

LCBB4001- ACCOUNTING FUNDAMENTALS

LECTURE 1 HANDOUT

. What is an organisation?

1.1 Introduction to organisations

Here are some examples of organisations. Which ones are profit orientated and which not-for-profit?

- A multinational car manufacturer (e.g. Ford)
- An accountancy firm (e.g. KPMG)
- A charity (e.g. UNICEF)
- A trade union
- A local authority
- An army
- A club

1.2 Why do organisations exist?

Organisations exist because they:

- Overcome individual limitations
- Enable people to specialise
- Save time
- Accumulate and share knowledge
- Enable people to pool their expertise
- Enable synergy

In brief, organisations enable people to be more productive!

1.3 What do organisations have in common?

Organisation: A **social arrangement** for the controlled performance of collective **goals**, which has a **boundary** separating it from its environment.

Characteristic	Car manufacturer (e.g. Ford)	Army
Social arrangement: individuals gathered together for a purpose		
Controlled performance: performance is monitored against the goals and adjusted if necessary to ensure the goals are accomplished		
Collective goals: the organisation has goals over and above the goals of the people within it		
Boundary: the organisation is distinct from its environment		

1.4 How do organisations differ?

Factor	Example
Ownership (public vs. private)	
Control	
Activity (i.e. what they do)	
Profit or non-profit orientation	
Size	
Legal status	
Sources of finance	
Technology	

2. What is a business?

2.1 Profit vs. non-profit orientation

Profit-oriented organisations are generally referred to as '**businesses**', though this is in fact a rather loose term.

- Businesses encompass a variety of legal structures:
 - Companies are owned by shareholders
 - A sole tradership is owned by one individual and
 - Partnerships are owned collectively by the partners

Not-for-profit organisations are frequently structured and run on the lines of a business, so that they benefit from the **economy, efficiency and effectiveness** in using resources that profit orientation brings. They are generally focused on providing goods and services to their beneficiaries at minimised cost.

Examples of **not-for-profit organisations**:

2.2 Definition of a business

Business: An organisation (however small) that is oriented towards making a profit for its owners so as to maximise their wealth and that can be regarded as an entity separate from its owners.

3. Stakeholders in the business

Stakeholder: A person or group of persons who has a stake in the organisation.

Stakeholders in a business	What is at stake?	What do they typically expect of the business?

4. Introduction to business structure

Businesses may take one of three basic legal forms.

- Sole tradership
- Partnership
- Companies

In addition any business may form an alliance with other businesses, or it may form a group structure.

5. Sole tradership

Sole tradership: A single proprietor owns the business, taking all the risks and enjoying all the rewards of the business.

5.1 Features of a sole tradership

- No legal distinction between the proprietor and the business.
- Proprietor is wholly liable for the debts of the business
- The business is usually financed by a mixture of owner's capital (including retained earnings), loans and short-term credit.
- Sole trader can offer a lender a fixed charge over assets such as buildings and machinery as security, they cannot use floating charges over all the business assets as a company can.
- Sole traders take drawings from the business.
- Many sole traders employ people to do some or all of the actual work in the business, but it is usual for the proprietor to take a very active role.
- A sole tradership business can be sold as a going concern by its owner.
- If a sole trader dies, the business's assets and liabilities form part of their estate but the sole tradership as such ceases to exist – there is no perpetual succession.

Advantages of sole traderships	Disadvantages of sole traderships

6. Partnerships

Partnership: The relation which subsists between persons carrying on a business in common with a view of profit.

6.1 Features of a partnership

- Frequently the partners are jointly and severally liable for the debts of the partnership.
- The financing issues that face sole traders also face many general and limited partnerships.
- Partners take drawings from the business.
- All the partners may be as actively involved in the business but there is more scope for partners to specialise, and/or to 'take a back seat' in the business.
- A share in a partnership is not a form of property as such and selling it can be difficult.
- If a partner dies, a general or limited partnership is dissolved – there is no 'perpetual succession'.

6.2 General partnerships

In a general partnership regulated by the Partnership Act 1890, the partnership has no separate legal identity. All partners are jointly and severally liable for the partnership's debts.

6.3 Limited partnerships

In a limited partnership regulated by the Limited Partnerships Act 1907, the partnership has no separate legal identity. One or more partners however may have limited liability for the partnership's debts provided there is at least one, fully liable partner.

6.4 Limited liability partnerships

LLPs have a legal identity separate from their owners. Because of this, some of the funding restrictions suffered by general and limited partnerships are relaxed.

Advantages of partnerships	Disadvantages of partnerships

7. Companies

Company: A legal entity registered as such under the Companies Act 2006. The owners of a limited company (its shareholders) have **limited liability** for its debts beyond any amount they may still owe for the shares they hold. **The company has unlimited liability for its own debts.**

7.1 Features of a limited company

- The company is legally distinct from its owners
- As well as a fixed charge, the company can offer a floating charge over its changing assets as security for lending
- Shareholders take dividends, not drawings, from the business
- Directors run the company; shareholders do not take part in the management of the business unless they are also directors and/or employees, but they have no automatic right to be directors
- Shares are a form of property that can easily be sold by their owners, especially if the company has a public listing of shares on a public stock exchange; transferring ownership of shares to another person has no direct effect on the company
- If a shareholder dies, their shares are transferred to another person without any effect on the company at all – there is what is known as 'perpetual succession'

7.2 Types of company

Public company: A company whose memorandum states that it is public and that it has complied with the registration procedures for such a company. It may offer its shares and other securities for sale to the public at large.

Private company: A company which has not been registered as a public company under the Companies Act 2006. It may not offer its securities to the public at large.

Advantages of companies	Disadvantages of companies

8. Which business structure should a business take?

Factor	Company	Partnership (non-LLP)
Entity	Is a legal entity separate to its members	Has no existence outside of its members
Liability	Members' liability can be limited	Partners' liability is usually unlimited
Succession	Perpetual succession – change in ownership does not affect existence	Traditional partnerships are dissolved when any of the partners leaves
Owners' interests	Members own transferable shares	Partners cannot transfer their interests in a partnership
Assets	Company owns the assets	Partners own assets jointly
Management	Company must have at least one or two director(s)	All partners can participate in Management
Constitution	Company must have a written constitution	A partnership may have a written partnership agreement, or the agreement may just be verbal
Financial statements	A company must deliver financial statements to the Registrar	Partners do not have to send their financial statements to the Registrar
Security	A company may offer a floating charge over its assets	A partnership may not give a floating charge on assets
Withdrawal of capital	Strict rules concerning repayment of subscribed capital	More straightforward for a partner to withdraw capital