Chapter 1

- 1 Obviously the scope here is almost endless. Here are three interesting definitions from the USA which students are not very likely to come across (extracted from A.R. Belkaoui (1992) *Accounting Theory*, 3rd edn, Academic Press, London). The Committee on Terminology of the American Institute of Certified Public Accounting defined accounting as follows:

> *Accounting is the art of recording, classifying, and 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*.[1]

The scope of accounting from this definition appears limited. A broader perspective was offered, by the following definition of accounting as:

The process of identifying, measuring, and communicating economic information to permit informed judgements and decisions by users of the information.[2]

More recently, accounting has been defined with reference to the concept of quantitative information:

> *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, in making resolved choices among alternative courses of action*.[3]

[1] 'Review and resume', Accounting Terminology Bulletin No.1, American Institute of Certified Public
Accounts, New York, 1953, paragraph 5.

[2] American Accounting Association, A Statement of Basic Accounting Theory, American Accounting
Association, Evanston, IL, 1966, p.1.

[3] financial statements of business enterprises', American Institute of Certified Public Accountants, New York, 1970, paragraph 40.

- 2 Accounting information is usually mainly past information, but user decisions are by definition future directed. Consider:

  Ŷ relevance v. reliability
  Ŷ objectivity v. usefulness
  Ŷ producer convenience v. user needs.

- 3 Perhaps it all depends on what ‘reasonably’ means. The needs of different users are certainly different (illustration required), but greater relevance from multiple reports would need to be set against:
  (a) costs of preparation
  (b) danger of confusion and the difficulties of user education.

4-6 We suggest that these three questions are treated as a set. There is scope for wide differences of view and considerable debate. We suspect that objectivity and prudence are likely to come higher up the ‘importance’ scale than they are up the ‘useful’ scale. This would lead to discussion of whether the user or the producer matters more!

- 7 It is really much less objective than people often claim. Examples of ‘unobjectivity’ include:

  Ŷ problem of determining purchase cost
  Ŷ overhead allocation
  Ŷ depreciation calculation
  Ŷ provisions and their estimation
  Ŷ prudence (a subjective bias by definition).

8 Completeness requires the inclusion of all relevant contents. The monetary measurement convention requires that which is not measurable be not recorded, even if it is clearly relevant. Discuss conflict.

9 The basic issue is matching (which says capitalize) v. prudence (which says write off as expense at once). Relevance, usefulness, etc. should again be brought out.

10 The more obvious conventions seem to be:
  Ŷ monetary measurement
  Ŷ historical cost
  Ŷ prudence (i.e. lower of cost and NRV)
  Ŷ realization (profits not realized until ‘sold’).

11 Historical cost accounts are certainly not very objective (see question 7). Analytically, they are not very useful - out of date, stewardship rather than forward-looking decision making etc. But people do accept them and use them, better the devil you know … etc.,

12 How prudent is prudent? (Again, this is a relative, not an absolute, term.) The normal accounting practice of revenue recognition is not the most prudent possible. Stating debtors at cost (i.e. not recognizing any profits until cash receipts are in) would be both feasible and more prudent than normal practice. Perhaps the normal practice suggests that accountants are 'reasonably' prudent (whatever 'reasonably' means!).

13-15 We suggest treating these three questions as a set. See discussion in the text. The whole process is subjective in principle and often arbitrary in practice (e.g. the date the invoice happened to get typed); the answer to question 15 is surely 'no'.

16 This is about the balance sheet equation: resources equals claims. Revenue recognition increases claims (i.e. profits) and therefore increases resources; for example, inventory at cost may be replaced by debtors at selling price.

17 (a) (i) Receipts €90 Payments €42 Surplus €48
(ii) Revenue €60 Expenses €36 Surplus €24

(b) Receipts and payments basis is easier, more objective and makes fewer, possibly risky, assumptions about the future. Revenue and expense basis follows matching convention, is more realistic and is a better measure of economic progress.

Discussion required. Difficulties are the treatment of subscriptions still unreceived for 20X8 and the corresponding 60% expense.