International Journal of Business Management Insight & Transformations
Vol. 5, Issue 1 – 2021
ISSN: 2581-4176

# The Importance of including Business Entities in the Introduction of any Basic Accounting Programme

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## Abstract

Business entities can either be organized as sole traders, partnership or companies according the Zambian law. This article focuses on the importance of including business entities in the introduction of any basic accounting programme. Despite the numerous classifications of business entities this articles focuses on the classifications stated above namely sole traders, partnership and companies. The details in this article are entirely collected through secondary research due to the specialized nature of the paper. Reference was specifically made from scholarly articles in finance and management, various text books in finance and management, and journals from professional bodies such as AAT, ACCA and CIMA.

**Keywords:** Sole Trader, Partnership, Companies, Limited Liability, Formalities, Secrecy, Separate legal entity.

## Introduction

This article focuses on the importance of including business entities in the introduction of any basic accounting programme. It details the importance of gaining insight on business entities in accounting and finance, particularly understanding the differences and similarities between various business entities thereby highlighting why learners should be introduced to business entities at the introduction level of any basic accounting programme.

## Definition of various Classifications of Business Entities

A business may be owned by one person as a sole proprietor or can be owned jointly with other persons or partners as a partnership. Another way in which a business could be owned is through the establishment of a limited liability company “BPP Learning Media, Page 1, 2007”

## A Sole Trader

This is a business owned by only one person who provides all the capital needed to set up and manage the organization and takes profit as his/her reward. The owner uses his/her labour assisted sometimes by one or two workers and/ or family members. This is normally a small business in size though it is not always small. “BPP Learning Media, Page 1, 2007”

## A Partnership

A partnership is an association that can be formed between two or more individuals for the purpose of engaging mainly in order to gain profit. The minimum membership in a partnership as a business entity is two and the maximum membership is twenty. Professional firms such as legal firms’ accountancy firms and audit firms operate as partnerships. “F.K. Musweu, Page 2, 2018”

*Partnerships may be established for purposes of pooling of skills, experiences, knowledge, contacts, finances, assets or a combination of any two or more factors. At individual levels, people may realize that they did not have adequate skills, knowledge or finance to run a business on their own, but as a team, they could achieve more “BPP Learning Media, Page 3, 2009”*

## Companies

Companies are corporate association of at least two persons, which is registered with the Registrar of companies and owned by the shareholders who have limited liabilities. Shareholders get to contribute to the funding of the company through the acquisition of shares, thus entitling them to ownership in the company. The shareholders get to appoint the directors as there agents.

## Distinguishing factors

The distinguishing factors of the three business entities described above are as follows.

## The concept of separate legal entity

A Legal person refers to a non-human entity that is treated as a person for limited legal purposes, corporations being good examples. Legal persons can sue and be sued, own property, and enter into contracts. Partnerships with the exception of limited liability partnerships are not legal persons.

In most countries, legal persons cannot vote, marry, or hold public office. Unlike other business entities a company is a separate entity from its owner in law.

## Separation of the ownership from management

It worth noticing that in company ownership is separate from management as it has been stated above shareholders are the ownership of the company and directors are the managers of the company. On the other hand in partnership ownership is not separated from management i.e. the partners in a partnership are both the owners of the undertaking and managers of the undertaking with the exception of limited liability partnerships. Each partner in the partnership can bind the other partners in a partnership for each contract or transaction they enter into. Similarly for sole proprietary businesses like partnership ownership is not separated from management i.e. the sole proprietor is both the owner and manager of the undertaking. Agency theory can be applied to the agency relationship deriving from the separation between ownership and control "F.K. Musweu, Page 2, 2020" like stated this mainly applicable to companies and not sole traders and partnerships.

## Formalities required

Unlike companies a sole trader or partnership can operate with little or no formalities.

On formation, the company must lodge a number of documents with the registrar of companies.

The company's annual profit and loss account and balance sheet must be lodged with the registrar and are then available for public inspection. The standard layouts for them are prescribed in the company's act.

## Limited Liability

A type of liability that does not exceed the amount invested in a partnership or limited liability company. The limited liability feature is one of the biggest advantages of investing in publicly listed companies. While a shareholder can participate wholly in the growth of a company, his or her liability is restricted to the amount of the investment in the company, even if it subsequently goes bankrupt and racks up millions or billions in liabilities.

In a partnership, the limited partners have limited liability, while the general partner has unlimited liability. The limited liability feature protects the investor's or partners personal assets from the risk of being seized to satisfy creditor claims in the event of the company's or partnership's insolvency.

In the context of a private company, incorporation can provide its owners with limited liability, since an incorporated company is treated as a separate and independent legal entity. Limited liability is especially desirable when dealing in industries that can be subject to massive losses, such as insurance.

Sole proprietary businesses possess unlimited liability meaning that is the creditors of the undertaking can also repossess the personal belongings of the owners to recover their liability if the assets in use in the undertaking aren't enough to recover the liability of the creditors.

 

## Levels of Secrecy

Sole traders and Partnership have their financial statements completely private and are not seen by anyone other than the sole traders or partners unless they choose to show them to a third party, for example a bank manager in support of loan application. The privacy of the financial statements of companies is usually compromised on instances where financial statements are published due to the legal requirement placed on companies to have their annual financial statements published. Additionally there is also a requirement that each shareholder is entitled to a copy of the financial statements before the annual general meeting or general meeting where financial statements are supposed to be laid as well the periodical lodging in of financial statements with the Registrar of companies.

## Conclusion

It is a common phenomenal to introduce learners in the basic principles of accounting to the preparation and presentation financial statements of sole proprietor before enlightening them to the preparation and presentation of partnership accounts and company accounts. It is vital for learners in the basic principles of accounting to have the know-how on how to prepare and present financial statements for sole proprietors, partnership and companies. It is therefore for this reason that the learners of most programmes offering basic principles of accounting usually have a sub topic on business entities in their introduction. This is done to enable the learners gain insight on the feature, advantages and drawbacks the business entities described above even before they are introduced to the preparation and presentation of financial statements of each of the types of business entities discussed namely sole trader, partnership and companies.

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