UNIVERSITI TEKNOLOGI MARA

Cawangan Negeri Sembilan
Kampus Seremban

BULETIN

FAKULTI PERAKAUNAN
UiTM CAWANGAN NEGERI SEMBILAN
KAMPUS SEREMBAN

EDISI 9 2025

HUBUNGI KAMI :

fpnuitmn9s3

https://encr.pw/FakultiPerakaunanS3

Financial Literacy in Sole Proprietorship: The Entity Concept.

Raziah Bi Mohamed Sadique, Musliha Musman & Salwa Muda

Running a business as a sole proprietor comes with its fair share of challenges, and financial literacy is one of the most important skills to master. Financial literacy is a complex concept encompassing knowledge, skills, and attitudes about effectively managing financial resources (Amirtha, 2024). It plays a crucial role in financial management, particularly for small and medium enterprises (SMEs). Studies have shown that financial literacy significantly affects financial management based on the economic entity concept, which separates business finances from personal finances (Dewi Fadila et al., 2023). However, many SMEs struggle to fully implement this concept in their financial statements due to familiarity with more straightforward accounting methods (Fadila Cristy et al., 2024). One key concept that every sole proprietor should understand is the entity concept, the idea that a business should be treated as a separate financial entity from its owner. The economic entity concept is fundamental to proper financial management and reporting, requiring separate recording of business and owner transactions (Fadila Cristy et al., 2024). Even though a sole proprietorship is not legally distinct from its owner, keeping business and personal finances separate is crucial for managing money effectively, maintaining accurate records, and ensuring long-term success. The entity concept comes from accounting principles and emphasizes that a business's financial transactions should be recorded separately from the owner's expenses. This helps provide a clear picture of the business's financial health without interference from personal spending.

Businesses can produce clear, unbiased financial statements by maintaining separate records. This accuracy is critical for stakeholders—investors, creditors, and regulators—to make informed decisions. Business owners benefit from this clear demarcation as it provides a transparent view of the business's financial status, aiding in strategy, planning, and resource allocation. This means that all financial records should reflect only business-related transactions. Whether running a small café, a freelance business, or an online store, keeping personal and business finances separate is essential. For example, a business owner using personal funds to cover a business expense should be recorded as a capital contribution rather than just another expense. A common mistake that sole proprietors make is mixing personal and business finances. Some common mistakes include

- **Paying Business Expenses with a Personal Credit Card:** While convenient, this practice makes it difficult to track business spending and may result in missed deductions or incorrect financial reports.
- **Using Business Revenue for Personal Expenses:** This inaccurate representation of business profits can lead to financial strain if business funds are depleted for personal use.
- **Failing to Record Personal Contributions as Capital Investments:** If a business owner injects personal funds into the business, it should be documented as a capital contribution, not an expense. Misclassifying this can distort financial records.

While this might seem harmless, it can create confusion, complicate tax filing, and make it harder to understand how well the business performs. The concept is foundational in accounting practices. It demands that all financial transactions be recorded under the business's books rather than being mingled with the owner's records. Individuals can apply the entity concept by maintaining separate bank accounts for different financial goals, such as emergency funds, retirement savings, and investment portfolios. This approach improves financial discipline and transparency, reducing the risk of mismanaging personal and business funds. Investors and financial analysts rely on the clean, delineated data provided by adhering to the entity concept to assess a business's profitability, liquidity, and overall financial health. Understanding the entity concept helps individuals and companies create accurate financial statements, determine profitability, and comply with tax laws. For investors, recognizing an entity's financial independence ensures clarity when analyzing its financial health before making investment decisions.

Treating your business as its own financial entity helps you stay on top of your finances, simplifies tax preparation, and makes financial decision-making much easier. It is a small but powerful step toward running a successful and financially healthy business. Grasping the entity concept is a cornerstone of financial literacy. Improving financial literacy among SME owners can lead to better financial performance and decision-making (Dewi Fadila et al., 2023). It empowers business owners and financial professionals to maintain accurate records, make informed decisions, and ensure compliance with legal and tax obligations. By recognizing the distinct boundaries between personal and business finances, individuals and organizations can better navigate the complexities of financial management and planning. This understanding not only aids in effective business management but also fosters greater trust and clarity in financial transactions, contributing to overall economic stability and growth.

References

Amirtha, R. (2024). Financial Literacy for the Future: Preparing Individuals for Economic Success. *rrrj*, *3*(2), 381-396.
Fadila, D., Astarina, Y., Riana, D., Kumalaputri, S., & Asfitri, M. K. (2023). Financial Literacy and Love of Money Attitude toward Financial Management. *Asean International Journal of Business*, *2*(2), 116-126.
Fadila Cristy, Riki Martusa, Meythi Meythi, Rapina Rapina. (2024) Application of the Business Entity Concept to the Financial Statements of SMEs. International Journal of Innovative Technologies in Economy. 2(46). doi: 10.31435/rsglobal_ijite/30062024/8194