ACCA Diploma in Financial and Management Accounting (RQF Level 2)

FA1

Recording Financial Transactions

STUDY TEXT

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Chapter 1

BUSINESS TRANSACTIONS

This chapter introduces the common types of business transaction. Later chapters will look at how transactions are recorded, how accounting records are controlled and how the accuracy of these is scrutinised.

This chapter covers syllabus area A1.

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LEARNING OUTCOMES

At the end of this chapter, you should be able to:

- understand the main types of transaction that a business is likely to undertake
- distinguish between cash and credit transactions
- distinguish between transactions in goods and in services
- distinguish between receipts and payments and income and expenditure
- understand the need to document business transactions
- identify the key personnel involved in initiating, processing and completing transactions
- understand the need for effective control over transactions
- identify the timing of various transactions.

1 TYPES OF BUSINESS TRANSACTION

Every business sells goods or services to customers and should be paid for what it sells. Every business buys goods and services from suppliers, and must pay for what it buys.

For example, retail businesses such as department stores and supermarkets buy goods from suppliers for resale to shoppers, and a garage buys car parts and components to repair customers' cars. Businesses buy stationery and computers for their office work.

All businesses incur expenses for various services, such as the supply of electricity, telephone services, property rental costs and local taxation (business rates). Many businesses have employees, and have to pay for their labour in the form of wages and salaries.

In this publication, the tern ‘business’ is used to refer to an organisation or entity which undertakes trading activities, irrespective of the legal structure or characteristics of that business. The ACCA FA1 syllabus does not require any knowledge of different business structures such as a partnership or limited liability company. The focus is upon sole proprietors – individuals who both own and manage the business.

2 TERMINOLOGY

Precise terminology is important in bookkeeping and accounting. Key terms are given at the end of each chapter to highlight appropriate terminology. It is important to be clear on the following:

- **Sales** – the exchange of goods or services for money. Items such as commission and fees received are also used instead of sales for some services, perhaps by professional businesses such as accountants and lawyers.
- **Purchases** – goods and services obtained for resale to customers, or for use or consumption in the business.
- **Receipts** – money received, mainly from cash sales or from customers who have been allowed a period of credit before making payment.
- **Payments** – money paid out in cash or from the bank account by cheque or digital or electronic means.
- **Income** – a more general term than sales to also include interest received, rent received from letting part of the business premises and so on.
- **Expenses** – cash paid for rent, electricity for lighting, telephone charges and so on. This does not include purchases of goods for resale or the purchase of assets, such as machinery and equipment for use in the business.
- **Expenditure** – includes purchases, expenses and money spent on buying anything else for the business.
- **Petty cash** – relatively small amounts of cash in the form of notes and coins used to pay small, occasional expenses, such as office refreshments or travel expenses. Normally, the cost would be paid by an employee who would then receive a cash reimbursement.
- **Payroll** –is accounting for the costs of having employees, which includes all elements of gross pay (before any tax deductions) such as basic wage or salary, plus any bonus, commission and also additional employer costs.

3 CASH AND CREDIT TRANSACTIONS

Most business transactions for buying and selling goods or services are either cash transactions or credit transactions.

- With a **cash transaction**, the buyer pays for the item either upon exchange of goods/services or they pay in advance. For example, sales in a shop or supermarket are cash transactions, because the customer pays at the cash desk or check-out point.
- With a **credit transaction**, the buyer doesn't pay for the item on receipt, but is allowed some time (a 'credit period') before having to make the payment.

Example of a credit transaction

Velocity Book Publishers places an order with a printing company, Q Print, to print 5,000 copies of a new book they are publishing. Q Print agree to print the books and Velocity Book Publishers will be given up to 60 days to pay after the books have been printed. Q Print delivers the books into the warehouse of Velocity Book Publishers on 1 March, and submits a demand for payment (known as an invoice) for $15,000, payable on or before 1 May.

This is a credit transaction because Velocity Book Publishers does not have to pay for the purchased items when it orders the books, nor even when the books are received. Instead, it has been given time to pay after the goods have been received.

Most transactions between two businesses are credit transactions. In other words, businesses usually buy from other businesses and sell to other businesses on credit. The credit terms, such as how long the buyer has to pay, are agreed between the buyer and the supplier in advance.

	Cash	Credit
Sale	Goods are sold or a service provided and the customer pays immediately.	Goods are sold or a service provided and the customer pays at a later date.
Purchase	Goods are purchased or a service received and is paid for immediately.	Goods are purchased or a service received and paid for at a later date.

ACTIVITY 1

A client receives a haircut by a self-employed hairdresser. The client pays for this with $20 cash.

1 What kind of transaction is this from the client’s perspective?

A The sale of goods by the hairdresser

B The sale of a service by the client

C The purchase of goods by the hairdresser

D The purchase of a service by the client

2 What kind of transaction is this from the hairdresser's point of view?

A A cash sale

B A credit sale

C A cash purchase

D A credit purchase

For a suggested answer, see the 'Answers' section at the end of the book.

Every purchase from one party's perspective is a sale from the other perspective of the other party to the transaction. The purchaser makes payment and seller receives it in exchange for the goods or services supplied.

3.1 METHODS OF PAYMENT

You need to understand the different methods of receiving payment from customers, or making payments to a supplier. Four common methods of receiving and making payments used in many businesses are:

- payments in 'cash', in other words, in notes and coins
- payments by debit and credit cards and electronic payment methods
- payments by cheque
- automated receipts and payments through the business bank accounts. Examples are standing orders and direct debits.

Receiving and making payments by each of these methods will be explained in subsequent chapters.

4 PETTY CASH

Most businesses prefer to make as few payments in notes and coins ('cash') as possible. It is more secure to pay by cheque or online because there is less risk of loss or theft. However, sometimes it is more convenient, or even necessary, to make payment in cash.

Examples of items for which a business may make payment in cash include the following:

- payment for small office expenses such as office refreshments, postage stamps etc
- payment for taxi fares for business purposes
- payment for travel costs such as rail and bus for business purposes
- payment for flowers to send to an employee who is absent due to illness.

A small amount of cash is held on business premises for such purposes. In a business that rarely makes cash transactions, such as a large engineering business, this is convenient. In businesses that regularly handles cash such as a restaurant, it is useful to retain a small amount of petty cash separate from income received from sales. This makes it easier to reconcile the cash received with the records of meals and drinks served and to investigate any discrepancies than it would be if a number of employees were able to take cash from the sales receipts to use to meet expenses at any time.