Basic Accounting Principles

Accounting has been defined as, by Professor of Accounting at the University of Michigan William A Paton as having one basic function: "facilitating the administration of economic activity. This function has two closely related phases: 1) measuring and arraying economic data; and 2) communicating the results of this process to interested parties."

As an example, a company's accountants periodically measure the profit and loss for a month, a quarter or a fiscal year and publish these results in a statement of profit and loss that's called an income statement. These statements include elements such as accounts receivable (what's owed to the company) and accounts payable (what the company owes). It can also get pretty complicated with subjects like retained earnings and accelerated depreciation. This at the higher levels of accounting and in the organization.

Much of accounting though, is also concerned with basic bookkeeping. This is the process that records every transaction; every bill paid, every dime owed, every dollar and cent spent and accumulated.

But the owners of the company, which can be individual owners or millions of shareholders are most concerned with the summaries of these transactions, contained in the financial statement. The financial statement summarizes a company's assets. A value of an asset is what it cost when it was first acquired. The financial statement also records what the sources of the assets were. Some assets are in the form of loans that have to be paid back. Profits are also an asset of the business.

In what's called double-entry bookkeeping, the liabilities are also summarized. Obviously, a company wants to show a higher amount of assets to offset the liabilities and show a profit. The management of these two elements is the essence of accounting.

There is a system for doing this; not every company or individual can devise their own systems for accounting; the result would be chaos!