have expressed their dissatisfaction with the working conditions within Jersey.

Jersey is owned and run by one person, H. She is concerned that the level of quality of production has fallen in recent months, as evidenced by an increase in wastage and a decrease in output. H is concerned about the effect this is having on the profitability of the company. As such, H is examining the possibility of introducing control processes to ensure that all units made are of adequate quality.

Task

Discuss the appropriateness of each of the following possible controls for Jersey:

- (a) Direct supervision of manufacturing staff
- (b) Setting performance targets for employees based on quality of output
- (c) Relying on individual employees to control their own work.

In this chapter, and the chapters that follow, we shall look in particular at how some of these impact the running of the accounting function and the role of internal controls within an accounting system.

1.3 Organisational structure

Organisational structure is concerned with the way in which work is divided up and allocated and can involve considering the following:

- **The division of responsibility:** some organisations may be split on divisional lines based on geography (e.g. having a 'UK Division'); others will be on divisional lines based on products (e.g. having a 'motorbikes division'), some on functional lines (e.g. having a 'Marketing department') and others a mixture of these elements.
- **The degree of decentralisation:** This refers to the level at which decisions are made.

In a centralised structure, the upper levels of an organisation's hierarchy retain the authority to make decisions. In a decentralised structure the authority to take decisions is passed down to units and people at lower levels.

For example, a company may have a division responsible for developing a new mobile phone but the manager concerned may find that all key decisions are made not by themselves but by the main Board of Directors.

Decentralisation can also refer to where certain functions operate – for example, within a divisional company should each division have its own accounts department (decentralised) or should there be just one at head office (centralised)?

- **The length of the scalar chain:** This is the line of authority which can be traced up or down the chain of command, from the most senior member of staff to the most junior.

It therefore relates to the number of levels of management within an organisation.

- **The size of the span of control:** A manager's span of control is the number of people for whom he or she is directly responsible.
- **Whether organisations are 'tall' or 'flat':** A 'tall' organisation has many levels of management (a long scalar chain) and a narrow span of control. A 'flat' organisation has few levels of management (a short scalar chain) and a wide span of control.

In order to discuss these issues, it is important to distinguish between authority, responsibility and accountability:

- **Authority:** if an organisation is to function as a co-operative system of individuals, some people must have authority or power over others. Authority and power flow downwards through the formal organisation.

- **Responsibility (for):** the allocation of tasks to individuals and groups within the organisation. It means being held accountable for personal performance and achievement of the targets specified by the organisation's plans.
- **Accountability (to):** the need for individuals to explain and justify any failure to fulfil their responsibilities to their superiors in the hierarchy. It is the extent to which persons are answerable for their actions, the consequences of those actions and the measured effect on end results.

2 The accounting/finance function

2.1 The role of the accounting function

Accounting is the systematic recording, reporting and analysis of financial transactions within a business. Within this, accuracy and cost effectiveness are critical.

The accounting function affects all areas of an organisation and should be capable of producing information to assist management with decision making, monitoring and control, as well as producing financial information to meet statutory obligations.

Accountants thus have to provide information to very diverse groups, both internally and externally. The specific needs of each determine whether these can best be served by the financial accounting or the management accounting function of the business organisation.

- **Financial accounting** is concerned with the recording and processing of transactions as they occur. Accounts are kept of all 'receivables' and 'payables' transactions and of all monies paid by and to the business.

Coupled with this will be the preparation of the annual accounts in the forms required for both shareholders and HMRC and also periodic financial statements (e.g. cash flow statements, receivable and payable balances, draft monthly profit and loss accounts and statements of financial position). For these there will be the need to incorporate adjustments such as for depreciation, asset valuation, accruals and provisions.

- **Management accounting** involves the preparation and presentation of internal accounting information in such a way as to assist management in formulating policies, planning and controlling activities.

Based mainly on the information provided by the cost accounts, data is analysed and information is presented to management to provide a basis for decision-making.

Associated with this will be the operating of systems of budgeting control and standard costing.

Information requirements could thus involve anything from monitoring inventory levels to monthly variance analysis to setting and monitoring key performance indicators (KPIs).

As you will know, the preparation of cost accounts involves a separate approach from financial accounting and will thus have a separate role in the accounting function.

An **integrated** accounting system combines the needs of external and internal users of the accounts.

This type of system is increasingly common and can be:

- cheaper to operate than two or more separate systems
- provide greater consistency of data
- increase the confidence in the data.

Normally other subdivisions of the accounting function include the cashiers' department and the wages department. The cashiers are responsible for all the transactions involving cash, such as receipts from customers, payments to suppliers and payments of wages. The wages department, in addition to the calculation of remuneration due to employees, will also provide basic data for both the financial and costing systems.

The role of internal auditor ideally should be a separate function but is very often part of the accounting function.

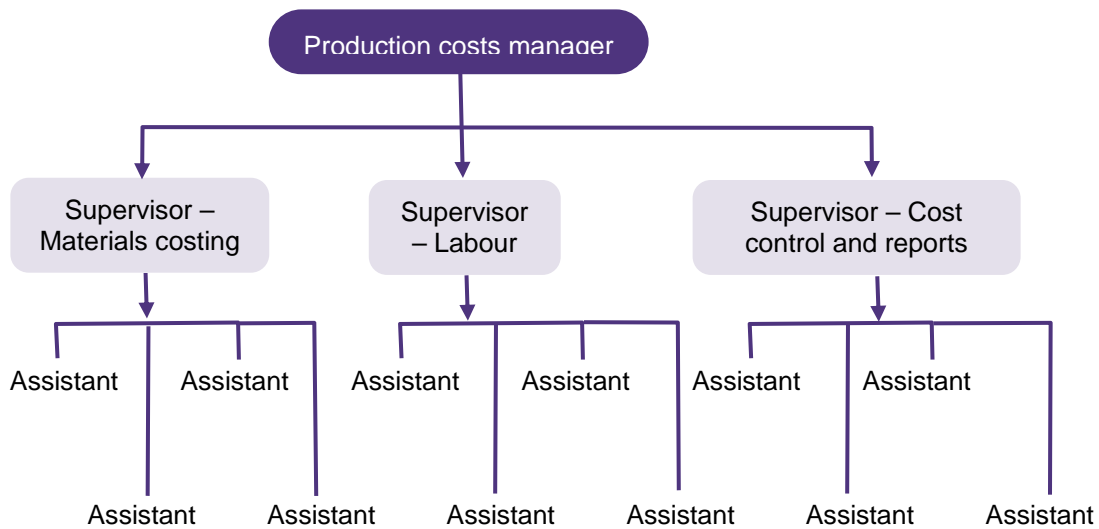
Note: Larger organisations may also have a separate **treasury** function. Treasury management is the corporate handling of all financial matters, the generation of external and internal funds for business, the management of currencies and cash flows, and the complex strategies, policies and procedures of corporate finance. These are beyond the scope of your assessment.

2.2 Sections in the accounts department

The financial accounts department will be further divided with a supervisor or manager responsible for each section e.g. sales ledger, purchase ledger, credit control and payroll.

Management accounting work will also be divided up with accountants as supervisors of sections responsible for keeping different cost records e.g. materials, production and marketing.

Taking a section of the cost accounts department, we can outline a possible structure:



2.3 Location of the accounts department(s)

For organisations with different sites, the overall policy on centralisation versus decentralisation and organisational structure will have important effects on the location of the accounts departments.

In some cases the accounting function may be carried out entirely at the head office; in others each location would be responsible for all its own accounting procedures, with only interim and final financial statements being forwarded to head office.

With centralisation there is the opportunity to employ specialist accounting staff and advanced EDP systems more effectively and economically.

When staff are in one central office, supervision may be improved and there is greater flexibility of staff and easier handling of peak loads. However day-to-day control over financial control systems may be lost and there may be delays in the flow of information and documents. In addition head office staff are quite often regarded with suspicion and resentment and there may be the danger of head office becoming out of touch with the peculiar characteristics of the methods of working at each location.

Organisational structure may determine the location of departments. A divisionalised structure with different activities within the group may lend itself to separate accounts departments at each division. On the other hand a major chain of retail stores may install strong control systems at each outlet, with basic data being transmitted daily for processing and reporting by a centrally located accounts department.

2.4 Relationships between the accounting function and other departments/functions within the organisation

Within any organisation (when seen as an entity), departments, sections and individuals must all be organised to ensure that:

- the overall objectives of the organisation are attained
- each department, section and individual makes a valid contribution.

It is therefore essential that the efforts of each contributor are co-ordinated to ensure that objectives are met.

In addition to the initial communication of expected objectives to contributors, it is essential that the organisational structure permits the flow of required information in all directions so that the attainment and achievement may be measured or forecast at any one moment. Reporting procedures should ensure that progress is constantly monitored and that the work plan is kept to schedule.

If we briefly consider the role of the accounting/finance function, then we can see that it has an important relationship with other major areas.

Finance has three main roles:

- (i) It is a resource that can be deployed so that objectives are met.
- (ii) An organisation's objectives are often expressed in financial or semi-financial terms.
- (iii) Financial controls are often used to plan and control the implementation of strategies and financial indicators are often used for detailed performance assessment.

The accounting department can be viewed as having responsibility for handling and processing information within the organisation. This information and any control procedures are provided as a service to the other departments.

Other relationships involving the accounting function include the following:

- (a) The marketing department will rely on an analysis of sales by region, sales person, customer or town in order to formulate an advertising strategy or sales promotion effort.

- (b) There is a relationship between the personnel department and the wages department, because employee details must be updated to cover any changes. This relationship could be extended to include the industrial relations officer, who may be employed by the production department and be responsible for initiating these changes.
- (c) The IT department, whether considered part of the accounting function or not, has a very wide span of responsibility in any organisation.

Most of the department managers will expect regular reports from this department and must therefore be in constant liaison with the staff to make sure the information is relevant to their current needs. Any suggestions for changes to the system would be negotiated here.

- (d) The statistician will have responsibilities for providing information on such things as production output, variations from quality standards, comparisons of efficiency in the sales department, analysis of questionnaires for the market research staff and comparative information on wastage of materials from different suppliers.



Test your understanding 2

BBO Ltd makes luxury cakes and desserts. Most of the cakes manufactured are for large food retailers who sell the cakes as their own brand. BBO packages the cakes using the brand required by each retailer. Some cakes and desserts are sold to small independent food retailers, such as hotels and coffee shops, under BBO's own brand. The smaller retailers typically take longer to pay invoices than larger retailers. Currently the Junior Accountants cover the role of credit control between them.

The board of BBO are keen to expand sales to smaller retailers under the BBO brand as margins are higher and they feel that it is important to strengthen BBO brand awareness to help in negotiations with larger retailers.

Task

Assess the impact of the proposed expansion on the finance function, highlighting key risks and outlining two ways risk can be mitigated.

3 Understanding systems

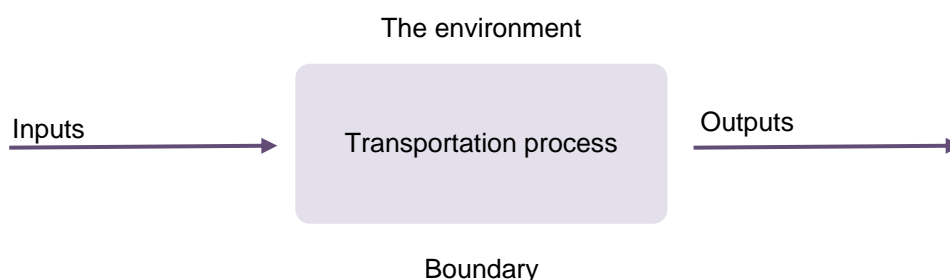
3.1 Systems

Before looking in detail at accounting control systems, it is worth considering the wider topic of what is meant by a 'system' and what are typical features of such 'systems'.

The term 'system' can be defined as a set of interacting elements responding to inputs to produce outputs.

Every system, whatever its nature and purpose (e.g. central heating system, banking system, payments system) is a way of viewing a group of components or elements and the way in which they interact.

The elements of a system are outlined in the diagram below.



Every system exists within an environment. This is the set of elements that affect the system, but are not controlled by it. The system boundary is the limit of the system; within it is the system and outside it is the environment.

A boundary is often a matter of definition. For example, if the system under examination is 'the whole company' then within the boundary will be found the subsystems of the system, for instance, the employees and procedures contained within departments such as production, purchasing, sales and finance. The sub-systems communicate by passing messages between themselves.

Outside the boundary is the environment, which includes customers, suppliers, the labour market, shareholders, lenders, competitors and the local community as well as more abstract and indirect influences such as the law and the economy.

If we are concentrating on the finance system, then sales, production and purchasing become part of the environment, and within the system boundary will be found smaller subsystems such as product costing, financial accounting and treasury.

Financial accounting staff responsible for the preparation of the annual accounts might rely on the management accounting staff for data about inventory records so as to place a value on closing inventory in the accounts.

The receivables section relies on sales staff to send copies of sales orders or confirmation of goods delivered to customers and on the cashier to pass on information about payments received. It must also co-operate with debt collection staff by helping to prepare monthly statements and lists of aged debtors.

The payables section relies on the purchasing department to send copies of purchase orders and confirm the validity of invoices received from suppliers and also inform the purchase ledger staff about any despatches concerning goods received or purchases returned. The section also relies on the cashier to inform it of all payments of invoices.

3.2 The systems approach

The systems that operate within organisations can be viewed in many ways, for example:

- Social systems – composed of people and their relationships
- Information systems – relying on information to support decisions
- Accounting systems – emphasising the organisation's cash flows
- Economic systems – utilising resources to produce economic welfare.

Our focus is solely on the accounting system.

The accounting system receives inputs from other systems (production for example), it converts that data in to meaningful financial information (its output). Clearly anything outside the accounting system is its environment (the wider organisation for example).

3.3 Control systems

Organisations have many control systems such as quality control, stock control and budgetary control. Control is the activity that monitors changes or deviations from those originally planned. The control of an organisation is exercised by managers obtaining and using information.

To get a better understanding of control systems, it is useful to start with an example that is in everyday use – a thermostat. All central heating systems contain thermostats to regulate the temperature of the rooms they are heating. The user sets the thermostat to the required temperature on the dial. There is a thermometer in the system, which measures the temperature of the rooms. The room temperature is continually compared with the pre-set temperature on the thermostat dial. If the room temperature is above the dial temperature, the power (e.g. gas) is switched off. When room temperature falls below the dial temperature, the power is switched on.

The elements of a control system are:

- **Standard** – is what the system is aiming for. In the thermostat system it is the pre-set temperature.
- **Sensor** (or detector) – measures the output of the system. In the thermostat system it is the thermometer.
- **Comparator** – compares the information from the standard and the sensor.
- **Effector** (or activator) – initiates the control action. In the thermostat system it is the switch.
- **Feedback** – is the information that is taken from the system output and used to adjust the system. In the thermostat example the feedback is the actual room temperature.

In an organisational system, information about how the system actually performs is recorded and this information is available to the managers responsible for their achievement of the target performance. For effective and accurate control it is essential that timely and efficiently detailed feedback is provided so that corrective action can be taken. This may be a minor operating adjustment or it may involve a complete redesign of the system.

A good example of such a system is variance analysis:

- 1 Standard costs are developed and a budget produced detailing what should happen – this is the ‘standard’.
- 2 Actual results are measured – this is the ‘sensor’.
- 3 Actual results are compared against budget in the form of variance analysis – this is the ‘comparator’.
- 4 Managers then decide which variances are significant and worth further investigation – this is the ‘activator’.
- 5 Managers can then take appropriate action, whether this is changing the budget or addressing operational issues – this is ‘feedback’.

In your assessment you will need to be practical and be focussed on controls within an accounting function, this is covered in more detail in chapter 3.

3.4 Systems and procedures best practice

As with most aspects of business administration, there are certain principles that have been built up over a long period. They include the following:

- There should be a smooth flow of work with no bottlenecks.
- Movement of staff should be kept to a minimum.
- Duplication of work should be avoided.
- The best and most effective use of existing specialist attributes should be made.
- Simplicity within systems should be sought. Complications usually lead to misinterpretations and/or mistakes.
- Machines should be used to help staff where appropriate.

Any system must be cost-effective. The benefits should be compared with the cost of implementation and subsequent supervision costs.

The establishment of systems and procedures will ensure that organisational objectives are attained. Data and information are constantly flowing within an organisation, some being generated internally and some stemming from external sources. All of this information must be processed and, to ensure that it is accomplished in the most effective, efficient and economical manner, a system needs to be established.

3.5 Systems and procedures manuals

Although they are not always immediately apparent, every organisation has systems, which are usually referred to as 'office procedures' that outline the operations necessary to perform a task associated with the receipt, recording, arrangement, storage, security and communication of information.

Sometimes these procedures are formalised by the preparation of 'laid-down' or written procedures in an office manual format stating the system, as it should be. These written instructions should indicate clearly what is required to be done, when, where and how. The preparation requires careful examination of the systems and procedures. This close attention can only be of benefit in that strengths and weaknesses are revealed.

There are, however, advantages and disadvantages associated with manuals.

A list of the advantages would include the following:

- Supervision is easier.
- It helps the induction and training of new staff.

- It assists the organisation in pinpointing areas of responsibility.
- Once they are written down, systems and procedures are easier to adapt and/or change in response to changing circumstances.

The disadvantages include:

- The expense in preparing manuals both in the obvious financial terms and the perhaps less obvious cost of administrative time.
- To be of continuing use an office manual must be updated periodically, again incurring additional expense.
- The instructions that are laid down in the office manual may be interpreted rather strictly and implemented too rigidly. Within any organisation it is often beneficial for employees to bring a degree of flexibility to their duties to cope with particular circumstances.

3.6 The review of office procedures

Systems should be kept under continuous review and altered as necessary to reflect changes in the organisation, advances in technology, or indeed suggestions from the staff as to how systems can be improved. The decision to review the office procedures could stem from weaknesses that may have already been highlighted (for instance, too much paperwork).

A review may be divided into two parts:

- (i) an overview of the office and the role it plays within the organisation, which will consider:
 - the purpose of the office
 - what actually happens within the office
 - who does what within the office
 - the techniques and methods employed by staff in carrying out assigned responsibilities
 - the quality of performance
- (ii) a detailed step-by-step examination of the procedures themselves.

The establishment of such information is vital as a first stage. After this a more detailed analysis of the day-to-day routine may be attempted.

In your assessment there is a requirement to consider the impact that changes to the environment might have on the accounting function. This is considered more specifically in chapter 7.

3.7 Wider environmental factors – legislation and regulations

The law constitutes a set of environmental factors that are increasingly affecting organisations and their decision-making. They can also affect the accounting function. Most of the nations of the world are, or are becoming, regulated economies.

Government, or self, regulation of business has four principal aims:

- **To protect business entities** – e.g. laws putting limits on market dominance by acting against monopolies and restrictive practices and providing financial assistance to selected ailing industries and companies.
- **To protect consumers** – with many detailed consumer protection regulations covering packaging, labelling, food hygiene and advertising, and much more.
- **To protect employees** – with laws governing the recruitment of staff and health and safety legislation that regulates conditions of work.
- **To protect the interests of society at large against excessive business behaviour** – e.g. by acting to protect the environment.

Also at the most basic level, perhaps, laws are passed that enable Government to levy taxes, whereas company law affects the corporate structure of the business and prescribes the duties of company directors.

Managers cannot plan intelligently without a good working knowledge of the laws and regulations that affect their own companies and the businesses they operate in. In addition to those laws that apply generally to all companies, such as laws regulating Corporation Tax or Value Added Tax, there are laws specifically used to deal with individual industries, e.g. Petroleum Revenue Tax in the offshore oil and gas industry.

There is an almost endless list of laws or categories of legislation that affect business enterprises, in domestic, national or international dimensions.

The key point for your assessment is that the accounting system must make provision for the relevant regulation in place at any one time. For example if the VAT rate set by government was to change then the accounting system must change with that.

3.8 Regulations affecting accounting practice

The financial statements of limited companies must usually be prepared in accordance with the legal framework relevant to that company, for example:

- The Companies Act 2006 in the UK.
- In addition companies are also required to comply with a generally accepted financial reporting framework, which is the International Financial Reporting Standards (IFRS), which are issued by the International Accounting Standards Board (IASB).

3.9 The IASBs conceptual framework

The framework states that the objective of the financial statements is to provide information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

The IASB's Framework also suggests that financial statements should have certain qualitative characteristics.

The Framework splits qualitative characteristics into two categories:

- (i) Fundamental qualitative characteristics
 - Relevance
 - Faithful representation.
- (ii) Enhancing qualitative characteristics
 - Comparability
 - Verifiability
 - Timeliness
 - Understandability.

3.10 Generally Accepted Accounting Practice (GAAP)

The concept of GAAP stems from US accounting. In the UK we publish financial statements, which show a 'true and fair' view. In the US the reference is to conforming to GAAP.

Although GAAP is not often referred to in the UK it comprises the whole set of accounting practices which have authoritative support amongst users of financial statements.

There will be crossovers between accounting standards and GAAP where standards reflect GAAP. However, there may be a GAAP that is not represented by a standard.

UK GAAP extends further than accounting standards alone to include the requirements of the Companies Act and The Stock Exchange.

4 Further 'Test your understanding' questions



Test your understanding 3

- 1 Outline the structure of your accounting function.
- 2 Explain quality control as a control system.
- 3 Outline the elements of a budgetary control system in which the financial performance of a department is compared with the budget.
- 4 What is the main function of an accounting system?

5 Summary

This chapter was a general introduction to systems and the accounting function in particular. It provides the theoretical background that you need to properly understand the relationships that exist for the accounting function.

Test your understanding answers



Test your understanding 1

(a) Direct supervision of staff

Jersey could opt to directly monitor the activities of its staff in order to ensure their work is of appropriate quality. This could be effective at stopping the production of poor quality speakers and the associated waste that would be involved in this. The fact that Jersey only has a small number of staff would also tend to make this approach work well.

However, there would be several problems associated with this control. Firstly, each group of workers has highly specialised skills. This may make it difficult for Jersey's supervisor to understand what each group does and monitor their activities effectively. In addition, the fact that each worker may undertake the same job as their colleagues but using a different technique, will increase the complexity of the monitoring role.

While the workforce is small, there is only one supervisor. They may have insufficient time available to supervise all staff. Hiring of additional supervisors would have cost implications for Jersey.

Finally, additional supervision may have a negative impact on the motivation of employees, who are used to having autonomy over the way they perform their jobs. A sudden change to being closely monitored could cause further job dissatisfaction.

(b) Performance targets

Setting performance targets could be of great use to Jersey. This would likely involve offering incentives for staff (such as pay rises and bonuses) depending on how well they perform their jobs. For Jersey, the number of defective units produced by each employee could be measured and a bonus could be offered if this was below a pre-agreed level.

This could be a very practical approach for Jersey, as it links employee rewards with the objectives of the company itself. It should be easy to implement and would prevent the production of units that were defective, reducing waste. The offer of an additional bonus or extra pay may also help to improve general motivation as workers are currently only adequately paid and have few other benefits or prospects.

Note that this may not improve the output of each worker, which is another issue for Jersey. Workers may spend longer on each unit in order to ensure the quality and thus receive their bonus, leading to a further fall in productivity.

(c) Reliance on self-control of workers

Relying on individual staff to monitor their own activities may be problematic. It has the advantage of being cheap for Jersey, as it does not require any further staff to be hired. In addition, the staff are clearly skilled at their jobs, making it easier for them to understand the best way to approach individual tasks.

However, staff seem to be relatively de-motivated. This means that they are less likely to be concerned about the quality of their output. Unless they are offered an incentive by Jersey, there is no reason why they would focus on higher quality production.

In addition, there is no agreed 'best practice' for each of the four teams. Each worker is likely to see their method as superior to those of their colleagues, whether this is in fact correct or not. This means that they are unlikely to change their working practices to ones that would improve output and quality.

Note: this exercise is not indicative of the style of tasks in the synoptic assessment. However, it is useful to help you start thinking about how to control an organisation and what might go wrong. In the sample assessment tasks will focus much more on **accounting** tasks and activities.



Test your understanding 2

The impact of the new customers on the finance function and key risks

Firstly, there will be a significant increase in the volume of transactions that will need to be processed within the finance team. There are two aspects to this that will need to be addressed: ensuring that there is adequate employee resource to deal with the processing of orders and invoices as well as the ability of our systems to deal with the volume of data.

Secondly, there will be a potential detrimental impact on our cash flows. As we already know our small independent retailers often pay late and it is likely that these new customers follow the same trend.

Thirdly, there will be an increase in the recoverability risk that the business faces. By their nature small independent businesses are more likely to become insolvent or simply cease to trade than larger corporations.

Lastly, and on a positive note, one key impact will be that our brand will benefit from an increased presence in the market. Although this benefit might be limited if hotels and coffee shops simply sell our cakes by the slice or serve our desserts, as the end consumer will be unaware of the fact that it is one of our products.

Measures to mitigate any additional risk

1 Recruit appropriate qualified people for the finance department:

It would be sensible to recruit an appropriate experienced and qualified credit controller to ensure that all new customers are assessed as to their credit worthiness and that the receivables are monitored and chased for payment as required in a timely manner.

2 Ensure sound credit control procedures are in place:

All potential customers should be assessed as to their creditworthiness prior to being accepted. This might involve purchasing credit agency reports or performing an internal assessment by looking at financial statements. In addition there should be procedures in place for the regular monitoring of outstanding debts and for chasing up late payments through telephone calls and letters.



Test your understanding 3

- 1 This should be based on your own business.
- 2 Quality control is the control system of setting quality standards, measuring performance against those standards and taking corrective action when necessary. The standard aimed for will depend on the nature of the product, the market for which the goods are produced and the standards achieved by competitors in the same market.
- 3 The elements of the control system are:
 - standard: the budget (e.g. standard costs)
 - sensor: the costing system, which records actual costs
 - feedback: the actual results for the period, collected by the costing system
 - comparator: the 'performance report' for the department, comparing actual with budget (e.g. variance analysis)
 - effector: the manager of the department, in consultation with others, takes action to minimise future adverse variances and to exploit opportunities resulting from favourable variances.
- 4 The main function of an accounting function is to take inputs and convert them in to meaningful accounting information, which is useful to the various stakeholders of an organisation.