

Accounting

Amir Adan, 2010-09-06

What is accounting?

This issue can be defined in many different ways. Deegan and Unerman¹ defines the external accounts as a process that covers the collection and processing of financial information which is designed to facilitate decision making for several different stakeholder categories. Financial accounting is therefore to provide the various stakeholder categories with external accounting information. D&U talk about external stakeholders such as customers, suppliers, creditors, shareholders and other investors, employees, State, municipal, etc. which essentially unrelated to the internal governance. These stakeholders have fundamentally different needs in terms of information. It is therefore rather difficult to draw up a consolidated report which satisfies all these stakeholders ' needs. What can be done is to identify these stakeholders' common informational needs and build reports on the basis of this. We therefore need a more precise description of the topic.

Accounts can be seen as a number of elements that have a close relationship with each other:

- The identification and collection of business events all tasks in an undertaking noted not as business events. Existing accounting law defines business events; "all the changes in the size and composition of a company's assets, which depends on the company's relations with the outside world, such as cash, damage claims and liabilities as well as its own contribution to, and withdrawals from the activities of money, goods or other".
- On-going registration of business events in chronological and systematic order. This is a central part of the topic bookkeeping.

¹ Financial Accounting Theory 2005 EU edi, Craig Deegan & Jeffrey Unerman, p. 32

- Processing of business transactions of a financial statement. Financial statement two main financial statements, the profit and loss account and balance sheet. As key elements in this section are the concepts of classification as well as income and expenses to assets, liabilities and equity. Measurement and valuation of the items are other key elements of the financial statement.
- On the subject of accounts, including the compilation and presentation of financial and other information in for example one annual report or interim financial report. An annual report consists of a balance sheet, profit and loss account, notes to these, a management report, as well as for large companies a cash flow analysis (financial analysis).
- On the subject of accounts, to further communicate this economic information to stakeholders who are likely to ask for this information as a basis for decisions.

Account history

To enhance understanding of accounting principles and their use, I think it may be of interest to clarify how, why and where accounts began. It is not always obvious how the accounts are to be interpreted and on what grounds this is done. Therefore, I will try to clarify precisely the historical development of accounts.

Double posting technology started between the 12th-15th century in the Italian trade cities. Banks started to emerge, and they demanded that the borrowers had books to keep good track of their business.² The post was quantified with contained notes where multiple events were noted. These notes could contain information about the name and location of the respondent and what business event concerned.³

Account of the development in the industrialized countries is characterized by two different accounting traditions, the continental and the Anglo-Saxon. The continental tradition was applied mainly by Western European countries except the

² Artsberg Kristina, *Redovisningsteori –policy och –praxis*, (Malmö: Liber AB 2003), p61

³ Artsberg Kristina, *Redovisningsteori –policy och –praxis*, (Malmö: Liber AB 2003), p62

United Kingdom, Ireland and the Netherlands which, together with The United States and Japan implemented the Anglo-Saxon tradition. The difference between them consists of two different civil law traditions. The Continental civil law tradition is more legalistic which means that it is based on the written laws. The Anglo-Saxon tradition is based on customary law which means that the accounts to some extent are regulated by law.

These two traditions have different views on how a "real" account is established. Under the continental tradition financial statements are drawn up in accordance with the law, while the Anglo-Saxon tradition accounts shall give a true and fair view of the company.⁴

As a result of Britain's entry into the EC and the rise of multinational corporations, the Anglo-Saxon tradition has become the basis for future development of the latter method. Internationally accounts have in recent decades developed toward the Anglo-Saxon tradition, with focus on the financial statements giving a true and fair view.⁵

The basics of accounting

To keep accounts, the company's business transactions, are made by most companies using so called double entry bookkeeping. Each account has a debit and a credit page (explained below). When an assignment is carried out, it is made on at least two accounts. One account and the other account debit side credit side. The sum of what is written on the debit side should be equal to the sum of what is printed on the credit side, that is, total debit = total credit.

- Sales of goods/services

Debit	Claims or bank funds increase
Credit	Revenues increase

- Purchase of goods/services

Debit	Costs increase
Credit	Liabilities increase or bank funds decrease

- Payment from customers

⁴ Smith, Dag, *Redovisningens språk*, (Lund: Studentlitteratur 2006), p64

⁵ Smith, Dag, *Redovisningens språk*, (Lund: Studentlitteratur 2006), p69-70.

Debit	Bank funds increase
Credit	Claims decrease

- Payment to suppliers

Debit	Liabilities decrease
Credit	Bank funds decrease

The balance sheet is a summary of a company's assets and liabilities at a given time. Balance sheet accounts are accounts that show what you have for assets and liabilities in the company. Often the balance sheet divides accounts into particular asset accounts and liability accounts. Total assets and total liabilities and shareholders' equity is called a Balance sheet total. The balance sheet accounts does not show the result, even if one can read it by comparing the balance accounts from different times.

Balance Sheet

Assets

Fixed assets
Current assets

Total assets

Equity and liabilities

Equity
Restricted equity
Non-restricted
equity
Total equity

Liabilities
Long-term liabilities
Current liabilities
Total liabilities

***Total equity and
liabilities***

The income statement is a summary of a company's revenue and expenses for a certain period of time. The profit and loss account is made by listing all balances from revenue accounts and loss accounts for the period. Profit is given by the sum of all balances on the revenue accounts and subtracting the balances on the cost accounts. Income accounts and cost accounts are commonly called for the profit and loss accounts, because it is from these that people read the result.

Profit and loss statement

Operating income
Operating costs
Operating surplus

Financial income
Financial costs
Earnings before tax

Appropriations
Tax
Profit/loss for the period/year