Chapter 2
Some basic ideas

INTRODUCTION

We said on p. 7 that we are setting out to consider three fundamental issues:

1. Who are the users of accounting statements?
2. What is the purpose for which each particular type of user requires the information?
3. How can we provide the user with information best suited to his needs?

Our detailed consideration of these issues will not follow this sequence, however. As stated earlier, a fundamental aim of this book is to help you to form and develop the ability to go on forming your own opinions. There was a time when rote learning was a sufficient preparation for many accounting exams. Memory was all. But those days have gone for ever. Understanding and mental ability are now also essential ingredients for success in professional examinations – as, of course, they are for a successful career as a qualified accountant.

So with this in mind, we shall adopt the following order. In Chapters 2 and 3 we shall consider the possibilities available as regards the information we could provide. This will provide a background knowledge of the various possibilities, the various tools, available to us as accountants. In Chapter 4 we shall look in detail at what purposes we are trying to use these tools for. In Chapters 5 and 6 we shall clarify the traditional accounting solution. We shall, in other words, specify which tools are generally used by the accountant out of the total available ‘tool-box’. In Chapter 7 we consider recent thinking towards a broader and more all – embracing framework. Then, in Chapter 8, we shall look back at ‘the story so far’. We shall ask ourselves whether the tools the accountant usually chooses to use do in fact seem to us to be the best. In Chapter 9 we consider some possible alternatives.
10 Some basic ideas

WEALTH

In a business context if we turn £10 into £8 we are doing badly. If we turn £10 into £12 we are doing well and if we turn £10 into £14 we are doing even better. Business wishes to make gains. The essence of business is to turn a small collection of resources into a bigger collection of resources. More briefly, it is to create wealth. Accounting has to report on this process, and to provide information to assist in its successful outcome. If we consider two points in time, and label them 1 and 2, then we can derive a very simple and very general equation:

Wealth Time 1 + Gain = Wealth Time 2

We must remember, however, that resources may have been withdrawn from the wealth of the business (e.g. as dividends) or may have been added from outside (e.g. by the issue of new shares). So we should write:

Wealth Time 1 + Gain - (Net) drawings = Wealth Time 2

or, more briefly:

\[ W_1 + G - D = W_2 \]

If you think about it, accounting fits neatly into this. Balance sheet 1 (the ‘opening’ balance sheet) plus the profit for the year (from the profit and loss account) less the net drawings in the year made by the owners, leaves us with balance sheet 2 (the ‘closing’ balance sheet). Previous resources plus net change in resources equals new resources.

But how should we measure resources?

A POLITICAL DISCLAIMER

It is important to realize that the above comments are not based on any particular political system or political philosophy. Business may be concerned with maximizing profit. It may be concerned with maximizing efficiency and minimizing waste. It may be concerned with maximizing social benefit. The wealth and resources created by the business may only benefit a few, or it may benefit whole communities. But none of this matters to the accountant. Accounting is concerned with the provision of useful information to people about their resources. We as accountants are not ourselves decision-makers, and therefore our work is independent of the philosophical framework of any particular decisions. We are merely providers of information.