

# **CREDIT AND DEBT MANAGEMENT**

## **STUDY TEXT**

### **Qualifications and Credit Framework**

**Q2022**

This Study Text supports study for the following AAT qualifications:

AAT Level 4 Diploma in Professional Accounting

AAT Diploma in Professional Accounting at SCQF Level 8

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# INTRODUCTION

## HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

## STUDY TEXT

This study text has been specially prepared for the revised AAT qualification introduced in 2022.

It is written in a practical and interactive style:

- key terms and concepts are clearly defined
- all topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style
- frequent activities throughout the chapters ensure that what you have learnt is regularly reinforced
- 'examination tips' help you avoid commonly made mistakes and help you focus on what is required to perform well in your examination
- 'Test your understanding' activities are included within each chapter to apply your learning and develop your understanding.

### ICONS

The study chapters include the following icons throughout.

They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained.



#### Definition

These sections explain important areas of Knowledge which must be understood and reproduced in an assessment.



#### Example

The illustrative examples can be used to help develop an understanding of topics before attempting the activity exercises.



#### Test your understanding

These are exercises which give the opportunity to assess your understanding of all the assessment areas.



#### Foundation activities

These are questions to help ground your knowledge and consolidate your understanding on areas you're finding tricky.



#### Extension activities

These questions are for if you're feeling confident or wish to develop your higher level skills.

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Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

# Legislation

## Introduction

This chapter covers the legislation that affects granting credit to customers, the characteristics of a contract, remedies for breaches of contract and other relevant legislation.

### ASSESSMENT CRITERIA

Statute and contract law applicable to credit control (1.1)

Breach of contract and the circumstances in which they can be used effectively (1.2)

Terms and conditions associated with customer contracts (1.3)

Data protection and ethical considerations associated with credit control activities (1.4)

Legal and administrative procedures for debt collection (4.1)

### CONTENTS

- 1 Contract law
- 2 Terms and conditions of contracts
- 3 Remedies for breach of contract
- 4 Data Protection Act
- 5 Other legislation

# 1 Contract law

## 1.1 Introduction

A sale or purchase is a legal contract between (usually) two parties. If credit is granted and then the invoice is not paid this is normally a breach of contract, hence the need for an awareness of contract law.

Control of the credit given to a customer is important for any organisation. Most organisations therefore appoint a **credit controller** whose responsibility it is to give appropriate credit terms to customers and ensure these terms are kept.

**Receivables** are an important part of **working capital** and **careful management** of this asset is required to maintain the company's **liquidity**.

Credit controllers do not need to be qualified lawyers but it is important to understand the legal background to contracts and credit arrangements.

## 1.2 Nature of a contract

The sale of goods and services is a type of contract and therefore the credit controller must ensure that each party abides by this contract.



### Definition

A **contract** is a legally binding agreement between two parties.

The **offeror** is the party making the offer (usually the buyer).

The **offeree** is the party accepting the offer (usually the seller).

The **law of contract** is the branch of the civil law that determines whether or not a promise is legally binding (i.e. enforceable by a court of law).

### 1.3 The essential characteristics of a contract

There are certain requirements if a contract is to be valid:

- **offer** and **acceptance** (i.e. an agreement)
- the **intention to create legal relations** (i.e. the parties must be willing to submit to the authority of the law and be bound by their contracts)
- **consideration**, in that both parties must do, or promise to do, something as their side of the contract
- the parties must have the **capacity**, or ability, **to contract and submit** themselves to the authority of the law (children and mentally disordered people are restricted)
- the parties must genuinely **consent to the terms** of the contract in that they must not have been mistaken by the contract terms, or lied to in negotiations – there must be **certainty of terms**
- the contract itself must be both **legal** and **possible**
- **written formalities** may be observed in **some** situations.

The key factors are a basic understanding of offer, acceptance, intention, consideration and capacity which will be detailed below.

### 1.4 Offer and acceptance

It is important to distinguish between an **offer** and an **invitation to treat**.



#### Definition

An **offer** is a definite and unequivocal statement of willingness to be bound on specified terms without further negotiations.

If you make an 'offer' it means that you are stating that you are willing to be bound to a contract in its current form with no changes required.

An offer can be in any form – oral, written or by conduct. However, it is not effective until it has been communicated to the offeree. For example, if a reward is offered for the return of a lost item, it cannot be claimed by someone who did not know of the reward before they returned the item.



### Definition

An **invitation to treat** is not an offer. An invitation to treat means an invitation to the other party to make an offer.

Examples of an **invitation to treat** are an advertisement, a price ticket, goods on display in a shop or a trade price list where a written order from a customer is then the **offer**.

Once an offer has been made the next stage is for the contract to be accepted.



### Definition

**Acceptance** is the unqualified and unconditional agreement to all the terms of the offer.

To be effective, the acceptance must be made while the offer is still in force; it must be **absolute**, **unqualified** and **communicated** to the offeror by word or action.

**Offer and acceptance constitute agreement.**



### Example

Sofia has a sign in her car stating 'For sale, £1,200'.

Benjamin sees the invitation to treat and offers £800 to Sofia.

Sofia does not accept but responds to Benjamin that the lowest she would accept is £1,000.

Benjamin accepts so long as the car has a valid MOT certificate.

This is still not an agreement as Benjamin's response has a criterion that must be met.

Once Sofia proves she has a valid MOT and Benjamin accepts this certificate there has been:

- an invitation to treat (sign in the car)
- an offer (to buy/sell the car) and
- acceptance (Benjamin approves of the certificate).

Therefore an agreement has been formed.





### Test your understanding 1

Which of the following are features of a simple contract:

- (i) Offer
  - (ii) Consideration
  - (iii) Relations
  - (iv) Acceptance
  - (v) Invitation
  - (vi) Certainty of terms
  - (vii) Intention to create legal relations
- A All of them
- B (i), (ii), (iii), (v), (vi) only
- C (i), (ii), (iii), (iv) only
- D (i), (ii), (iv), (vi) and (vii)



### Test your understanding 2

Mohammad has a notice in his shop window saying that the books he has for sale are half price. This is an example of:

- A Offer
- B Acceptance
- C Invitation to treat
- D Consideration



### Test your understanding 3

Harper is ordering an Indian takeaway on the telephone and says she will pay when she picks up the order. Which of the following would constitute consideration?

- A Placing the order
- B Paying for the order
- C Saying she will pay for the order
- D Picking up the order



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