CHAPTER 1 INTRODUCTION TO ACCOUNTING

DPA10013 FINANCIAL ACCOUNTING 1

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INTRODUCTION TO ACCOUNTING

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THE SYNOPSIS

This ebook is to help students develop knowledge and understanding of accounting and bookkeeping. This chapter will cover about users of accounting information, types of business entity, types of accounting field and accounting cycle.

TABLE OF CONTENTS

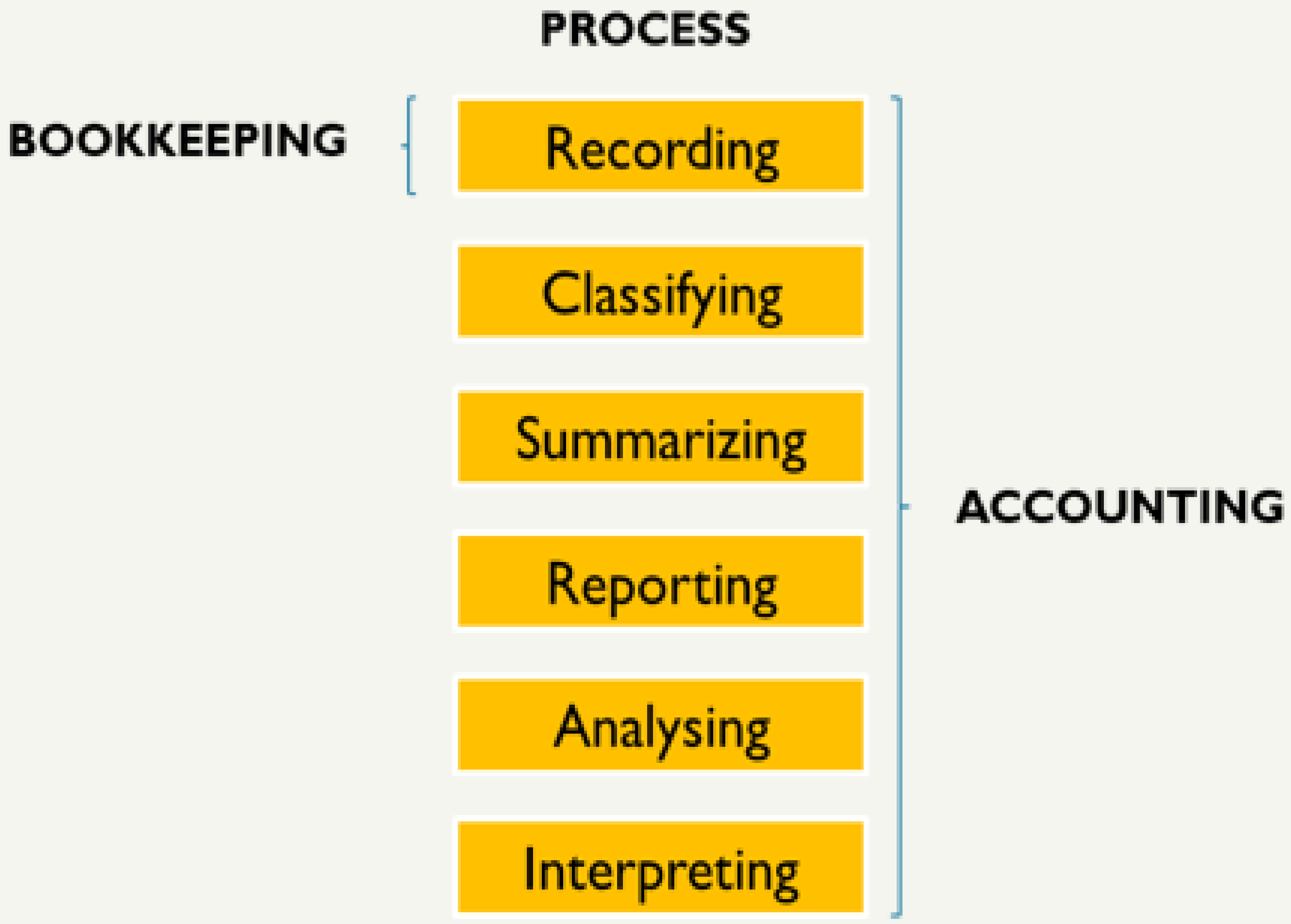
At the end of this chapter, you should be able to:

- define accounting and bookkeeping
- describe the users of the following accounting information
- recognize types of the following business entity
- discuss each types of accounting field
- identify the steps of accounting cycle

Definition Of Accounting And Bookkeeping

Accounting is the process of recording, classifying, summarizing, reporting, analyzing, and interpreting business activities into monetary units to assist users of this information in decision making.

Bookkeeping is the process of recording business activities into the books of accounts. It only involves one step of the accounting process.



Recording: is to keep a systematic record of all business transactions. Recording is done in the order of their occurrence. First transactions are recorded in the book called journal. This journal is again further be divided into several subsidiary books according to the size and nature of business.

Classifying: Classification refers to the process of analysing and grouping the recorded data in one place on the basis of their nature to get the instant information. The book where the classification is done is called Ledger.

Summarising: Summarising refers to the preparation and presentation of classified data in a useful form to the users of accounting information. In this process the financial statement are prepared which are:

(*a*) Profit & Loss Account

(*b*) Balance Sheet

(*c*) Cash Flow Statement

Analysing: The accounting information which are presented by financial statements may not be easily understandable to everyone. So this requires the simplification of the data from financial statements. Therefore analysing refers to the process of simplification of the data presented in financial statements to make the users easily understandable.

Interpreting: Interpreting in the process of explaining the meaning and significance of the simplified data established by the analysis. Interpretation helps the users to take correct decisions on the basis of the information available.

Differences Between Accounting And Bookkeeping

ACCOUNTING	BOOKKEEPING
Accounting represents the complete accounting process, from the process of recording until interpreting the business financial information.	Bookkeeping is only limited to the recording process.
Accounting involves more technical understanding and advance accounting procedures.	Bookkeeping requires a basic undertanding and practice of financial accounting.
Accounting tasks are performed by accounting graduates or certified professional accountants.	Bookkeeping is performed by non-accountants who have gained the necessary training and experience in bookkeeping.
Accounting is responsible for a wide range of accounting tasks and manages the various financial decisions from the respective business departments.	Bookkeeping comprises only the simple accounting tasks in a financial department such as: • Issue bill from cash or credit activities • Record receipts from customers • Veerify and record invoices from suppliers

Users of Accounting Information

Internal Users

External Users

Internal Users

a) Middle-level or top-level management

b) Human resource department

c) Marketing department

d) Strategic planning department

External Users

a) Potential shareholders

b) Government related authority bodies

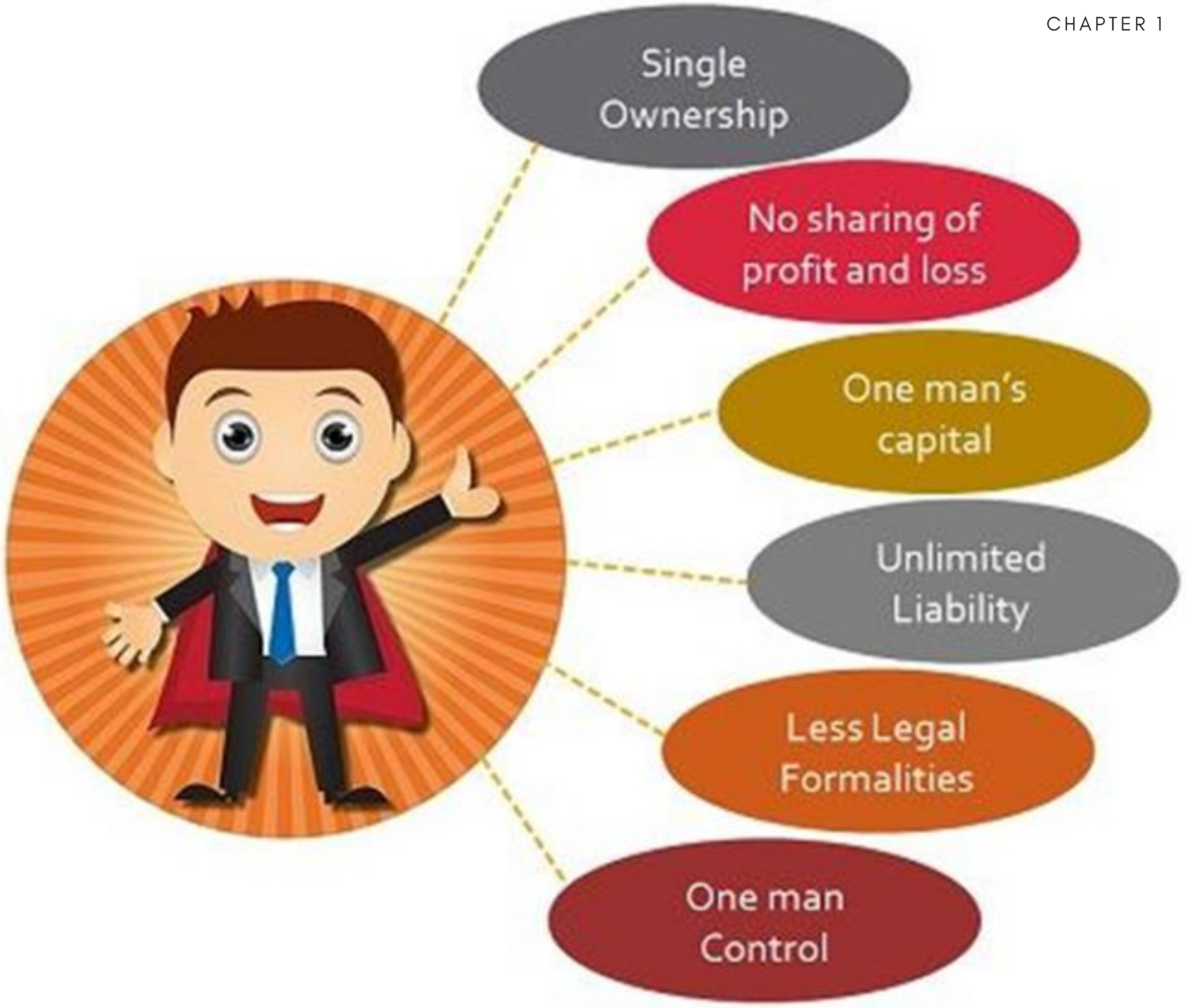
c) Creditors

d) Analysis

e) Public at large

Types of Business Entities

Sole Proprietorship



- Is a business owned by two or more persons (partners) who share their resources to start the business.
- The number of partners is usually limited to a maximum of 20.
- Each partner shares the responsibility of operating the business based on their partnership agreement.
- The partners share the profits and losses of the business among themselvesl.
- Two types of partnership : general partnership and limited liability partnership

General Partnership

- Is a conversional partnership.
- Partners contribute cash or any assets that can be converted to cash as their capital.
- General partnership is not a separate legal entity.
- Each partner bears an unlimilited liability to debts, claims or charges against the partnership and this can extend to their personal assets.
- The liability for any debts of the business is borne by the partners.
- Partnership is regulated under the Registration of Businesses Act 1956(RBA), and law of Partnership Act 1961 in Malaysia.

Limited Liability Partnership (LLP)

- Is an altenative type of business entity regulated under the Limited Liability Partnerships Act 2012 which combines the characteristics of a company and a conventional partnership.
- Capital is contributed by partners in the form of shares.
- Is a separate legal entity in which each partner contributes capital to the business and thus, technically, owns the business and has the advantage of limited liability.
- Limited liability means that the personal assets of the partners (shareholders) are protected from any legal action if the LLP business faces any misfortune.
- Is regulated under the Limited Liability Partnership Act 2012 (LLP) and Limited Liability Partnership Regulations 2012.

COMPANY

- The capital is funded by owners called shareholders.
- Shareholders are the public who bought the shares .
- The business name end with the word 'Sdn Bhd' or 'Bhd'.
- Separate legal entity.
- Limited liability
- Regulated under the Companies Act 2016.

Types of Accounting Field

1. Financial Accounting

Financial accounting involves recording and classifying business transactions, and preparing and presenting financial statements to be used by internal and external users.

In the preparation of financial statements, strict compliance with generally accepted accounting principles or GAAP is observed. Financial accounting is primarily concerned in processing historical data.

2. **Managerial Accounting**

Managerial or management accounting focuses on providing information for use by internal users, the management. This branch deals with the needs of the management rather than strict compliance with generally accepted accounting principles.

Managerial accounting involves financial analysis, budgeting and forecasting, cost analysis, evaluation of business decisions, and similar areas.

3. **Cost Accounting**

Often times considered as a subset of management accounting, cost accounting refers to the recording, presentation, and analysis of manufacturing costs. Cost accounting is very useful in manufacturing businesses since they have the most complicated costing process.

Cost accountants also analyze actual costs versus budgets or standards to help determine future courses of action regarding the company's cost management.

4. **Auditing**

External auditing refers to the examination of financial statements by an independent party with the purpose of expressing an opinion as to fairness of presentation and compliance with GAAP. Internal auditing focuses on evaluating the adequacy of a company's internal control structure by testing segregation of duties, policies and procedures, degrees of authorization, and other controls implemented by management.

5. **Tax Accounting**

Tax accounting helps clients follow rules set by tax authorities. It includes tax planning and preparation of tax returns. It also involves determination of income tax and other taxes, tax advisory services such as ways to minimize taxes legally, evaluation of the consequences of tax decisions, and other tax-related matters.


Source documents
Books for prime entry
Ledgers
Trial balance
Adjustments
Adjusted trial balance
Financial statements
Financial reports
ACCOUNTING CYCLE

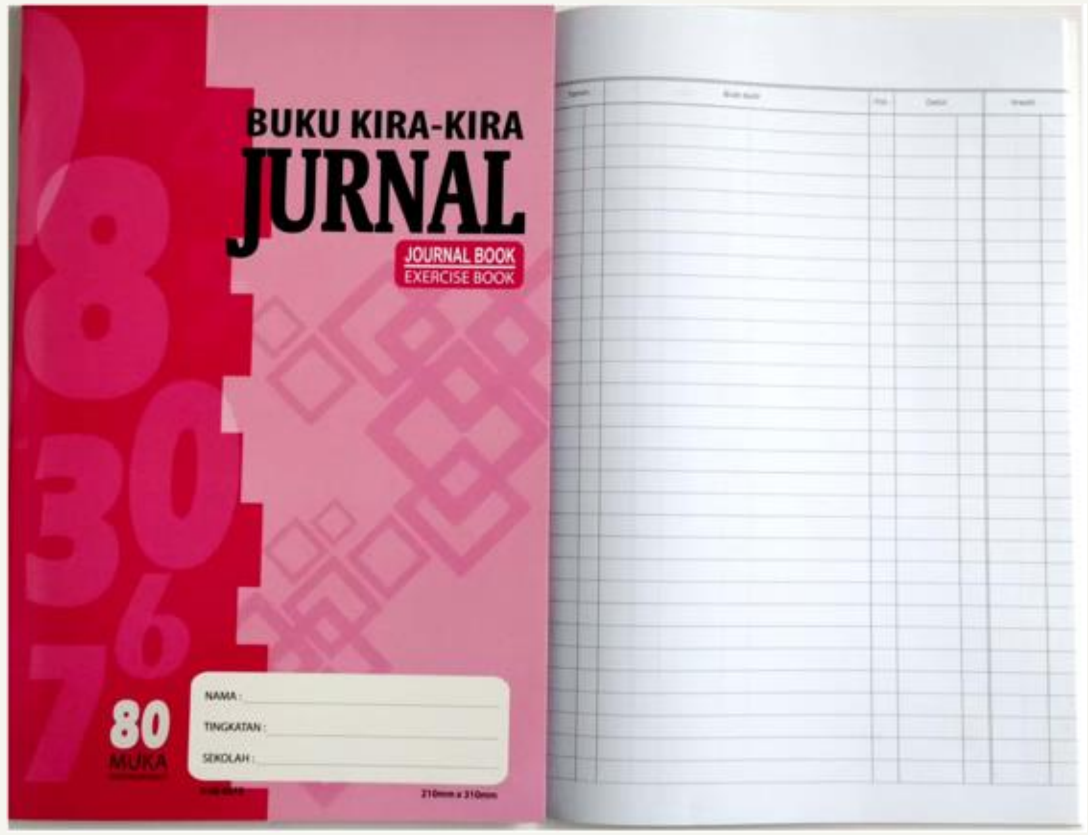
Steps in the Accounting Cycle

Step 1 : Source documents

Gather records of your business transactions—receipts, invoices, bank statements, and other things like that. All business activities must be supported with documents as evidence.

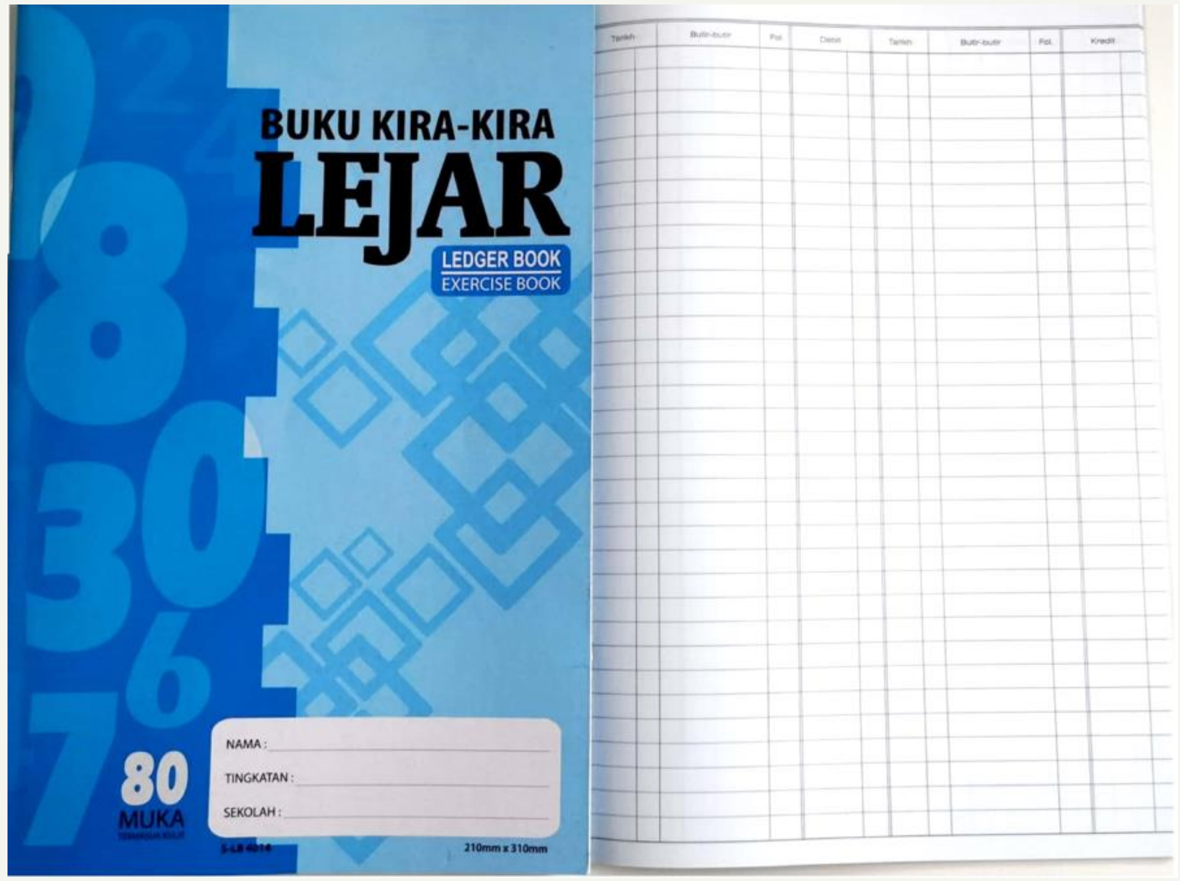
Step 2 : Books for prime entry

Record information such as name of customers or suppliers, date and amount written in the source document in the books for prime entry such as the cash book and the journal.



Steps in the Accounting Cycle

Step 3 : Ledgers
From books prime entry are then posted to the various accounts in the ledger where a summary of all transactions to individual accounts can be seen.



Steps in the Accounting Cycle

Step 4 : Trial balance

At the end of each month, the ledger accounts are closed and a trial balance is prepared to determine the equality of debits and credits.

Trial Balance

Account Titles	Debit		Credit
Assets	XXX		
Liabilities			XXX
Equity			XXX
Drawings	XXX		
Revenues			XXX
Expenses	XXX		
	XXX	=	XXX

Step 5 : Adjustments

Any business activity that occurs beyond the current accounting period will have to adjusted.

Step 6 : Adjusted trial balance

The adjusted trial balance contains all the account balances created after the adjustment is made.

Adjusted Trial Balance
December 31, 2015

Account Name	Debit	Credit
Cash	$ 24,550	
Consulting fees receivable	17,200	
Prepaid office rent	2,100	
Prepaid dues and subscriptions	100	
Supplies	225	
Equipment	18,000	
Accumulated depreciation - equipment		$ 5,400
Notes payable		2,500
Income taxes payable		8,500
Unearned consulting fees		1,550
Salaries payable		850
Interest payable		50
Capital stock		15,000
Retained earnings		16,350
Dividends	30,000	
Consulting fees earned		135,515
Salaries expense	45,260	
Telephone expense	1,275	
Rent expense	12,050	
Interest expense	50	
Income tax expense	28,000	
Dues and subscription expense	330	
Supplies expense	875	
Depreciation expense - equipment	3,600	
Miscellaneous expenses	2,100	
Totals	$ 185,715	$ 185,715

Step 7 : Financial statements

Balance from the adjusted trial balance will be used to prepare the financial statements. They'll tell you where your money is and how it got there.

Step 8 : Financial report

The summary of business activities obtained from the financial statements will be presented in the form of a financial report.

Exercise

Question 1

Define what is accounting.

Question 2

Define what is bookkeeping.

Question 3

Give examples of internal and external users.

Question 4

List three characteristics of sole proprietorship.

Question 5

List three characteristics of a partnership.

Question 6

Explain the accounting cycle.

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