



EDEXCEL INTERNATIONAL GCSE (9–1)

# ACCOUNTING

Student Book



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Stuart Kinlough

# TOPIC 1

# THE ACCOUNTING ENVIRONMENT

## Assessment Objective 1

Demonstrate a knowledge and understanding of accounting terminology, principles, procedures and techniques

Topic 1 explains the different types of organisation a business can have, and covers some key concepts you need to understand to work in the accounting environment. Technology is increasingly important in the field of accounting and this topic covers the benefits of technology as well as some of the main difficulties, such as data security and confidentiality.

## Assessment Objective 2

Select and apply their knowledge and understanding of accounting procedures to a variety of accounting problems

The topic also explains the concept of professional ethics, vital on both an individual level and a company level.

## Assessment Objective 3

Analyse, evaluate and present information in appropriate accounting formats and communicate reasoned explanations

This Topic will be examined in Paper 1 of the examination, 'Introduction to Bookkeeping and Accounting'. You will need to answer a mixture of multi-choice and short- and long-answer questions. These questions will test your ability to meet the Assessment Objectives for this Topic. You will also need to have a good understanding of this topic to be able to answer Paper 2.

# 1 TYPES OF BUSINESS ORGANISATION



▲ There are several types of business organisation to choose from when setting up a new business. ▼



## LEARNING OBJECTIVES

- Describe the characteristics of:
  - sole traders
  - partnerships
  - private sector organisations
  - public sector organisations.
- Explain the relationship between stakeholders and a business
- Understand how stakeholders use the financial statements of the business
- Understand the importance of unlimited liability and limited liability
- Understand the different types of stakeholder

## GETTING STARTED

In this chapter, we look at the different types of business organisation. Business organisations can be small, with just one owner, or large, with over 100 owners. They may be local or multinational. To be successful, a business must meet the needs of its customers. The structure of a business organisation can have a big impact on its finances. Choosing the right business organisation is vital to the success of the business itself.

A business organisation can have many different legal forms and identities. It can be owned by just one person, or be more complicated and be owned by thousands of shareholders. In this chapter, we will look at four different types of ownership:

- sole trader
- partnership
- private sector organisations
- public sector organisations

The type of business organisation you choose to set up is very important from an accounting point of view, as this can add extra financial and legal costs to the business.

## ACTIVITY

- 1 Why do you think it is important to choose the correct business organisation?
- 2 Make a list of local businesses. Do you know what type of business organisation they are?

**HINT**

A sole trader is sometimes called a sole proprietor.

**GENERAL VOCABULARY**

**beneficiary** someone who gets advantages from an action or change

**SUBJECT VOCABULARY**

**sole trader** an individual who owns his or her own business

**unlimited liability** full responsibility for the debts of the business

**bankrupt** without enough money to pay what you owe

**capital** money invested in the business by the owner(s)

**KEY POINT**

In the UK, for example, sole traders must complete an annual tax return. However, they do not have to make details of their accounts available to the public.

▼ Typical sole traders include plumbers, window cleaners and shopkeepers.

**1.1 SOLE TRADER**

Sole tradership is the easiest form of business organisation to set up. A **sole trader** is an individual trading alone under his or her own name, or under a trading name. The sole trader is fully responsible for the running of the business. He or she is the only financial **beneficiary** of its success, but he or she is also financially responsible for its failure.

The owner and the business are treated the same in terms of the legal status of a sole trader. This is called **unlimited liability**. If a sole trader is unable to meet its financial obligations and cannot pay its bills, a court has the authority to hand over the sole trader's personal assets to any creditors to cover these debts. The sole trader may have to sell his or her home or car, for example, if the sole trader cannot cover these outstanding debts, then the creditors can force the owner to be declared **bankrupt**.

There are no formal rules or guidelines to follow when setting up as a sole trader. There are also no set-up costs. As a result, sole traders are often small organisations. Sole traderships, unlike other types of business organisation, also benefit from not having any legal obligations to publish their accounts.

▼ ADVANTAGES	▼ DISADVANTAGES
Business is easy to set up.	Sole trader may lack <b>capital</b> and find it difficult to raise more.
Sole trader keeps all profits.	Sole trader is personally liable for all debts.
Sole trader has complete control.	Sole trader may lack appropriate skills.
Easier to make decisions	Making all decisions can be stressful.
Accounts do not have to be published.	No continuity, as business ceases when sole trader dies.



**SKILLS** INTERPRETATION

- ▶ How do you think an accountant can help a sole trader run their business?
- ▶ What businesses in your local area may be sole traders? Make a list and compare with your classmates.

**GENERAL VOCABULARY**

**drawn up** prepared (usually applied to a written document, such as a list or contract)

**SUBJECT VOCABULARY**

**deed of partnership** a formal agreement to begin a partnership

**1.2 PARTNERSHIP**

The main difference between a partnership and a sole trader is the number of owners. A partnership is defined as having between two and 20 owners. These owners have unlimited liability. A contract is usually **drawn up** to show how profits and losses are shared. This contract is called the **deed of partnership**. An accountant or solicitor normally draws up this deed of partnership to avoid potential problems. It must obey the law of the country which the business is in, for example, the Partnership Act 1890 in the UK and the Partnership Act of 1932 in Bangladesh.

## SUBJECT VOCABULARY

**limited partners** a partnership in the US where partners are responsible for the partnership's debts only up to the amount they originally invested

▼ ADVANTAGES	▼ DISADVANTAGES
More capital can be raised through additional partners.	The partners have unlimited liability. This means they will have to cover the debts of each partner. For example, if one of the partners steals money from the business, the other partners will have to cover these debts and may have to sell their personal assets to do so (note: this excludes <b>limited partners</b> , see page xx).
Losses can be shared between partners.	A partnership is dissolved on the death of a partner.
Additional partners may bring more skills and expertise to the business.	It is difficult to liquidate or transfer partnerships.
The responsibility of management can be shared between the partners.	A partnership may still find it difficult to raise capital for expansion, as increased unlimited liability could act as a deterrent.
Partnerships are ideal organisations for professional practices such as medicine, law and accounting.	Profits have to be shared between the partners.
Profits from a partnership are taxed as the personal income of the partnership.	There could be conflict between the partners.
Financial information is not published.	

## SKILLS COMMUNICATION

► Give examples of businesses in your local area that are partnerships. Why do you think they are partnerships?

## LIMITED PARTNERS

A partnership may be unlimited or limited. In a limited partnership, there must be at least one partner who is not limited. Limited partners are not liable for the debts of the business. They can only lose the capital they have invested in the business. All limited partners must be registered with the Registrar of Companies.

## DEED OF PARTNERSHIP

A Deed of Partnership is a contract between partners that can be either written or verbal. A Deed of Partnership has no specific requirements by law, so it can contain as much or as little as the partners wish. In fact, by law you do not need a Deed of Partnership, but it can help solve any arguments later. It normally includes:

- the capital contributed by each partner
- the ratio at which profits and losses are to be shared
- salaries to be paid to partners
- interest, if any, to be paid on capital
- interest, if any, to be charged on partners' **drawings**.

## SUBJECT VOCABULARY

**drawings** money taken (withdrawn) from the business by the owner(s)

**SKILLS** **CRITICAL THINKING**

**GENERAL VOCABULARY**

**shareholders** people who own shares in a company or business

**SUBJECT VOCABULARY**

**incorporation** the official listing of a company by meeting certain legal requirements which apply in a particular country or a particular state; companies which are incorporated become corporations

**limited liability** the legal responsibility to pay only a limited amount of debt if something bad happens to you or your company

**divorce of ownership** when shareholders are owners of the business, but they are not necessarily involved in the day-to-day running of the business

**auditor** an independent accountant who examines the accounts of a limited company on behalf of the shareholders to see if they show a 'true and fair' view of how the business is performing

**EXAM HINT**

Here you will find advice from past examiners and exam writers regarding trends and pitfalls in exam questions about PSOs.

**PRIVATE LIMITED COMPANIES**
**SUBJECT VOCABULARY**

**dividends** the reward that shareholders get for investing in the business, usually paid from the profits of the business

**CASE STUDY: PARTNERSHIPS**

Hanif has been running a fruit and vegetable stall successfully in the local market in Nairobi for five years. Hanif is a sole trader. He enjoys being his own boss, but he does not like the long hours he sometimes has to work. Hanif wants to expand his business but has found it difficult to borrow money from banks to finance a new shop. Hanif has spoken to other traders in the market. Another fruit and vegetable stall owner, Mzuzi, is also interested in expanding his own business. Hanif and Mzuzi have decided to go into business together and are forming a partnership. They will share their capital and open a new store.

- 1 Why do you think Hanif wants to expand his business?
- 2 What are the advantages for Hanif and Mzuzi of going into a partnership together?
- 3 What are disadvantages for Hanif and Mzuzi of going into a partnership together?

**1.3 PRIVATE SECTOR ORGANISATIONS**

All profit-making businesses that are not run or operated by the government are private sector organisations. Sole traders and partnerships are small businesses that are part of the private sector. Companies in the private sector that want to expand can go through the process of **incorporation**. This allows the business organisation to create its own legal identity. In the UK, a company must be registered with the Registrar of Companies, and comply with the Companies Act 2006, to have separate legal status. This means, by law, that the owners of the business and the company are now separate.

Separate legal status allows the owner to have **limited liability**, which will make it easier for the business to raise finance. Limited liability means that the owners, also known as **shareholders**, are not liable for the company's debts and can only lose the capital that they have invested in the business.

Separate legal status also allows for **divorce of ownership**. This means that shareholders do not have to be involved in the business and, as owners, they are separate or 'divorced' from the day-to-day running of the business. Directors are responsible for the running of the business and make the decisions on behalf of the shareholders.

The accounts of Limited Liability Companies need to be checked and approved by an independent accountant, known as an **auditor**. An auditor acts on behalf of the shareholders/owners to check that the accounts are accurate and show a 'true and fair' view of how the business is doing. This is called the 'audit'.

There are two types of Limited Liability Company: Private Limited Companies and Public Limited Companies.

A Private Limited Company (LTD) is a business that allows its owners to have limited liability. The owners of an LTD are called shareholders. Shareholders are rewarded for their investment in the company in the form of **dividends**. The dividend is taken from the company's profits and is paid on the number of shares. For example, if a shareholder has 500 shares and the dividend is \$2 per share, he or she would receive \$1 000.

## KEY POINT

If a company name is followed by 'Ltd', this means that it is a Private Limited Company.

An LTD is only allowed to have up to 50 shareholders. This allows the business to be closely controlled. Many limited companies are run by family members or close friends. An LTD is not allowed to trade shares publicly on the stock market. In the UK, it is also not allowed to have more than £50 000 of share capital. The letters 'Ltd' must be stated after the company's name, for example, JCB Ltd and Virgin Atlantic Ltd.

▼ ADVANTAGES	▼ DISADVANTAGES
The company can raise capital more easily, as shareholders have limited liability.	In the UK, Private Limited Companies have to send their accounts to Companies House. This means they are available to the public for viewing.
The company has a separate legal identity.	Company accounts need to be audited. This adds extra costs to the running of the business.
A limited company can access a wider range of borrowing.	Shareholders and directors can sometimes have a conflict of interest.
	Capital is still restricted compared to Public Limited Companies.

► Name five Private Limited Companies in your local area.

## PUBLIC LIMITED COMPANIES

## HINT

The abbreviation 'PLC' stands for 'Public Limited Company'. Do not confuse this with the business form 'Private Limited Company'.

A Public Limited Company (PLC) is a large business in which its owners (shareholders) have limited liability. The main difference between a Public Limited Company and a Private Limited Company is how they can sell shares and who they can sell them to. Anybody can buy shares in a Public Limited Company and they can be traded on the stock market. Shareholders receive dividends from the company's profits. The minimum cap on start-up capital needed for a PLC is £50 000. Unlike in the case of an LTD, there is no maximum cap on start-up capital. A PLC can raise more capital. The letters 'plc' must appear after the company's name. Examples of PLCs in the UK include BP plc, Tesco plc and Marks & Spencer plc.



▲ The supermarket chain Tesco is a prominent UK-based example of a PLC.

**DID YOU KNOW?**

In the US, Public Limited Companies are known as Incorporations. For example, Facebook is listed on the US stock market and includes 'Inc.' after the company name.

**KEY POINT**

When a company name is followed by 'plc', this means that it is a Public Limited Company.

▼ ADVANTAGES	▼ DISADVANTAGES
A Public Limited Company may find it easier to raise finance.	The accounts of a PLC have to be published; they also have to provide much more detail than the accounts of non-PLCs.
PLCs are usually seen as stronger organisations, so they may find it easier to get good credit terms from their suppliers.	Anybody can buy shares in a PLC. This could lead to a takeover by another company. For example, Kraft mounted a successful takeover of Cadbury's in 2010.
Investing in PLCs is usually seen as less risky.	The cost of floating on the stock market can be very high. The company also needs to advertise that its shares are for sale.
	The accounts need to be audited. This increases the cost of running the business.

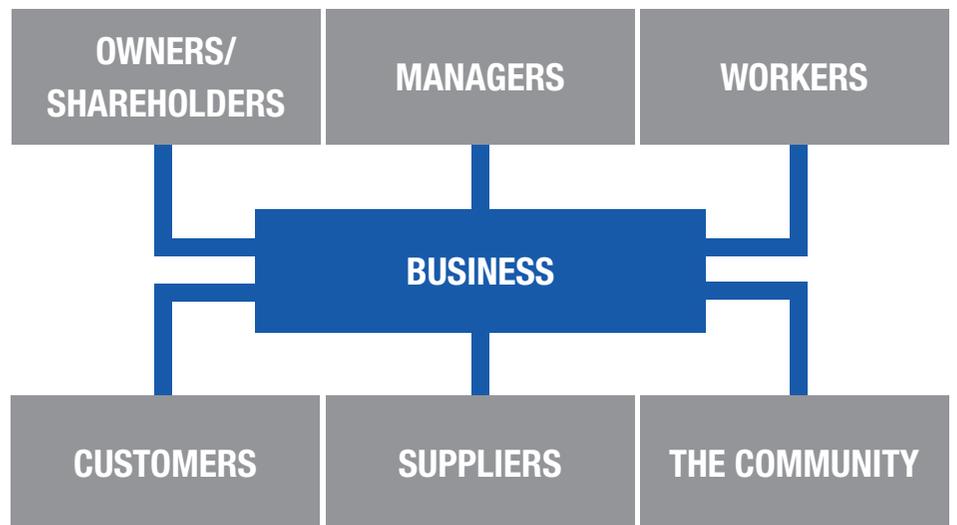
► Name five Public Limited Companies in your local area.

**1.4 PUBLIC SECTOR ORGANISATIONS**

Public Sector Organisations are operated by the government. They usually provide a service rather than aiming to make a profit, unlike Private Sector Organisations. Public Sector Organisations are financed from the taxes that have been paid by companies and individuals. Some of the services provided by the government in the UK are free, including hospitals, libraries and education up to the age of 18. Other public services, such as travelling by bus, are paid services.

**THE CONNECTION BETWEEN STAKEHOLDERS AND BUSINESS**

► Different types of stakeholder



A stakeholder is any person or business who is affected by the actions of that business. These include: owner/shareholders, directors, employees, customers, suppliers, competitors, providers of external finance and the government.

## SUBJECT VOCABULARY

**Statement of Comprehensive Income**  
a statement of all income and expenses recognised during a specified period

## GENERAL VOCABULARY

**liquidity** when a business or a person has money or goods that can be sold to pay debts

## SUBJECT VOCABULARY

**Statement of Financial Position** shows the value of a business on a specific date, including the assets, liabilities and capital

## SKILLS CRITICAL THINKING

The **owner/shareholders** look at the overall profitability of the business. They monitor how the business traded over the previous financial year. They compare that year with the last year to judge how safe their capital is and whether they would get a return on their investment. The shareholders look at the **Statement of Comprehensive Income** to assess if they will receive any dividends.

**Directors** run the business on behalf of the shareholders. They monitor the accounts to see how the business is performing. They make decisions based on the financial data available.

**Employees** may want to look at the accounts to see how well the business is performing and whether they have job security. The employees would look at the Statement of Comprehensive Income to assess the overall profitability of the business. They could also use the accounts to try to secure a pay rise.

**Customers** may want to check to see how financially stable the company is. They can then assess whether the supply of goods and services is secure, and whether they should trade with the company.

**Suppliers** look at the company accounts to see how stable the business is. The supplier can then assess what credit terms to give and how much interest to charge.

**Providers of external finance** assess the company's ability to be able to pay back any money that they lend the business, such as loans. They would look the **Statement of Financial Position** to assess the **liquidity** of the business.

The **government** looks at the profits of the business to monitor whether the business is paying enough tax.

## CASE STUDY: DYSON LTD

Dyson Ltd was founded in 1991 by Sir James Dyson. His most famous invention is the dual-cyclone vacuum cleaner, also known as the 'bagless' vacuum cleaner. Dyson Ltd also manufactures the bladeless fan, hand dryers and hairdryers. It employs more than 7 000 people and sells products in more than 65 countries.

- 1 What are the advantages for Dyson Ltd of being a Private Limited Company?
- 2 Why do you think Dyson Ltd is not a Public Limited Company?
- 3 Which is the most important stakeholder in a company like Dyson Ltd?



## REVISION QUESTIONS

- 1 Explain the meaning of the term 'unlimited liability'.
- 2 Explain briefly what is meant by the phrase 'divorce of ownership'.
- 3 Give **two** examples of businesses that would typically be sole traders.
- 4 What are the two types of partnership?
- 5 Explain the role of an auditor in producing final accounts.
- 6 State **two** reasons why a business might not want to become a Public Limited Company.
- 7 State **two** characteristics of a Private Limited Company.
- 8 Briefly explain what is meant by a Public Sector Organisation.
- 9 Identify **five** stakeholders and explain how they are affected by the business.
- 10 Who do you think is the most important stakeholder for a Public Limited Company?
- 11 State **two** differences between sole trader business and partnership business.
- 12 State **two** differences between a partnership and a Public Limited Company.
- 13 State **two** features each of Public Limited Companies and Private Limited Companies.
- 14 Two partners decide to form a Limited Liability Company. Evaluate their decision.

## CHAPTER CHECKOUT

## GENERAL VOCABULARY

**sue** make a legal claim against someone, especially for money, because they have harmed you in some way

- A sole trader is set up to make a profit and has only one owner. The owner has unlimited liability and is personally responsible for the debts of that business.
- A partnership is made up of between two and 20 partners. The partners have unlimited liability and are responsible for the actions of the other partners.
- Limited companies have a separate legal identity to the shareholder and can **sue** or be sued in their own name.
- A shareholder is the owner of a limited company.
- Limited companies have limited liability. This means the owners can only lose the capital they have invested in the business.
- In the UK, limited companies have to publish their accounts at Companies House.
- A stakeholder is anybody who has an interest in, or is affected by, a company.

# EXAM PRACTICE

Answer ALL questions in this section. Write your answers in the spaces provided. Questions 1–10 must be answered with a cross in the box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

- 1** Which of the following is not a stakeholder for a business?
- A doctor  
 B competitor  
 C supplier  
 D government (1 mark)

- 2** Which of the following is a disadvantage of becoming a sole trader?
- A you keep all the profit  
 B you have unlimited liability  
 C you have full control over your business  
 D the business is easy to set up (1 mark)

- 3** Which of these is most likely to be a Public Sector Organisation?
- A a car manufacturer  
 B a biscuit factory  
 C the Police  
 D a restaurant (1 mark)

- 4** The word 'limited' after a business name indicates:
- A the number of shareholders is limited  
 B there is a limit to the number of loans that can be issued  
 C the shareholders' liability for the debts of the business is limited  
 D there is a limit to the number of businesses of this type (1 mark)

- 5** A Public Limited Company must have which of the following?
- A unlimited liability  
 B the ability to sell shares to friends and family  
 C an auditor check on its financial statements  
 D a government-run business (1 mark)

- 6** Which of the following is the best definition of a stakeholder?
- A someone who is affected by a business  
 B someone who has control over a business  
 C someone who is paid by a business  
 D someone who sponsors a business (1 mark)

- 7** Why should a sole trader record all the financial information about her business?
- A because she is required to do so by law  
 B because she needs to pay her creditors on time  
 C so that she can prepare final accounts  
 D so that she knows how much her debtors owe her (1 mark)

- 8** Which best describes the term 'limited liability'?
- A the owner is responsible for all the debts of the business  
 B the owner is only responsible for the assets of the business  
 C the owner is only liable for the money they have invested in the business  
 D the owner is only liable for all the taxes that are paid by the business (1 mark)

- 9** What of the following is a disadvantage of a partnership?
- A increased capital  
 B increased workload  
 C increased knowledge  
 D increased arguments (1 mark)

- 10** Why might a government department be interested in the financial statements of a company?
- A to check that the company is paying the correct amount of tax  
 B to decide whether to invest in the company  
 C to ensure that the company continues to receive supplies  
 D to see if the company could repay a loan (1 mark)

**(Total 10 marks)**

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