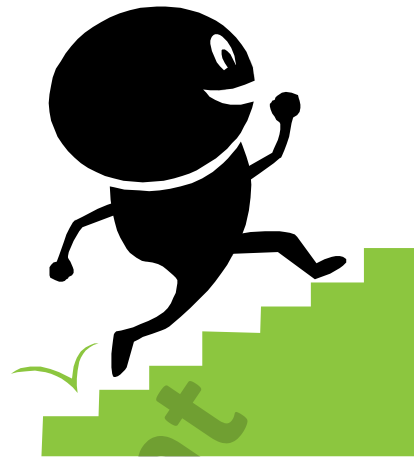


# Easy Steps



## **Unit 328 (V6)**

**Identify the requirements for a financial record system for an entity**

- ☒ Easy to follow
- ☒ Step-by-step instructions
- ☒ Covers Unit Standard Criteria

*A Cheryl Price Publication*

## **Unit Standard 328 (Version 6)**

### **Identify the requirements for a financial record system for an entity**

This book covers the course outline for the following New Zealand Qualifications Authority Unit Standard (version 6):

Unit Standard 328 v6 - BUSINESS ADMINISTRATION SERVICES (Level 3, Credit 4)  
Identify the requirements for a financial record system for an entity

All topics in this Unit Standard are included in this book.

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**ISBN 978-1-927155-94-3**

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**Published in New Zealand**

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Sample Document

## Unit Standard 328 Version 6

<b>Title</b>	<b>Identify the requirements for a financial record system for an entity</b>		
<b>Level</b>	<b>3</b>	<b>Credits</b>	<b>4</b>

<b>Purpose</b>	People credited with this unit standard are able to: identify the requirements for a financial record system for two different entities; and identify the financial record system components of an entity.
----------------	--

<b>Classification</b>	Business Administration > Business Administration Services
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<b>Available grade</b>	Achieved
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### Explanatory notes

- 1 All activities associated with this unit standard must comply with the requirements of: Health and Safety in Employment Act 1992, Privacy Act 1993, Goods and Services Tax Act 1985, and their subsequent amendments.
- 2 An *entity* may include but is not limited to – an entire organisation; a part of an organisation such as a cost-centre, department, or branch; a small-to-medium enterprise (SME); a community group such as a sports club.

---

### Outcomes and evidence requirements

#### Outcome 1

Identify the requirements for a financial record system for two different entities.

Range one small entity, one large entity;  
the small entity may be, but is not limited to – a SME, a community group.

#### Evidence requirements

- 1.1 Each selected entity is described in terms of factors determining its requirements for a financial record system.  
  
Range factors – size of entity, number of staff, accounting system functions, reporting and/or compliance and/or legislative requirements, inventory control, turnover, manual and computer processing options, information requirements.
- 1.2 The accounting entity concept is explained in terms of responsibilities for keeping business and personal financial activities separate.

- 1.3 Sources that provide professional advice related to establishing a financial record systems are identified for each selected entity in terms of service provided and cost for services.

Range sources may include but are not limited to – bankers, accountants, business advisors, Inland Revenue, government or local body agencies that provide business mentoring; evidence of two is required.

## **Outcome 2**

Identify the financial record system components of an entity.

Range the entity may be one of those used in outcome 1.

### **Evidence requirements**

- 2.1 Components of the financial record system are explained in terms of how they meet the needs and activities of the entity.

Range components may include but are not limited to – cash receipts, payments and petty cash analysis, sales, purchases, debtors' and creditors' records; evidence of at least three is required.

- 2.2 The entity's financial record system is explained in terms of the banking services required.

Range banking services may include but are not limited to – cheque, savings, and investment accounts; lending facilities; money transfer services; international services; overdraft facilities and fees; interest rates; electronic banking.

Sample Document

## The Business Entity

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### Learning Outcomes

*At the end of this section you should be able to –*

- ☐ Identify different types of entities
- ☐ Understand the requirements for a financial records system
- ☐ Describe the factors involved in determining a suitable financial record system
- ☐ Understand why entities have a responsibility to keep records for personal and business expenses separate

# Introduction

All businesses start somewhere and they will usually change and develop as they progress.

New Zealand, like most other countries, has a large number of business organisations (enterprises) that trade in a variety of different areas. These include:

- Agriculture, forestry and fishing
- Mining
- Manufacturing
- Electricity, gas, water and waste services
- Construction
- Wholesale trade
- Retail trade
- Accommodation and food services
- Transport, postal and warehousing
- Information media and telecommunications
- Financial and insurance services
- Rental, hiring and real estate services
- Professional, scientific and technical services
- Administrative and support services
- Education and training
- Health care and social assistance
- Arts and recreation service

You will probably be able to think of examples for each of these. We live our everyday lives surrounded by businesses of various types.

This section aims to show some of the structure that needs to sit behind these enterprises in order for them to function legally and practically.

## What is an entity?

An *entity* is a person, partnership or business that legally has a separately identifiable existence. An *enterprise* is a business or service entity. Examples include a company, partnership, trust, government department or agency, state-owned enterprise, university, or self-employed individual.

This book will deal with the **business** entity. A business entity should have a separate, identifiable existence. Legally it is defined by the way in which it sets up and operates its accounting systems. By law the accounting records of a business entity must reflect the activities of the actual business, not the people who work in it. In other words, financial activities that relate to the business should be in the accounting records and anything personal should not.

This is one of the basic rules of accounting.

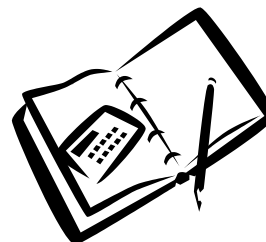


## Definition of business entities

There are two things to remember when defining business entities:

- 1 They need to legally have a separate, identifiable existence
- 2 They must have separate accounting records that reflect the activities of the actual business.

People usually think of an entity as being an entire organisation. However, this is not necessarily so. Large corporations often have departments or branches that are considered to be separate entities. Examples include cost centres and franchises. Why are they considered separate entities? Because they legally have a separate, identifiable existence and because they keep separate accounting records that reflect the activities of the actual business.



The usual function of an entity is to provide its customers with quality products and/or services while at the same time making a profit. However, entities can also be non-profit making. For example any community group that has financial dealings legally needs to organise their accounting records as an entity. The fact that they have not been set up to make a profit is academic. They still have to show exactly which finances relate to their business.

## Types of business entity



Entities can be classified according to their size and the way that they are set up. Looked at another way, the size of a business usually determines the way in which it is set up.

An entity may include but is not limited to – an entire organisation; a part of an organisation such as a cost-centre, department, or branch; a small-to-medium enterprise (SME); a community group such as a sports club.

Although many large businesses operate in New Zealand, we are really a country of small businesses – 74% of all New Zealand companies had fewer than 20 employees in August 2010.<sup>1</sup>

Over 90% of businesses in New Zealand in 2010 had 99 employees or less.

In this book we will look at accounting structure considerations for these.

## Small to medium enterprises (SMEs)

Interestingly, there are no universal definitions of what an SME is. It varies from country to country. There are also several definitions within New Zealand. These definitions mainly depend upon research requirements.

Massey University has an SME research centre that defines SMEs as being:

- micro enterprises (fewer than 5 staff)
- small enterprises (6-49 staff)
- medium enterprises (50-99 staff).

1

<sup>1</sup> New Zealand Business Operations Survey, Statistics New Zealand, August 2010

The Ministry of Economic Development, on the other hand, conducts their research on the basis that an SME has 19 full time employees (FTEs) or less.

This can be a little confusing but, as mentioned, these organisations use those numbers for their own research purposes. The problem with defining an SME is that businesses are so diverse that it is difficult to establish a 'one size fits all' description.

SMEs in New Zealand, as in any other country, cover a wide range of business activities and ideas. The term 'SME' is internationally recognised. Every country has small to medium businesses and it is acknowledged that these represent diverse cultural and social dimensions. For example, a dairy in New Zealand has different aspects to a convenience store in the States. This is one factor that has led to varying definitions as to what an SME actually is. Some countries like to include industry type, turnover and other business criteria. Others have legal definitions.

The overall agreed concept of an SME is that it is a business that is usually personally owned with most management decisions being made by the owner. There are no specialists at management level. In addition they are not part of a larger business or group of companies, so won't have access to managerial expertise from further up the line.

Notwithstanding which definition of personnel numbers is used, most businesses in New Zealand are SMEs. The majority of them employ 19 people or less.

Their financial record systems are usually straightforward to set up as the main reporting line goes through to an owner, or partners. However, this can vary with the type of business.

## Sole trader

A small business that is owned and operated by one person will usually operate as a *sole trader*.

A sole trader business is very closely associated with its owner, not only in an operational sense, but also legally. In the eyes of the law, the sole proprietor business *is the actual owner of the business*.

### SOLE TRADER

- The owner is responsible for providing the funds to start up the business.
- Any profits from the business go to the owner.
- The owner is responsible for any losses incurred by the business.
- The debts of the business are the sole responsibility of the owner.
- The owner's personal assets can be sold to meet the debts of the business.

Even though the sole proprietor and his or her business are legally the same entity, it is standard business practice for the affairs of this type of business to be kept separate and distinct from the affairs of the owner. However, the one time when business and personal finances could become entwined is if the sole trader falls into financial difficulties. In that case, their personal assets could be used to meet debts.

A sole trader has complete responsibility for implementing and maintaining their financial records system – even if they outsource it to a third party, such as an accountant.



## Franchises

New Zealand has the highest proportion of franchises per capita in the world so it is well worth mentioning them here because a franchise is a type of entity.

A franchise is a business model, designed by one company and then sold onto other businesses. These businesses have the right to operate in a specific geographical area, using the franchise name and any materials provided.

A franchise is different to a stand-alone small business because a franchisor (the entity that has bought the franchise) is able to obtain advice and management expertise from the franchisee (the entity that has sold the franchise).

The franchisee has a separate, identifiable existence because they are running their own business in a specific geographical area. They are legally obliged to keep separate accounting records. Any royalties and fees they pay to the franchisor are recorded on their own accounts.

Franchisee entities vary in size from those that employ few people, for example, Green Acres, to those that can employ more than 100, for example, some larger branches of New World.

Some franchisees set themselves up as sole traders. Others may set up partnerships with two or more people; others may form limited liability companies.



All franchises need to report aspects of their accounts to their head office (franchisor). It is important that the financial records system of the franchisee is able to provide this information accurately and efficiently.

## Partnership

### PARTNERSHIP

- The partners share responsibility for running the business.
- Any profits from the business are shared according to the set up agreement.
- The partners are responsible for any losses incurred by the business.
- The debts of the business are the responsibility of the partners.
- The partners' personal assets can be sold to meet the debts of the business.

Two or more people can join together to form a business partnership.

As with the sole trader, a partnership business is very closely associated with its owners, not only in an operational sense, but also legally. In the eyes of the law, the partnership is the actual owner of the business and the partners are personally liable for debts.

Partnerships are often used in SMEs, but they can also be utilised for much bigger companies where there may be a number of people who work together in a large partnership.

Partners have complete responsibility for implementing and maintaining their financial records system – even if they outsource it to a third party, such as an accountant. Each partner will share in profits/losses according to the way the partnership has been set up.

## Cost Centres

A cost centre is a part of a larger organisation that doesn't produce direct profits. In other words it adds to the cost! However, cost centres generally contribute to profits indirectly, or help with some other business function. They are an essential part of an organisation.

Cost centres can be found in many areas. Examples include:

- Marketing
- Customer service
- Public relations
- Research and development
- Human resources



It is very difficult to establish how much these centres contribute to profits, so they are treated as separate entities, with their own accounting records.

As a rule, the manager of a cost centre is only responsible for the costs that it incurs, rather than any revenue. They receive a separate budget and the performance of the department is evaluated on how well they were able to keep to this. Sometimes, however, cost centres charge internally for their expertise and equipment. For example IT departments within large organisations often hire out computer equipment to other areas and keep timesheets for their service hours. A call centre will keep records of calls handled, time taken and service level and may charge out these services to other areas.

For these reasons, cost centres are often kept as separate entities.

## Departments

Some large organisations prefer to organise their business into separate departments, with each one having a different function. These effectively become separate entities.

An example would be a company that manufactures cars, motorbikes and bicycles. It could keep each department separate so that profits can be more accurately measured. The same could be said of a department store. In each case, the people running the business would decide whether to maintain the accounts as a whole single unit, or whether to separate out each area in order to be able to measure the individual profits.



## Limited Liability Company

### LIMITED LIABILITY COMPANY

- The company exists as a formal and legal entity in its own right.
- The company is separate from its owners or shareholders.
- Owns the assets and liabilities of the business.
- Liability for losses is limited to the share of ownership.

A limited liability business is kept separate to its owners or shareholders, unless they have given personal guarantees for company debts.

SMEs and larger entities make use of limited liability companies. Often, they set up a combination of structures, for example, a limited liability partnership.

The limited liability company owners have complete responsibility for implementing and maintaining their financial records system – even if they outsource it to a third party, such as an accountant.

## Community Groups

Community groups generally operate as non-profit making entities. In other words they are not primarily guided by commercial goals. They are usually self-governing and have some degree of internal organisational structure. They generally receive funding from an external source or sources. Often this is government funding, but it can also be from a variety of other sources.

It is important that they keep accurate accounting records in order to show how they are using the funds they receive. Accordingly, they are considered to be separate entities.

There are a large number of community groups operating in New Zealand, with varying roles and focus. These include those that:

- provide services to strengthen communities, eg Age Concern <http://www.ageconcern.org.nz/>
- focus on identifying and promoting culture and identity, eg Arts Access Aotearoa <http://www.artsaccess.org.nz/>
- undertake research and act as advocates for individuals or groups, eg Consumer New Zealand, <http://www.consumer.org.nz/>
- provide self-help and aid for others eg Cancer Society of New Zealand <http://www.cancernz.org.nz/>



## Large entities

Officially, for accounting purposes, to qualify as a large entity in New Zealand, a business should have any two of the following:

- 1 Total assets of at least \$10 million
- 2 Consolidated revenues of at least \$20 million and/or
- 3 At least 50 full time equivalent employees



There are proposed reforms in the pipeline that suggest raising the levels of assets and revenues, but these will not be implemented for some time yet.

However, as with SMEs, it is very difficult to define 'large entity'. There are so many variants to be taken into consideration.

Notwithstanding this, large businesses are not usually personally owned. Many are set up as limited liability companies.

Most management decisions are made after obtaining advice from specialists (internal or external) and they are often part of a larger business or group of companies, so have access to managerial expertise from further up the line.

Their financial record systems can be quite complex as there may be a number of reporting lines. There could also be several branches, offices or departments that integrate their accounts into the parent company.

As mentioned earlier, a private limited company owns all the assets and liabilities of its business.

A public company, on the other hand, offers to sell securities such as shares/stock/bonds or loans to the general public.

A private company is owned and operated by its own board of directors or governors.

Shareholders of a public company have varying rights, depending on the conditions under which they bought into the company. Typically, these rights can include voting power on major issues; ownership in a specified portion of the company; the right to transfer ownership; an entitlement to dividends; opportunity to inspect corporate books and records and the right to sue for wrongful acts.



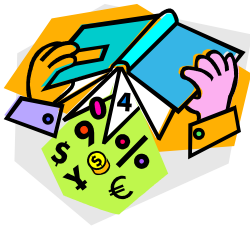
Nowadays it is a requirement of public companies that they make their financial records public. This means that their financial record systems need to be set up in a way that can produce reports that can be easily read and interpreted by a wide spectrum of people.

### Exercise 1

Read each question carefully, and then circle T (true) or F (false) on the right of it.

- 1 An entity has a legally separate, identifiable existence .....T / F
- 2 The personal and business accounts of an entity usually operate together .....T / F
- 3 An entity has to be the whole business, not just a department of it .....T / F
- 4 Entities must always aim to make a profit .....T / F
- 5 Most businesses in New Zealand employ 19 people or less .....T / F
- 6 The sole trader and his/her business are legally the same entity .....T / F
- 7 Franchisees are not separate accounting entities .....T / F
- 8 Cost centres do not produce direct profits .....T / F
- 9 The personal assets of a limited liability company owner are part of the business .....T / F
- 10 Community groups are usually self-governing .....T / F
- 11 Large entities are not usually personally owned .....T / F
- 12 A public company does not have to make its financial records public .....T / F
- 13 A sole trader doesn't have to worry about keeping good accounting records .....T / F
- 14 Charitable trusts are exempt from keeping any financial records .....T / F
- 15 One characteristic of an SME is that it is usually personally owned .....T / F
- 16 At least three people are required to form a business partnership .....T / F
- 17 The IRD is responsible for setting up a good financial record system for each business .....T / F
- 18 A franchise can only employ 19 people or less .....T / F
- 19 End of year accounts will be viewed by third parties such as accountants and the IRD .....T / F
- 20 Public companies need to consider how their financial reports will look in public .....T / F

# Requirements for a financial record system



We've looked at a number of different types of entities, including SMEs, franchises, cost centres, departments and community groups. These represent businesses that are very different in terms of size and what they do. A financial record system is not a 'one size fits all' solution. Each entity has to look at a series of factors in order to determine what is required and then try to match their accounting system accordingly.

Deciding on an appropriate, efficient and effective financial records system involves thinking carefully about the business and how it operates. Naturally, the answers will be different for every business. A large business that undertakes many transactions will have far more complex requirements of an accounting system than a sole proprietor operating a small business.

Choosing an accurate and reliable record keeping system helps to:

- keep control of the business
- track income and expenses
- calculate taxes correctly
- save on accounting fees (the accountant will spend less time organising your reports if you have accurate and reliable records)
- secure a loan if necessary

## Size of the entity

An SME can vary in size from fewer than 5 to 99 staff. There is certainly a big difference between dealing with a handful of people and nearly 100 and there will be a lot of difference in the size and scope of the entities at each end of the scale.

A franchisee might be operating a 'one man band' type of business such as lawn mowing or cleaning services, or they might be running a large supermarket.

A cost centre might be two people in the human resources department or a large number of people in customer services.

The very small spares department of a local garage would contrast greatly with the ladies clothing department of a large store.

A community group the size of the Samaritans is very different to the local Rotary club.

Each of these entities has to determine what type of financial record system would best suit them. In order to do this they have to look at a number of factors. On the following pages are some overall requirements that apply to every type of entity. It is important to bear these in mind when setting up an accounting system.

# Legislative requirements



There is a legal requirement for entities to record

- **Assets and liabilities**
- **All business expenses**, including who they are paid to
- **All business income**, including where the payments have come from
- **Wages, income tax, PAYE, ACC, KiwiSaver and any other employer/employee contributions**
- **Details of GST transactions** (if registered for GST)

The New Zealand Inland Revenue Department (IRD) has specified that all financial records need to be kept in New Zealand, in the English language, for a period of seven years.

**Note**

It doesn't matter whether the entity is considered an SME, sole trader, partnership, community group, franchise, or a limited liability company. The legal requirements are the same for each.

Business records should cover:

- banking – cheque books, deposit books, bank statements
- income – invoices, credit card sales, debit and credit notes
- expenses – invoices for purchases, credit card purchases
- cashbooks – petty cashbooks and wage books

*To find out more on legislative requirements for record keeping visit the Inland Revenue Department website at <http://www.ird.govt.nz/>*

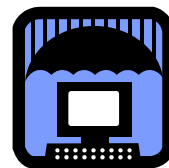


## Assets and liabilities

An asset is something of value that an entity owns.

Tangible (physical) assets can include items such as:

- cash
- stock
- buildings and equipment.
- Outstanding credits from debtors (i.e. money owed to the entity by organisations/ individuals such as customers)



These tangible assets are part of the 'book value' of the business. The book value is the value of the asset on the business balance sheet.

Intangible (non-physical) assets include items such as:

- patents
- copyrights
- trademarks
- brand recognition.



Intangible assets can form part of the entities 'goodwill' if the business is sold. Goodwill is the amount paid for a business over the book value and is usually linked to the intangible assets.

A liability is a legal debt. It is an obligation to pay an amount in money, goods or services to another party.

Liabilities can include:

- loans
- mortgages
- outstanding debts from creditors (i.e. money owed to other parties such as suppliers)

Current liabilities are debts payable within a year, whereas long term liabilities are debts payable over a longer period.

It could be assumed that a micro SME (less than 5 staff) won't have many assets and liabilities, However, a dairy may have less than five staff, but there will be a shop full of inventory to consider, plus equipment and fittings and fixtures. Conversely, the SME could be a small online business operated out of the corner of a room in a house with one computer and a printer.

The larger an enterprise the more assets and liabilities they may have – or not as the case may be! It really comes down to the individual requirements of the business.

The important thing to do is to establish exactly how many assets and liabilities there are and then to work out how to record them. That is the legal accounting obligation. A small home business should be able to record their stock manually, whereas a large supermarket would have to use electronic means. Having said that, the small business owner may absolutely love all things 'computer' and be the proud owners of an excellent computer programme that holds their records superbly. The point is that it comes down to personal preference in conjunction with the practicalities involved.

The entity may well expand and gain more assets and liabilities in the future. In that case, the records system would need to be re-assessed and adapted as required. In other words, the records have to suit the current and foreseeable future requirements, but may be changed as things progress.