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CPA REVIEW (May 2019 Batch)

FAR Theory

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Module 1

1. Overview of Accounting
2. Accounting Standard-setting Process and Institutions
3. Conceptual Framework

OVERVIEW OF ACCOUNTING

1. History of Accounting

Historical records show that the beginnings of record keeping or storing information dates back some 76,000 years ago in the Blombos caves of Africa.

Accounting In Ancient Egypt, China, Greece and Rome

- Government accounting records in Egypt show “in kind” tax payments.
- China used Accounting as a means of evaluating the efficiency of governmental programs
- Legislation on financial matters in Greece (5th century BC) included control of receipts and expenditures of public monies through the oversight of “public accountants” chosen by lot
- In its thousand years of existence, these records showed simple list-making only, similar to single-entry bookkeeping
- Early financial records in the Roman Empire include the **Account**, (listed public revenues); the **Treasury**, (which listed amounts of cash in the provincial tax officials and in the hands of the public contractors). The records included not only cash and commodities but also the names of freed men and slaves, especially the records Roman army.
- Medieval Europe (13th century) –introduction of double-entry bookkeeping. The chief objective was to keep track of amounts owed by customers (debtors) and amounts owed to creditors. Debit is Latin for 'he owes' and credit is Latin for 'he trusts'.
- The **Messari** (Italian for Treasurer’s accounts, of the city of Genoa 1340) is the oldest discovered record of a complete double-entry system. These accounts contain debits and credits journalized in a bilateral form.

Luca Pacioli and Double-entry System of Bookkeeping

- Luca Pacioli's "Summa de Arithmetica, Geometria, Proportioni et Proportionalità," published in Venice in 1494, included a 27-page, 36 short chapters on bookkeeping.
- Books of accounts used by Luca Pacioli
 - The **memorandum** (a daybook) – for chronological recording of business transactions as they occurred
 - The **journal** – the merchant's private account book
 - The **ledger** – the money and date columns were almost identical to those in modern ledgers, with entries consisting of brief paragraphs
- The **trial balance** is the end of Pacioli's accounting cycle. Debits from the old ledger are listed on the left side of the balance sheet and credits on the right. If the two totals are equal, the old ledger is considered balanced. If not (in balance), says Pacioli, *"that would indicate a mistake in your ledger, which mistake you will have to look for diligently with the industry and intelligence God gave you."*
- The objective of Luca Pacioli’s keeping records is to give traders prompt information as to his assets and liabilities.
- The Summa is the first known printed treatise on bookkeeping and was translated into different languages. It is widely believed to be the forerunner of modern bookkeeping practice.
- Thus, it can be said that Luca Pacioli systematized record keeping through the double-entry bookkeeping system.

Professional Accountancy Travels across the Globe

- 1880: Institute of Chartered Accountants in England and Wales (ICAEW) brought together all the accountancy organizations in those countries
- 1887: the first national accounting society of the United States was formed, the American Association of Public Accountants (predecessor of the AICPA)

Accounting in the Internet Era

- The act of accounting is usually defined as the act of collecting information on resource usage for the purpose of trend analysis, auditing, billing, or cost allocation.
 - For example when a user uses a connectivity service paid with a pay-per-view approach the accounting process is based on a metering of the resource usage by the user (usually time spent with an active connection or the amount of data transferred using that connection). The accounting is hence the recording of this connectivity service consumption for subsequent charging of the service itself.

Recent Trends and Developments in Accounting

- Cloud Accounting
- Automation (Artificial Intelligence)
- Data Analytics
- Environmental Accounting
- Standardization and Harmonization

2. Definition, Nature, and Purpose of Accounting

Definition: Accounting is a service activity. Its function is to provide quantitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions.

Accounting is the art of recording, classifying, summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and interpreting the results thereof.

Nature:

- Accounting as Science and Art – Accounting is a social science with a body of knowledge which has been systematically gathered, classified, and organized. It is influenced by, and interacts with, economic, social and political environments. Accounting is a practical art which requires the use of creative skill and judgment.
- Accounting as an Information System – Accounting identifies and measures economic activities, processes information into financial reports and communicates these reports to decision makers.

Purpose: To provide quantitative information¹ about economic entities² intended to be useful in making economic decisions.

1 – Types of information provided by accounting

- Quantitative information – expressed in numbers, quantities or units
- Qualitative information – expressed in words or descriptive form
- Financial information – expressed in terms of money

2 – Economic entity vs business entity

- Economic entity – is a separately identifiable combination of persons and property that uses or controls economic or scarce resources to achieve certain goals or objectives. Scarce resources have one significant characteristic: because of their limited nature, they command a price.
 - Business entity is an economic entity that produces and distributes goods or services primarily for profit.
 - Not-for-profit or non-profit entity is one that carries out some socially desirable needs of the community or its members whose activities are not directed towards making profit.

3. Functions of Accounting

- a. **Identification** – the accounting process of recognition or non-recognition of business activities as “**accountable events**” or whether they have accounting relevance.
- b. **Measurement** – the accounting process of assigning of peso amounts or numbers to the economic transactions and events. The unit of measure of accounting is **money**, expressed in prices.
- c. **Communication** – the accounting process of preparing and distributing accounting reports to potential users of accounting information and interpreting the significance of this processed information. The three aspects of communicating are:
 - i. **Recording** – the process of systematically committing to writing business transactions and events in books of account in a systematic and chronological manner according to accounting rules and regulation.
 - ii. **Classifying** – the grouping of similar and interrelated items into their respective classes.
 - iii. **Summarizing** – expressing in condensed or brief form the recorded and classified information in financial statements.

4. Branches of Accounting

- a. **Financial Accounting** – the recording of transactions, preparation of financial statements and communication of financial information to external user groups. (Focus: general purpose reports)
- b. **Auditing** – the examination of financial statements by independent certified public accountant for the purpose of expressing an opinion on the fairness of presentation of financial statements. (Focus: audit report)
- c. **Management Accounting (or Management Services)** – the accumulation and communication of information for use by internal parties or management. This includes services to clients on matters of accounting, finance, business policies, organization procedures, product costs, distribution, and many other phases of business conduct and operations. (Focus: advisory services; consultancy)
- d. **Government Accounting** – accounting for the national government and its instrumentalities, focusing attention on the custody of public funds and the purpose or purposes to which such funds are committed.
- e. **Tax Accounting** – involves the preparation of tax returns and rendering of tax advice, such as determination of tax consequences of certain proposed business endeavors. (Focus: Tax advisory services)
- f. **Fiduciary Accounting** – handling of accounts managed by a person entrusted with the custody and management of property for the benefit of another.
- g. **Social Responsibility Accounting** – reporting of programs and projects that have to do with the upliftment of the welfare of the people of a community or of the nation.
- h. **Environmental Accounting** – the area of accounting that focuses on programs, activities and projects that are focused on care for Mother Earth. One example is carbon accounting which is a process of encouraging reductions in greenhouse gas emissions.
- i. **Price-level Accounting (Accounting for Hyperinflationary Economies)** – is accounting that recognizes in the financial statements changes in the purchasing power of money. This is in contrast to traditional accounting which assumes a stable monetary unit when it reports financial information.

5. Financial Accounting vs. Management Accounting

| Financial Accounting | Management Accounting |
|---|---|
| ○ Basically concerned with income determination and asset valuation | ○ Basically concerned with decision-making |
| ○ Prepares statements in accordance with GAAP | ○ Prepares statements in accordance with management needs |
| ○ Prepares general purpose statements | ○ Prepares special purpose reports for internal users |

| | |
|---|--|
| that can be used by external and internal users | ○ Future-oriented |
| ○ Historical in nature | ○ Makes use of subjective data as long as it is relevant |
| ○ Emphasizes objective data | |

6. Areas of Professional Accounting Practice

- a. **Public Accounting** – composed of individual practitioners, accounting firms and large multinational organizations that render independent expert financial services to the public on a professional fee basis. Public accountants usually offer three kinds of services: assurance and audit, taxation, and management advisory services.
- b. **Private Accounting** – composed of individuals employed in business enterprises on salary basis. The major objective of private accounting is to assist management in planning and controlling the enterprise's operations.
- c. **Government Accounting** – composed of accountants employed in the different branches of government, such as the BIR, COA, SEC, and GBEs. The focus of government accounting is custody and administration of public funds.
- d. **Accounting Education** – composed of CPAs who are professors of accounting in various colleges and universities. Their task is to prepare entrants into the accountancy profession.

7. Environment of Accounting

Financial accounting is shaped to a significant extent, by the environment, and in particular, all of the following:

- The economic activities in society
- The means of measurement of economic activity
- The financial statement users and their information needs

Economic Activities and their Classification

- a. **Production** – the process of converting economic resources into outputs of goods and services that are intended to have greater utility than the required inputs
- b. **Exchange** – the process of trading resources or obligations for other resources or obligation
- c. **Income distribution** – the process of allocating rights to the use of output among individuals and groups in society
- d. **Consumption** – the process of using the final output of the production process
- e. **Investment** – the process of using current inputs to increase the stock of resources available for output as opposed to immediately consumable output
- f. **Savings** – the process by which individuals and groups set aside rights to present consumption in exchange for rights to future consumption

Accountable Events – are events that are quantifiable and has an effect on assets, liabilities and equity. Also known as economic activities, these are the subject matter of accounting.

- Only economic activities are emphasized and recognized in accounting. Sociological and psychological matters are not recognized.
- Criteria for an accountable event
 - It must affect a financial element of accounting (increasing or decreasing asset, liability or equity (probability criterion))
 - It is a result of a past activity
 - Its cost can be measured reliably (measurability criterion)

Types of Accountable Events

1. External Events – events wherein another party participates
 - a. Transfers – there is flow of economic resources
 - i. Exchanges – two-way
 - ii. Non-reciprocal Transfers – one-way
 - b. External Events other than Transfers – no flow of economic resources
2. Internal Events – those wherein only the entity participates
 - a. Production
 - b. Casualties

Measurement of Accountable Events (to be discussed in Conceptual Framework)

1. Historical Cost
2. Current Cost
3. Realizable (Settlement) Value
4. Present Value

QUIZZER 1 – OVERVIEW OF ACCOUNTING

History of Accounting

1. Are the following statements about the history of Accounting true or false?
 - I. According to the history of accounting, debit means “he owes” and “credit” means “he trusts”.
 - II. Frater Luca Bartolomes Pacioli did not invent accounting but his treatise, “De Computis et Scripturis is said to have laid the foundation for double-entry bookkeeping as it is practiced today.
 - III. The earliest accounting records date back to the 14th Century and were found in the Roman Empire.

| | Statement I | Statement II | Statement III |
|----|-------------|--------------|---------------|
| a. | True | False | True |
| b. | False | True | False |

- c. True True False
- d. False False True

2. Which of the following statements pertaining to Luca Pacioli's bookkeeping system is (are) true?
 - I. The books of accounts included a Memorandum, a Journal and a Ledger
 - II. The objective of Luca Pacioli's keeping records is to give traders prompt information as to his assets and liabilities.
 - III. Luca Pacioli's accounting cycle is basically the same as the accounting cycle as practiced today.
 - a. Statements I and II are true
 - b. Statements I and III are true
 - c. Statements II and III are true
 - d. All statements are true

3. Which of the following statements is (are) true?
 - I. Accountancy is a communication service profession.
 - II. Financial accounting is the process of identifying, measuring, analyzing, and communicating financial information needed by management to plan, evaluate, and control an organization's operations.
 - III. Financial statements are the principal means through which financial information is communicated to those outside an enterprise.
 - a. Statements I and II only
 - b. Statements I and III only
 - c. Statements II and III only
 - d. Statements I, II and III

4. Which of the following statements is not a proper description of accounting as a communication profession?
 - a. Financial statements can be expressed in any national language.
 - b. Financial statements can be expressed in any dialect of a country.
 - c. Financial statements should use terminology within the level of understanding of the statement user.
 - d. Financial statements, as far as possible, should show information that can be verified from documentary evidence in order to gain the confidence of statement users

5. Which of the following statements about accounting information is (are) true?
 - I. Accounting provides quantitative and financial information only.
 - II. Accounting provides quantitative, qualitative and financial information
 - III. Information in the financial statements are sourced only from the books of account.
 - a. I and II only
 - b. II and III only
 - c. II and III only
 - d. I, II and III

6. Which of the following statements is not an objective of financial reporting?
 - a. Provide information that is useful in investment and credit decisions.
 - b. Provide information about enterprise resources, claims to those resources, and changes to them.
 - c. Provide information on the liquidation value of an enterprise.
 - d. Provide information that is useful in assessing cash flow prospects.

7. How does accounting help the capital allocation process attract investment capital?
 - a. Provides timely, relevant information
 - b. Encourages innovation
 - c. Promotes productivity
 - d. (a) and (b)

8. The information provided by financial reporting pertains to
 - a. Individual business enterprises, rather than to industries or an economy as a whole or to members of society as consumers.
 - b. Business industries, rather than to individual enterprises or an economy as a whole or to members of society as consumers.
 - c. Individual business enterprises, industries, and an economy as a whole, rather than to members of society as consumers.
 - d. An economy as a whole and to members of society as consumers, rather than to individual enterprises or industries.

9. Which of the following represents a form of communication through financial reporting but not through financial statements?
 - a. Statement of financial position
 - b. President's letter
 - c. Income statement
 - d. Notes to financial statements

10. Qualitative information is found

| | a | b | c | d |
|--|-----|-----|-----|----|
| Only in the face of the financial statements | yes | no | yes | no |
| In the face of the financial statements and the accompanying notes | yes | yes | no | no |

11. In which of the following situations is the science aspect of accounting demonstrated?
 - I. The accountant makes use of the rules of debit and credit in recording transactions of the business
 - II. Transactions and events are processed using the steps of the accounting cycle.
 - III. A provision for doubtful accounts was estimated by the accountant on the basis of recorded data and the collection experience of the company
 - a. I only
 - b. I and II only
 - c. II and III only
 - d. I, II and III

12. The art aspect of accounting is applied in which of the following circumstances?
 - I. The accountant records a purchased equipment at cost plus expenses in acquisition and putting it available for use.
 - II. The external auditor gives an unqualified opinion that the financial statements are fairly presented in conformity with generally accepted accounting principles.
 - III. The accountant selects the reliable fair value at which a consumable biological asset will be recognized and measured in the books of account.

- a. Statement I only
- b. Statements I and II
- c. Statements II and III
- d. Statements I, II and III

13. Which of the following statements is (are) true?

- I. Not all quantitative information is also financial in nature.
- II. Measurement is the process of assigning numbers to objects such as inventories or plant assets and to events such as purchases or sales.
- III. Management decisions are oriented to the future whereas the decisions of external users are oriented to the past.

- a. I and II only
- b. II and III only
- c. I and III only
- d. I, II and III

14. Which of the following features of an asset closely links its definition to the science of Economics?

- a. An asset is controlled by an entity
- b. An asset can provide future benefits to an entity
- c. An asset can command a price
- d. An asset is exclusively owned by an entity

15. Which of the following is not an economic entity?

- a. Aldo, Baldo, Calvo & Associates, a law office
- b. Luna Sangre Group of Companies
- c. Polytechnic University of the Philippines
- d. Janet, a Filipino citizen who owns JLN Piggery

16. Which of the following is an economic entity but not a business entity?

- a. Golden Acres, a charitable institution
- b. Consolidated Foods Corporation
- c. Rustan's supermarket
- d. ABC Co., a stock corporation

17. It is the process of recognition and non-recognition of business activities as "accountable events" or whether they have accounting relevance

- a. Identification
- b. Measurement
- c. Communication
- d. Summarization

18. The accounting process of assigning peso amounts or numbers to relevant objects and events is known as

- a. Identification
- b. Measurement
- c. Communication
- d. Summarization

Branches of Accounting / Areas of Professional Practice

19. Which of the following branches of accounting focuses on general purpose reports on financial position and results of operations, known as financial statements?

- a. Financial accounting
- b. Auditing
- c. Management advisory services
- d. Bookkeeping

20. The process of analyzing, recording, classifying, summarizing and communicating all transactions involving state funds and property is known as

- a. government accounting
- b. estate accounting
- c. fiduciary accounting
- d. receivership accounting

21. An independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization.

- a. external auditing
- b. internal auditing
- c. fiduciary accounting
- d. management accounting

22. The process of identifying, measuring and communicating financial information used for planning, evaluation, and control within the organization

- a. financial accounting
- b. estate accounting
- c. social responsibility accounting
- d. management accounting

23. Handling of accounts for fiduciaries who wind up the affairs of a deceased person.

- a. estate accounting
- b. fiduciary accounting
- c. receivership accounting
- d. macro accounting.

24. The process of measuring and disclosing the performance of a firm in terms of community involvement and related criteria.

- a. macro accounting
- b. enterprise accounting
- c. social responsibility accounting
- d. community accounting

25. Accounting for not-for-profit entities other than the government

- a. Estate accounting
- b. Institutional accounting
- c. Receivership accounting
- d. Enterprise accounting

26. The practice of accounting by one whose principal employment is confined to a single enterprise

- a. single-proprietorship accounting
- b. enterprise accounting
- c. estate accounting
- d. private accounting

27. Branch of accounting which deals with rendering of services to the public for compensation.

- a. Private Accounting
- b. Government Accounting
- c. Public Accounting
- d. Enterprise Accounting