
AN INTRODUCTION TO ACCOUNTANCY

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Accountancy, owing to continuous developments in these last decades, has moved and is still moving away from its traditional basis of routine work such as record-keeping, preparation of final accounts, budgeting etc., towards a role which emphasises its social importance. From the first description of double-entry book-keeping published in 1494 by Luca Pacioli, an Italian friar, accountancy has developed as a result of the growth of large-scale corporate enterprises, regulations by parliaments affecting accountants and auditors, inclusion in the accountants' work of economic and mathematical ideas, scientific management, imposition of taxes on income and legal regulations obliging companies to keep proper books of account and in certain cases to publish such accounts.

Such a development in accounting can also be seen in the broadening of definitions used. As an example one can quote a definition used in the middle of this century dealing with the purposes of accountancy: 'The purpose of identifying, measuring and communicating economic information to permit informed judgement and decisions by the users of the information'.

Compare this with the following which today seems to be more appropriate: 'Accounting is concerned with the quantification of economic events in money terms in order to collect, record, evaluate and communicate the results of past events and to aid in decision-making'.

Accounting is emerging as a social science. An individual businessman may benefit from a proper set of accounts and from the availability of other accounting information which helps him to evaluate circumstances and arrive at proper and appropriate decisions. The whole of society should however benefit from accounting since its individual members use the information, given and prepared by qualified accountants, to solve their business problems.

The same history of accounting proves the evolutionary pattern of social developments which reflect changes in socio-economic conditions and the changing purposes to which accounting is applied.

One can distinguish four phases which relate accounting to its social role.

1. *Stewardship accounting*, which reflects the origin of the purpose of accounting, namely to provide a safeguard to the owner of wealth from theft, fraud etc.

2. *Financial accounting*, the need for which was felt as a result of larger units of production after the Industrial Revolution. The emergence of the Limited Liability Company made it obligatory for companies to disclose financial information to shareholders. The information required was in the form of the Trading and Profit & Loss accounts and balance sheet.

3. *Management accounting*, which has developed as a result of the Industrial Revolution. It is obvious that management needs the right information, presented in the right manner, prepared by qualified and trained people in order to be able to arrive at the right decisions. Although management accounting is not new, we have witnessed a rising interest in the subject in the last decades. Accountants had previously concerned themselves with obtaining figures of a historical nature. Today their attention is directed more particularly towards the extraction of information from records and preparation of statements which enable management to function properly and with the utmost efficiency. Therefore, management accounting centres on the importance of using information to arrive at decisions which effect the future.

4. *Social responsibility accounting*, which is a novelty in the accounting field. Social responsibility accounting widens the scope of accounting in that it takes into account the economic and the social effects of business decisions.

FUNDAMENTAL ACCOUNTING ASSUMPTIONS

Certain fundamental accounting assumptions underlie the preparation of financial statements. If they are not followed in the preparing of final accounts, a disclosure by way of a note is necessary. The term 'financial statements' covers balance sheets, income statements or profit and loss accounts, notes and other statements and explanatory material which are part of the financial statements.

The management of any commercial, industrial or business enterprise may prepare financial statements for its own use in ways which are best suited to its own needs. But when financial statements are issued to other persons, such as shareholders, creditors and the public in general, they should conform to international accounting standards.

The following are fundamental accounting assumptions as recognized by the Accounting Standards Committee:

a) *Going Concern*. The enterprise is normally viewed as a going concern, that is as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations.

b) *Consistency*. It is assumed that accounting policies remain consistent from one period to another.

c) *Accrual*. Revenues and costs are accrued, that is recognized

as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate.

ACCOUNTING POLICIES

Accounting policies encompass the principles, bases, conventions, rules and procedures adopted by managements in preparing and presenting financial statements. There are many different accounting policies in use even in relation to the same subject. Judgement is required in selecting and applying those, which, in the circumstances of the enterprise, are best suited to present properly its financial position and the result of its operations.

Three considerations should govern the selection and application by management of the appropriate accounting policies and preparation of financial statements:

c) *Prudence.* Uncertainties inevitably surround many transactions. This should be recognized by exercising prudence when preparing financial statements. Prudence, however, does not justify the creation of secret or hidden reserves.

b) *Substance over Form.* Transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form.

c) *Materiality.* Financial statements should disclose all items which are material enough to affect the evaluation or decisions.

What an accountant has to keep in mind is that financial statements should be clear and understandable. Financial statements are based upon the accounting policies which vary from enterprise to enterprise. Therefore, disclosure of the significant accounting policies on which the financial statements are based is necessary so that they are properly understood.

INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE

The objectives of the international accounting standards committee are to formulate and publish in the public interest basic standards to be observed in the presentation of audited accounts and financial statements and to promote their worldwide acceptance and observance.

This committee is made up of accountancy bodies of different countries who undertake to adhere in all respects to the object of IASC and to supply the same disciplinary procedures.

CHANGES IN THE RELATIONSHIP BETWEEN PRICES AND IN THE GENERAL LEVEL OF PRICES

One of the major problems facing the accountant today is changes in prices mainly because of inflation. Prices do not remain constant.

They change as a result of various economic and social forces. Now most financial statements are prepared on a 'historical basis' without having any regard either to changes in the general level of prices or to changes in specific price except to the extent that they are reflected in the accounts realised by sale of goods or in the net realisable value of inventories which have fallen below historical cost.

The need to remedy for this has focused attention on

- a) specific price changes
- b) changes in the general level of prices.

SPECIFIC PRICE CHANGES

The specific prices of goods or other assets held by an enterprise may change while such assets are held by the enterprise in question. These prices might change whether or not there is a significant change in the general level of prices.

Some questions which face the accountant when dealing with such a problem are:

- a) whether the assets held at the balance sheet date should be presented on a historical cost basis or at current cost, and how should the changes in prices be reflected in the financial statements?
- b) for assets consumed or sold during the accounting period, how should changes in prices of these assets while they are held be dealt with in the financial statements?

CHANGES IN THE GENERAL LEVEL OF PRICES

Financial statements have (and are always presented in) units of money. During inflation or deflation, the value of a unit of money changes. In other words, its general purchasing power decreases under inflationary conditions or increases under deflationary ones. The instability in the general purchasing power of money has led to questions as to whether financial statements should continue to be prepared without regard to changes in the general purchasing power of money.

There has not yet been an international consensus on a single method which could reflect the impact of changing prices on financial statements. Throughout the world many different proposals have been made and currently financial statements are being prepared on the basis suggested in some proposals. Certainly the development and application of the proposed methods will lead to a considerable improvement in the information supplied by accountants through financial statements.

THE ACCOUNTANT'S PERSONALITY

Sometimes people are tempted to think of an accountant as an orderly, methodical, cautious and pedantic man. There is an element

of truth in all this, but an accountant has to have the same sort of personality which businessmen and managers have or should have. All accountants, like everyone else, are individuals, and, therefore, one may find a large variety of personality types.

Many accountants are thinking, sensing and judging types. 'Thinking' means that accountants like dealing in a thoughtful and analytic way rather than in an emotional, subjective or impressionistic manner. 'Sensing' means that they prefer facts, figures and all other relevant data rather than speculation and imagination. 'Judging' means that after having collected all the necessary data and after having examined it in a cautious and prudent manner, they arrive at a conclusion.

Recent research has shown that, although there are great individual differences in the preferences and personalities of accountants, they are slightly more likely than average to be introverts, that is, calm, controlled, peaceable, thoughtful and more likely to be hard-headed and practical.

It is therefore clear that an accountant should be a responsible person. His task, especially in present times, is a difficult one and he is to make judgements continuously. That is why accountancy is a profession. An accountant should adhere to the principles of integrity, objectivity and confidentiality.