

CHAPTER 1 : INTRODUCTION TO ACCOUNTING

Learning Outcomes

- 1.1 Definition of accounting.
- 1.2 Users of accounting information.
- 1.3 Differences between bookkeeping and accounting.
- 1.4 Branches of accounting.
- 1.5 Types of business ownerships.
- 1.6 Types of business activities.
- 1.7 Types of Financial Statements
- 1.8 Professional accounting bodies in Malaysia.
- 1.9 Potential career in accounting.

1.1 DEFINITION OF ACCOUNTING

Accounting is a process of identifying, recording, classifying, summarising, communicating and interpreting the results of business or economic transactions to users in order for them to make better decisions.

Exercise 1:

1. Which of the following is not a step in the accounting process?
(a) Identification. (c) Recording. (b) Economic entity. (d) Communication.
2. Categorize the accounting tasks listed below as relating to either it is the Identification **(I)**, recording **(R)**, or communication **(C)** aspects of accounting.

_____ Analyzing and interpreting information.
_____ Classifying economic events.
_____ Explaining uses, meaning, and limitations of data.
_____ Keeping a systematic chronological diary of events.
_____ Measuring events in dollars and cents.
_____ Preparing accounting reports.
_____ Reporting information in a standard format.

_____ Selecting economic activities relevant to the company.

_____ Summarizing economic events.

1.2 USERS OF ACCOUNTING INFORMATION

Internal users	Purpose
a. Management (directors & managers)	To make routine decisions and control all operations such as pricing decision, elimination of product line, projection of income from sales campaign, and forecasts of cash needs for the next year and etc.
b. Internal auditors	To verify that management system and the financial system of a company complying with accounting standards. To provide recommendations to the management based on analyses and assessments of accounting information.
External users	Purpose
a. Investors	To know the company's profitability and the amount of dividend paid out to shareholders. To decide whether to buy more shares or to dispose the shares they have. (buy/hold/sell decision)
b. Potential investors	To know the company's profitability and the amount of dividend paid out to shareholders. To decide whether to buy the shares or not. (investment decision)
c. Creditors	To assess the capability of the business repaying debts or loans. Example of creditors are such as Suppliers and Bankers or Finance Institution
d. Government agency/Regulatory authorities (e.g. LHDN)	To determine the amount of tax that should be collected from a company.

Exercise 2:

- Which of the following statements about users of accounting information is incorrect?
 - Management is an internal user.
 - Taxing authorities are external users.
 - Present creditors are external users.
 - Regulatory authorities are internal users.

2. Identify the following users of Financial Statements as being either external users (**EU**) or internal users (**IU**).

_____ Customers
 _____ Securities and Exchange Commission
 _____ Internal Revenue Service
 _____ Store manager
 _____ Labor Unions
 _____ Suppliers
 _____ Marketing manager
 _____ Vice president of Finance
 _____ Production Supervisor

3. Identify each of the questions listed below as being more likely asked by an internal user (**IU**) or an external user (**EU**).

_____ Can we afford to give our employees a pay raise?
 _____ Did the company earned a satisfactory income?
 _____ Do we need to borrow in the near future?
 _____ How does the company's profitability compare to other companies?
 _____ What does it cost us to manufacture each unit produced?
 _____ Which product should we emphasize?
 _____ Will the company be able to pay its short-term debts?

1.3 DIFFERENCES BETWEEN BOOKKEEPING AND ACCOUNTING

	Bookkeeping	Accounting
Definition	- Bookkeeping is a part of accounting. - A process of recording the daily transactions of a business entity , in chronological order.	- Accounting is an information system. - A process of recording, classifying, summarizing, reporting, analyzing and interpreting the financial condition and performance of a business.

Scope	- The process involved is a preliminary work in the accounting.	- It is more extensive and involving a thorough work beyond the bookkeeping.
Person in charge	Account Clerk	Accountant

1.4 BRANCHES OF ACCOUNTING

1. Financial Accounting

Financial accounting is a specialized branch of accounting that keeps track of a company's financial transactions. Using standardized guidelines, the transactions are recorded, summarized, and presented in Financial Statement that provides economic and financial information (in terms of financial performance and position) to the external users and the internal users.

2. Management Accounting (Managerial Accounting)

Management accounting involves preparing and providing timely financial and statistical information to the internal users (directors and managers) so that they can make day-to-day, short-term and long-term managerial decisions. Starting and maintaining solid, professional accounting practices is essential for the growth of a business.

3. Cost Accounting

Cost accounting focused on analyzing business costs and operations in order to determine the cost per unit of a product manufactured by manufacturing company or cost per service given by a service company. Information about cost is important to value inventory, to set selling price and to determine cost of goods sold. It also helps in controlling the costs and providing necessary costing information to management for decision making.

4. Auditing

Financial auditing is the process of examining an organization's financial records to determine if they are accurate and in accordance with applicable accounting standards, regulations, and laws.

- **External auditing** refers to the independent examination of an entity's financial statements and other accounting records that an entity publishes for the use of external parties. The auditor gives his opinion about the fairness of all accounting information examined by him.
- **Internal auditing** is performed to determine whether or not the policies and procedures set by management are being followed. An important purpose of internal auditing is to evaluate whether the activities performed by the employees at various levels are in line with the goals set by management.

5. Public Sector Accounting

- Involves maintaining and examining the records of government agencies and also to audit private businesses and individuals who pay taxes, and entities subject to other government regulations (e.g. businesses providing contract services to the government or organizations receiving government grant money).
- Budgets are among the most important considerations in government accounting since government agencies and other recipients of government money are fiscally accountable to tax payers and must demonstrate compliance with the intended uses of budgeted resources.
- Malaysia Public Sector Accounting Standard (MPSAS) is used by public sector entities in Malaysia in the preparation of general purpose financial statements.

6. Taxation

- Involves tax related matters of a business enterprise.
- It includes computation of taxable income and presentation of financial or other information to tax authorities required by tax laws and regulations of a country.

1.5 TYPES OF BUSINESS OWNERSHIPS (DIFFERENCES OF CHARACTERISTICS)

Characteristics	Sole Proprietorship or Sole Trader	Partnership	Company
a. Number of owner	1	2 - 20 (common partnership) 2 - 50 (professional partnership)	2 - 50 (private limited co.) 2 - unlimited (public co.)
b. Capital Source	Proprietor/Owner	Partners	Shareholders
c. Life of the organization	Limited	Limited	Indefinite
d. Liabilities	Unlimited	Unlimited	Limited
e. Laws of regulation	Businesses Act 1956	Partnership Act 1961	Companies Act 1965
f. Distribution of profits/losses	Wholly owned by proprietor	Among partners based on agreement.	Allocated according to shares of capital/ equity ratio

Exercise 3:

1. The three types of business ownerships are:
 - (a) proprietorships, small businesses, and partnerships.
 - (b) proprietorships, partnerships, and corporations.
 - (c) proprietorships, partnerships, and large businesses.
 - (d) financial, manufacturing, and service companies.

1.6 TYPES OF BUSINESS ACTIVITIES

Services	Merchandising	Manufacturing
Provide services to customers. e.g.: MAS (Malaysia Airline System), PwC (PricewaterhouseCoopers), BIMB (Bank Islam Malaysia Berhad).	Purchased inventories from other businesses (such as from manufacturers, wholesaler) and sold the inventories to customers. e.g.: Giant, Tesco, Parkson, Econsave.	Purchased raw materials and convert or change or process them into finished products and sold to customers (individual or other manufacturer). e.g.: Gardenia, Intel, Yeo's

1.7 TYPES OF FINANCIAL STATEMENTS (refer Exhibit 1 for the formats)

The components of financial statements as stated in FRS 1 are:

1. **Statement of Comprehensive Income or Statement of Profit or Loss. (*Income Statement*)**

- Reports the financial performance of an entity over a specific accounting period.
- Contains information on revenues and expenses including the net profit or loss of the business entity.
- There are several formats in reporting the revenue and expenses depending on the business activity runs by the entity.

2. **Statement of Owner's Equity**

- Reports how the owner's equity has changed over the reporting period.
- It reports how opening capital has increased through the net income and additional investment by the owner, and how it decreased through the net loss and withdrawals.

3. Statement of Financial Position (*Balance Sheet*)

- It is also known as balance sheet; reports the financial position of a business entity at a certain date (normally at the end of the accounting period).
- It contains of three main components
 - (1) Assets (non-current assets + current assets)
 - (2) Liabilities (non-current liabilities + current liabilities)
 - (3) Owner's equity
- At matriculation level, the format is comply to the accounting equation which is :-

$$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$$

4. Statement of Cash Flows

- It is also known as Cash Flow Statement, presents the movement in cash flows over the accounting period.
- It shows the in-flow and the out-flow of cash of an organization according to three main activities which are operating, investing and financing.

Exercise 4:

1. The financial statement that reports assets, liabilities, and owner's equity is the:
 - (a) Statement of Comprehensive Income
 - (b) Statement of Owner's Equity
 - (c) Statement of Financial Position
 - (d) Statement of Cash Flows.
2. Which of the following statements is false?
 - (a) Statement of Cash Flows summarizes information about the cash inflows (receipts) and outflows (payments) for a specific period of time.
 - (b) Statement of Financial Position reports the assets, liabilities, and owner's equity at a specific date.
 - (c) Statement of Comprehensive Income or Statement of Profit or Loss presents the revenues, expenses, changes in owner's equity, and resulting net income or net loss for a specific period of time.

- (d) Statement of Owner's Equity summarizes the changes in owner's equity for a specific period of time.

1.8 PROFESSIONAL ACCOUNTING BODIES IN MALAYSIA

1. Malaysian Accounting Standards Board (MASB)

Established under the Financial Reporting Act 1997

The main functions and authorities:

- a. Issuing new accounting standards [Malaysian Financial Reporting Standards (MFRS)]
- b. Reviewing, revising or adopting existing accounting standards.
- c. Issuing statements of principles for financial reporting.
- d. Sponsoring or undertaking the development of possible accounting standards.
- e. Developing a conceptual framework for the purpose of evaluating proposed accounting standards.

2. Malaysian Institute of Accountants (MIA)

Established under the Accountants Act (1967)

The main functions of MIA are to:

- a. Determining the qualifications for members.
- b. Providing trainings and continuing professional education to existing and potential practitioners.
- c. Controlling the accounting practice in Malaysia.

3. Malaysian Institute of Certified Public Accountants (MICPA)

The Malaysian Institute of Certified Public Accountants (MICPA) was formed as a professional body in 1958. The main functions of MICPA are to:

- a. Advancing the theory and practice of accountancy in all its aspects.
- b. Recruiting, educate, train and assess a body of members skilled in these areas.
- c. Maintaining high standards of practice and professional conduct by all its members.
- d. Developing the accounting profession.

1.9 POTENTIAL CAREER IN ACCOUNTING

Public Sector	Private Sector
Students from accounting field are eligible to apply suitable positions in most public service departments, especially in Lembaga Hasil Dalam Negeri, Jabatan Kastam, Jabatan Akauntan Negara, or financial units in all government offices or become accounting teachers/lecturers in schools or public universities (IPTA).	Students from accounting field have opportunities to participate in the private sector in various positions such as accountants, auditors, tax consultant, managers, or administration executives; because many companies worldwide are very keen to hire accounting graduates. Accounting students also can become teachers/lecturers for private schools or private universities (IPTs).

In Malaysia, under the Accounting Act 1967, those who registered with Malaysian Institute of Accountant (MIA) are known as Chartered Accountants (CA). To be called a Chartered Accountant; one must: -

- i. Have an accountancy degree from any institution recognized by the Malaysian Institute of Accountant (MIA),
- ii. Have 3 years of working experience in accounting field, or
- iii. Becoming a full members of the recognized professional body of MIA, or pass the eligibility examination conducted by MIA.