Module 2 – Accounting Concepts & Principles

Table of Contents

2.0 Learning Outcomes 3
2.1 The Regulatory Framework for 4
Accounting in Malaysia 4
2.1.1 Malaysia Institute of Accountants 4
2.1.2 Malaysia Accounting Standard Board 5
2.1.3 The Companies Commission of Malaysia (SSM) 6
2.1.4 Tax System 7
2.2 Accounting Conceptual Framework 7
2.2.1 Primary Characteristic 8
2.2.1.1 Relevance 8
2.2.1.2 Representational faithfulness 8
2.2.2 Secondary Characteristic 9
2.2.2.1 Verifiability 9
2.2.2.2 Timeliness 10
2.2.2.3 Understandability 10
2.2.2.4 Comparability 10
2.3 Accounting Conventions 11
2.3.1 Conservatism 11
2.3.2 Consistency 12
2.3.3 Full disclosure 12
2.3.4 Materiality 12
2.3.5 Areas Where Accounting Conventions 13
Apply 13
2.4 Accounting Concepts 14
2.4.1 Business entity concept 14
2.4.2 Money measurement concept 14
2.4.3 Dual aspect concept 14
2.4.4 Going concern concept 15
2.4.5 Cost concept 15
2.4.6 Accounting year concept 15

2.4.7 Matching concept 15
2.4.8 Realization concept (Revenue Recognition) 16
2.4.9 Accrual concept 16

2.0 Learning Outcomes

In this chapter your will learn the followings:

1. Understand Malaysia Accounting Regulatory Framework

2. Understand the objective for a Financial Statement

3. Understand various users of Financial Statement

4. Understand basic accounting principle and concept

2.1 The Regulatory Framework for Accounting in Malaysia

2.1.1 Malaysia Institute of Accountants

The accountancy profession in Malaysia is regulated by the Malaysian Institute of Accountants (MIA) through the powers conferred by the Accountants Act, 1967.

The MIA is an agency under the Ministry of Finance and reports directly to the Accountant General's Office in Putrajaya.

Accounting firms must be registered with MIA and members of MIA who wish to offer public practice services should also possess practicing certificate issue by MIA.

MIA sets the By-Laws (On Professional conduct & Ethics) and auditing standards for the accountancy profession in Malaysia, which are in line with the standards issued by the International Federation of Accountants (IFAC) and the International Auditing and Assurance Standards Board (IAASB).

2.1.2 Malaysia Accounting Standard Board

The Malaysian Accounting Standards Board **(MASB)** was established under the Financial Reporting Act 1997 (Act) as the standard-setting body of FRF whose functions shall be the determination and issuance of accounting standards for the preparation of financial statements, which are required to be prepared or lodged under any law administered by the Securities Commission Malaysia, Bank Negara Malaysia or the Registrar of Companies.

The MASB, together with the **Financial Reporting Foundation (FRF)**, make up the frameworks for financial reporting in Malaysia. This framework comprises an independent standard-setting structure with representation from all relevant parties in the standard-setting process, including preparers, users, regulators and the accountancy profession.

The Malaysian Financial Reporting Standards **(MFRS)** framework was introduced by the Malaysian Accounting Standards Board (MASB) and came into effect on 1 January 2012.

It is fully compliant with the International Financial Reporting Standards (IFRS) framework, which enhances the credibility and transparency of financial reporting in Malaysia.

Companies registered in Malaysia are required to prepare statutory financial statements in accordance with the approved accounting standards issued by the Malaysian Accounting Standards Board (MASB).

Foreign companies listed on a stock exchange in Malaysia may prepare financial statements in accordance with certain internationally

recognized accounting standards such as International Financial Reporting Standards (IFRSs).

MASB has two sets of approved accounting standards, namely:

- MASB approved accounting standards for entities other than private entities – Malaysian Financial Reporting Standards (MFRSs)

- MASB approved accounting standards for private entities – Malaysian Private Entities Reporting Standard (MPERS) – effective for annual reporting periods beginning on or after 1 January 2016.

2.1.3 The Companies Commission of Malaysia (SSM)

i. The Companies Commission of Malaysia (Malay: Suruhanjaya Syarikat Malaysia, abbreviated SSM), is a statutory body formed under an Act of Parliament that regulates corporate and business affairs in Malaysia.

ii. The SSM was formed in 2002 under the Companies Commission of Malaysia Act 2001, assuming the functions of the Registrar of Companies and Registry of Business.

iii. The main purpose of SSM is to serve as an agency to incorporate companies and register businesses as well as to provide company and business information to the public. The commission launched SSM e-Info Services to allow information on companies and businesses obtainable via its website.

iv. As the leading authority for the improvement of corporate governance in Malaysia, the commission also handles monitoring and enforcement activities to ensure compliance with business registration and corporate legislation.

v. All enforcements were governed by:

- Company Act 2016
- Registration of Business Act 1956 Partnership Act 1974(1961)
- Limited Liability Partnership Act 2012

2.1.4 Tax System

- Corporate Tax
- Consumption Tax
- Withholding Tax
- Individual Tax

2.2 Accounting Conceptual Framework

The primary purpose of financial information is to be useful to existing and potential investors, lenders and other creditors (users) when making decisions about the financing of the entity and exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

Generally Conceptual Framework allowed the financial statement to be interpreted its qualitatively.

2.2.1 Primary Characteristic

Primary qualitative characteristics of accounting information that must be present for information to be useful in making decisions:

2.2.1.1 Relevance

Relevance refers to how helpful the information is for financial decision-making processes. For accounting information to be relevant, it must possess:

- Confirmatory value – Provides information about past events
- Predictive value – Provides predictive power regarding possible future events

Therefore, accounting information is relevant if it can provide helpful information about past events and help in predicting future events or in taking action to deal with possible future events.

For example, a company experiencing a strong quarter and presenting these improved results to creditors is relevant to the creditors' decision-making process to extend or enlarge credit available to the company.

2.2.1.2 Representational faithfulness

Representational faithfulness, also known as reliability, is the extent to which information accurately reflects a company's resources, obligatory claims, transactions, etc. To help, think of a pictorial depiction of something in real life – how accurately does the picture represent what you see in real life? For accounting information to possess representational faithfulness, it must be:

- Complete – Financial statements should not exclude any transaction.

- Neutral – The degree to which information is free from bias. Note that there are subjectivity and estimation involved in financial statements, therefore information cannot be truly "neutral." However, if a company polled 1,000 accountants and took the average of their answers, that would be considered neutral and free from bias.

- Free from error – The degree to which information is free from errors.

2.2.2 Secondary Characteristic

Secondary Qualitative Characteristics are characteristics of accounting information that impact how useful the information is:

2.2.2.1 Verifiability

Verifiability is the extent to which information is reproducible given the same data and assumptions.

For example, if a company owns equipment worth $1,000 and told an accountant the purchase cost, salvage value, depreciation method, and useful life, the accountant should be able to reproduce the same result. If they cannot, the information is considered not verifiable.

2.2.2.2 Timeliness

Timeliness is how quickly information is available to users of accounting information. The less timely (thus resulting in older information), the less useful information is for decision-making. Timeliness matters for accounting information because it competes with other information.

For example, if a company issues its financial statements a year after its accounting period, users of financial statements would find it difficult to determine how well the company is doing in the present.

2.2.2.3 Understandability

Understandability is the degree to which information is easily understood. In today’s society, corporate annual reports are in excess of 100 pages, with significant qualitative information. Information that is understandable to the average user of financial statements is highly desirable. It is common for poorly performing companies to use a lot of jargon and difficult phrasing in its annual report in an attempt to disguise the underperformance.

2.2.2.4 Comparability

Comparability is the degree to which accounting standards and policies are consistently applied from one period to another.

Financial statements that are comparable, with consistent accounting standards and policies applied throughout each accounting period, enable users to draw insightful conclusions about the trends and performance of the company over time.

In addition, comparability also refers to the ability to easily compare a company's financial statements with those of other companies.

The qualitative characteristics of accounting information are important because they make it easier for both company management and investors to utilize a company's financial statements to make well-informed decisions.

2.3 Accounting Conventions

Accounting conventions are the set of practices discussed by the accounting bodies before preparing final accounts.

These procedures and principles are not legally binding but are generally accepted by accounting bodies.

Basically, they are designed to promote consistency and help accountants overcome practical problems that can arise when preparing financial statements.

Accounting Convention Methods. There are four main accounting conventions designed to assist accountants:

2.3.1 Conservatism

Playing it safe is both an accounting principle and convention. It tells accountants to err on the side of caution when providing estimates for assets and liabilities.

That means that when two values of a transaction are available, the lower one should be favored.

The general concept is to factor in the worst-case scenario of a firm’s financial future.

2.3.2 Consistency

A company should apply the same accounting principles across different accounting cycles.

Once it chooses a method it is urged to stick with it in the future, unless it has a good reason to do otherwise. Without this convention, investors' ability to compare and assess how the company performs from one period to the next is made much more challenging.

2.3.3 Full disclosure

Information considered potentially important and relevant must be revealed, regardless of whether it is detrimental to the company.

2.3.4 Materiality

Like full disclosure, this convention urges companies to lay all their cards on the table.

If an item or event is material, in other words important, it should be disclosed.

The idea here is that any information that could influence the decision of a person looking at the financial statement must be included.

2.3.5 Areas Where Accounting Conventions Apply

Accounting conservatism may be applied to inventory valuation. When determining the reporting value of inventory, conservatism dictates that the lower of historical cost or replacement cost should be the monetary value.

Accounting conventions also dictate those adjustments to line items should not be made for inflation or market value. This means book value can sometimes be less than market value.

For example, if a building costs $50,000 when it is purchased, it should remain on the books at $50,000, regardless of whether it is worth more now.

Estimations such as uncollectible accounts receivables and casualty losses also use the conservatism convention.

If a company expects to win a litigation claim, it cannot report the gain until it meets all revenue recognition principles. However, if a litigation claim is expected to be lost, an estimated economic impact is required in the notes to the financial statements.

Contingent liabilities such as royalty payments or unearned revenue are to be disclosed, too.

2.4 Accounting Concepts

Accounting concepts are the rules and regulations of accounting that companies are required to follow when reporting all accounts and financial data.

refer to the principles that are put in place to ensure that accounting information presented in financial statements of a business entity is given truly and fairly.

The major accounting concepts are classified as follows:

2.4.1 Business entity concept

A business and its owner should be treated separately as far as their financial transactions are concerned.

2.4.2 Money measurement concept

Only business transactions that can be expressed in terms of money are recorded in accounting, though records of other types of transactions may be kept separately.

2.4.3 Dual aspect concept

For every credit, a corresponding debit is made. The recording of a transaction is complete only with this dual aspect.

2.4.4 Going concern concept

In accounting, a business is expected to continue for a fairly long time and carry out its commitments and obligations. This assumes that the business will not be forced to stop functioning and liquidate its assets at “fire-sale” prices.

2.4.5 Cost concept

The fixed assets of a business are recorded on the basis of their original cost in the first year of accounting. Subsequently, these assets are recorded minus depreciation. No rise or fall in market price is taken into account. The concept applies only to fixed assets.

2.4.6 Accounting year concept

Each business chooses a specific time period to complete a cycle of the accounting process—for example, monthly, quarterly, or annually—as per a fiscal or a calendar year.

2.4.7 Matching concept

This principle dictates that for every entry of revenue recorded in a given accounting period, an equal expense entry has to be recorded for correctly calculating profit or loss in a given period.

2.4.8 Realization concept (Revenue Recognition)

According to this concept, profit is recognised only when it is earned. An advance or fee paid is not considered a profit until the goods or services have been delivered to the buyer.

2.4.9 Accrual concept

Accrual concept is the most fundamental principle of accounting which requires recording revenues when they are earned and not when they are received in cash and recording expenses when they are incurred and not when they are paid.