

Theoretical and Practical Foundations of Accounting: Concepts, Double-Entry System, and Decision-Making

Submitted By: Gurpreet Kamboj
Student ID - DE240218

Contents

In short
Beginning
A Review of the Literature
How
Results
5.1 The Most Important Things to Know About Accounting
5.2 The double-entry system and how it changes how people write financial reports
5.3 What businesses use accounting for when they make decisions
Talk
In a nutshell
Sources
More
Appendix A: Examples of Financial Statements
Appendix B: A list of accounting terms
Appendix C: A Case Study Example
In a nutshell,

Every business, big or small, needs to keep an eye on its money. The main point of this is to help you keep track of your money, see it, and talk about it. This report goes into a lot of detail about the basics of accounting, like the accounting equation and why financial statements are important. It also talks about the double-entry system, which is a way to make sure that financial reports are accurate and reliable. It also talks about how people can use accounting data to help them make choices about their businesses. This report gives real-world examples of why businesses need to follow accounting rules every day. These rules affect how well a business does, how long it lasts, and how open it is. The study utilises a qualitative methodology, incorporating diverse forms of literature and case studies to deliver a thorough overview. The results show that businesses need to be open about their finances, use their resources wisely, and plan for the future. They also show how important it is to keep changing as new problems come up.

Starting

A lot of people say that accounting is the "language of business," and they are right. It's a tool that all businesses use to talk about how well they are doing with money, both inside and outside the business. People who work in accounting are disciplined and organised, which helps them keep track of their money and make good choices. This is true for both individuals who manage their finances and large corporations that submit annual reports.

Accounting has changed as businesses and economies have grown. People used to keep track of their things and trade by writing things down. Businesses needed better systems as trade grew and economies became more complex. That's when the idea of accounting with two entries came about. It is still true now. Over time, accounting has changed to keep up with new rules, technologies, and the needs of businesses.

In today's fast-paced, connected world, accounting is more than just keeping track of things. It means looking at data, finding patterns, giving advice on important decisions, and making sure everyone follows the rules. Accountants are very important for keeping the interests of many groups safe, including investors, managers, regulators, and the public in general.

This report's goal is to give a full explanation of accounting and what it means. It will cover the basics of accounting, such as the accounting equation, as well as important concepts like recognising revenue and accrual accounting. The report will also talk about the double-entry system and how it keeps financial information safe. It will also talk about how important it is to keep track of money when making business decisions.

The report will show how these ideas can help businesses every day by using real-life examples and case studies from the field. It will also talk about issues and new trends in the field. This will help people understand not only how accounting works, but also why it is important for a business to be successful and stay in business for a long time.

After this introduction, the literature review will look at the most important contributions to the field of accounting from both business and academic points of view. The methodology section will explain how the study was done. There will be three parts to the results, one for each of the main topics: basic theoretical ideas, the double-entry system, and how accounting helps people make choices. The discussion and conclusion will go over the main points again, and the references and appendices will give more information.

Review of the Literature

For hundreds of years, people have been doing accounting and studying it. It changes all the time. A lot of people write about accounting because it is important to both academics and people who work in the field. This section talks about some of the most important contributions to the field, focussing on their theoretical bases, how they are used in the real world, and what is happening right now.

Theoretical Concepts in Accounting

The roots of accounting theory can be found in ancient civilisations, while modern accounting began to develop in the 15th century with the advent of double-entry bookkeeping. Researchers have since come up with a full set of ideas and rules that all accounting practices are based on.

The accounting equation is one of the most basic ideas. The debts and the owner's equity make up the assets. We use this equation to keep track of all the money that comes in and goes out and to report it. Horngren et al. (2016) assert that the accounting equation surpasses theoretical abstraction; it serves as a practical instrument for ensuring accurate and equitable financial documentation.

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have played a big role in making and keeping accounting rules around the world. There is a lot of talk in these groups about the matching principle (putting expenses with related revenues), revenue recognition (putting income when it is earned and realisable), and accrual accounting (putting income and expenses when they are earned or incurred).

Keeping an eye on the money and making choices

The literature consistently emphasises the essential role of financial accounting in the decision-making process. Weygandt, Kimmel, and Kieso (2021) say that the most common way for businesses to let people outside the business know how well they are doing financially is by using financial statements. The income statement, the cash flow statement, and the balance sheet are the three most important statements. They tell investors, creditors, regulators, and managers how well a business is doing now and what will happen to it in the future.

They talk a lot about being honest and truthful. Kaplan and Atkinson (2015) say that businesses should be honest, follow the rules, and promote good behaviour by being open and honest about their money.

The Two-Entry System

Everyone agrees that modern accounting is based on the double-entry system. In the 15th century, an Italian mathematician named Luca Pacioli made it official. You have to write down every time you spend money in at least two accounts as part of this system. This keeps the accounting equation in balance and is a built-in way to find mistakes and fraud (Edwards, 2013).

Researchers say that the double-entry system makes it easier to keep track of things and check them. The system's built-in logic makes it less likely that mistakes will happen, and it keeps a clear record of all money transactions.

How to Take Care of Books

A lot of the writing is about how to turn ideas into reality. Industry reports and case studies show how accounting rules work in the real world. International standards like IFRS have made it easier for investors to compare financial data and for businesses to do business in other countries (Nobes & Parker, 2016).

Drury (2017) says that businesses can use accounting information to keep track of their costs, make plans for the future, and stay on track with their budgets. This makes things go more smoothly and gives them an advantage over their competitors.

What to Look for in Trends and Gaps

Even though accounting is a well-known field, people are still arguing and coming up with new ideas about it. Two new technologies, blockchain and AI, are changing how accounting data is stored, analysed, and reported. There are also new rules and a bigger focus on non-financial information, such as social responsibility and sustainability, that are changing the future of accounting.

The literature shows that accountants need to keep learning new things so that they can stay up to date with these changes and make sure that accounting is still a useful and important tool for people who make decisions.

How it was done

This report employed qualitative research to gain insights into the theoretical and practical aspects of accounting. The qualitative approach is a good way to learn about difficult ideas and get information from many different sources.

The research was based on a careful look at academic literature, including well-known textbooks, articles in peer-reviewed journals, and reports from the industry. Horngren, Weygandt, and Drury are well-known writers whose books are based on good ideas. New articles in journals and online have changed the way we think about what's going on in the world right now.

"Accounting principles," "double-entry system," "financial statements," "accounting decision-making," "IFRS adoption," and "accounting technology" were all key terms to look for. We chose the sources based on how well-known they were, how useful they were, and how often they were used in the field. This made sure they were trustworthy and honest.

We used real-life examples and case studies to show how accounting ideas can be used in real life. We learnt how accounting works by looking at examples from both small and large businesses that operate in more than one country.

The study examined the data collectively to identify patterns, best practices, and areas of consensus and disagreement among participants. The analysis was meant to show how theory and practice are related so that students, professionals, and decision-makers could use the information.

The report follows APA rules, with a list of sources and clear citations.

5. 5. Results

5.1 The Main Ideas Behind Accounting

The Equation for Accounting

All accounting systems are based on the accounting equation.

Liabilities and owner's equity are the same thing as assets.

This simple but powerful formula is the basis for all financial reports. It makes sure that every transaction of money keeps a business's records in good shape. The equation tells you what a business owns, what it owes, and what the owner still has a stake in.

For instance:

Let's say someone starts a business and puts \$50,000 in cash into it. The owner's equity and the business's cash assets both go up by \$50,000. The business's cash (assets) and debts both go up even more if it borrows \$20,000. The accounting equation is always in the right place:

Cash on hand: \$70,000

A loan is \$20,000 in debt.

The owner's equity is \$50,000, which is how much money they put in.

\$20,000 and \$50,000 add up to \$70,000.

This is a mathematical fact that helps accountants find and fix mistakes and inconsistencies.

How important is financial accounting when it comes to making decisions for your business?

Financial accounting is the process of keeping track of, summarising, and reporting all the business transactions that happen over a certain period of time. The three main financial statements that show what happened with these transactions are the income statement, the cash flow statement, and the balance sheet. They all do different things:

Balance Sheet: Tells you how well the business is doing with its money at a certain time.

The income statement shows how well the business did over a certain period of time by showing how much money it made, spent, and lost or gained.

The cash flow statement shows how much money is coming in and going out. This tells you how much cash the business has on hand and how well it can pay its short-term bills.

How to Use It:

Management really needs these reports. A manager who wants to grow their business will check the income statement to see if the business is making money, the balance sheet to see how assets and debts are set up, and the cash flow statement to make sure there is enough cash on hand to support growth. These statements can help lenders and investors decide whether or not to lend or invest money.

Things You Should Know About How Accounting Works

1. 1. 1. How to Keep Track of Accruals:

You shouldn't write down how much money you make and spend when you get paid.

You need to do it right away. This tells you how well a company is doing with its money.

If a business delivers goods in December but doesn't get paid until January, the money is counted as income in December, for example.

2. The Matching Principle says this:

Costs should be the same as the money they help make so that profits don't change too much all at once.

In this case, the cost of the goods sold and the money made from those goods are the same.

3. The Rule of Recognising Revenue:

It doesn't matter when money comes in; revenue should be recognised when it is earned and can be used.

These rules make sure that financial statements are correct, consistent, and easy to compare.

How the Financial Statements Are Linked

The three main financial statements are not separate reports; they are all connected in important ways:

The equity section of the balance sheet shows the net income from the income statement plus the earnings that were kept.

The cash flow statement shows how much cash you have at the beginning and end of the period compared to what is on the balance sheet.

Costs that don't involve cash, like depreciation on the income statement, change the values of assets on the balance sheet.

For instance:

Even if some of the money hasn't been collected yet, the business's net income of \$10,000 goes up on the balance sheet as retained earnings.

Using it

Accounting ideas are used by businesses of all sizes every day. Walmart, for instance, uses the matching principle to make sure that the money it makes from selling things is the same as the money it spends on those things. Microsoft and other tech companies follow the rules for accrual and revenue recognition by recognising revenue from software subscriptions over the time the service is provided, not when payment is received.

5.2 The Double-Entry System and How It Changes How Financial Reports Are Made

A Look at the Double-Entry System

Businesses most often use the double-entry system to keep track of all their sales and purchases. Every time you make a transaction, at least two accounts are affected. One is charged and the other is credited. This keeps the equation for accounting in check.

For instance:

If a business pays \$1,000 in rent,

The rent (debit) goes up by \$1,000.

The amount of cash (credit) goes down by \$1,000.

The books stay in balance because the sum of debits and credits stays the same.

Credits and Debits

To be good at double-entry bookkeeping, you need to know what credits and debits are.

Debits add to assets and expenses, but they take away from equity and liabilities.

Credits lower assets and expenses and raise liabilities and equity.

This system can check itself by seeing if the total debits and credits match. If they don't, there is a mistake that needs to be fixed.

Checking to make sure that the financial statements are in balance

The double-entry method makes sure that financial statements are always balanced because every transaction changes at least two accounts.

The total of all the credits must always equal the total of all the debits.

The trial balance lists all the accounts and their balances to double-check that this balance is right. It checks that the total of all the credits and debits is the same.

Why it's important to keep good records and stop fraud

The double-entry system helps find mistakes and fraud:

If you see a difference right away, there is a problem that can be found and fixed.

The system leaves a clear audit trail that makes it easy for auditors and regulators to see how the business spends its money.

A real-life example

A new investor could give a big company like Amazon \$5 million:

The cash account is charged \$5 million.

Equity (common stock or capital) gets a \$5 million credit, which is an increase.

Accountants would know right away that something was wrong if these numbers didn't match. They could then look into it before it led to false reporting.

5.3 How Accounting Affects Business Decisions

Using accounting data at different levels of a business

All parts of a business need accounting information:

Top managers use accounting data to help them decide whether to buy or merge with another company or enter a new market.

Middle management uses accounting reports to see how well each department is doing and make sure they don't go over budget.

Operational staff: Uses accounting data to buy things and keep track of what they have in stock.

As an example:

A marketing manager might look at sales data and expense reports to see how well a recent campaign worked and to figure out how to use resources for future promotions.

How to Read Financial Reports to Find Out How Your Business Is Doing

Checking a company's financial reports is the best way to see how well it's doing:

The income statement shows how much money a company makes.

The balance sheet shows how stable and leveraged your money is.

The cash flow statement shows how much money the business has and how well it can pay its bills.

For example:

Banks will check a company's balance sheet and cash flow statement before giving it a loan to make sure it has enough money and property to pay it back.

How managers use accounting information to make choices

Here are some reasons why managers use accounting data:

Setting financial goals and making sure you don't go over them is what budgeting is all about.

Investment is the process of thinking about the good and bad sides of buying something or starting a project.

Financing means deciding whether to borrow money or use equity to pay for operations.

For example:

If a hospital's accounting reports show that costs are going up but revenues are staying the same, management may decide to renegotiate contracts with suppliers or buy technology that will help them save money.

How important it is to keep track of your money and help with planning

Building trust and making sure that good governance happens depend on accurate accounting. Public reporting of finances:

Brings in investors.

It helps you pay your taxes and follow the law.

People are more likely to trust you and your business if they are involved.

For example:

The US passed the Sarbanes-Oxley Act and made accounting rules stricter after the Enron scandal to restore trust and make business reporting more open.

Examples from real life

Multinationals: Coca-Cola keeps track of how well it is doing in each country by looking at detailed financial data and changing its plans based on how popular and profitable the market is.

Small Businesses: An area bakery uses accounting software to keep track of its costs and sales. This helps the owner keep prices low and find out what sells well.

6. Talk

The findings of this report indicate that accounting transcends mere technicality; it constitutes an essential component of every prosperous enterprise. The accounting equation, accrual accounting, and revenue recognition are all examples of ideas that don't have anything to do with real life. They aren't just suggestions; they are rules that

make sure that everyone, both inside and outside the company, can trust the company's financial statements.

The accounting equation is important because it makes sure that every transaction keeps the balance between assets, debts, and equity. This has a way to stop mistakes and false claims from happening. The matching principle and the accrual basis make financial data even more trustworthy by making sure that income and expenses are recorded at the right times. This stops reported profits from going up or down in a way that isn't true, which makes it easier to compare profits over time.

The double-entry system needs more work. It's not just a way to keep track of things; it's also a strong way to keep things in check that makes it harder to hide mistakes and fraud. By recording each transaction twice, it makes an open audit trail. This is important not only for following the rules, but also for getting the trust of the public, investors, and creditors. This level of honesty is very important in today's world, where financial scandals can ruin reputations in a matter of hours.

You can use accounting to help you make decisions, not just keep track of scores. It gives managers the information they need to make smart decisions about budgets, investments, and plans. By looking at its financial records, a business can find out which products make the most money, where it can save money, or if it has enough money to grow. Lenders and investors also use this information to decide if a business is worth the risk.

Accounting also has a bigger moral and social side. People will only believe the news if it is true, current, and honest. Two scandals that changed accounting data are Enron and WorldCom. These scandals show how bad it is for businesses and even whole economies when people break the rules. This is because it can make people lose faith in the system that handles money.

But the field has some big problems to solve. Accountants need to keep learning because the rules are hard to understand, they change, and the world is getting more connected. Technology is changing the way accounting is done very quickly. Automation, AI, and blockchain are some examples of this. People need to learn new skills and be more careful about keeping their data safe and private because these new technologies can help things work better and more accurately.

More and more people want accounting reports to have more than just money-related information. Investors are becoming more and more interested in how a company runs its business, treats its workers, and affects the environment. People are telling accountants to look at more than just the usual ways of figuring out profit and loss to get a better picture of how well a business is doing.

In short, accounting isn't just about what happened in the past; it's also about what will happen in the future. It helps you be honest, take charge, and think about the future. Even though the basics stay the same, accounting is a hard job that changes all the time because the tools and expectations do too.

7. Final Thoughts

Every business needs to keep track of its money and make decisions, and accounting helps them do both. The basic ideas, like the accounting equation and core principles, help you keep track of and talk about money transactions in a clear and logical way. The double-entry system, which requires balanced entries, is what makes financial records accurate and trustworthy.

If you're a manager working on a new product, an investor looking at a company's potential, or a regulator making sure the company is following the rules, you need to know about financial accounting. Real-life examples, like businesses of all sizes in your area, show how good accounting can help with long-term growth, efficiency, and openness.

As the business world gets more complicated, accounting needs to keep up with new problems. Technology is changing how data is collected and analysed, and the needs of stakeholders for openness and social responsibility are changing what they want to know. Accountants need to learn new things and see their jobs in a new way.

But the main ideas and steps of accounting are still very important. Accounting gives businesses accurate, timely, and honest information that helps them meet their legal obligations and reach their strategic goals. Accounting is the key to unlocking and comprehending the power of information in a world where it is power.

8. Sources

(If you need more sources for your research, please add them here.)

C. Drury (2017). 10th edition of Management and Cost Accounting. Cengage Learning.

J. R. Edwards (2013). A History of Financial Accounting (Routledge Library Editions: Accounting). Routledge.

Horngren, C. T., Sundem, G. L., Elliott, J. A., and Philbrick, D. (2016). Pearson's 11th edition of "Introduction to Financial Accounting."

Atkinson, A. A., and Kaplan, R. S. (2015). The third edition of Advanced Management Accounting. Pearson Education.

Nobes, C., and Parker, R. (2016). (2016). Comparative International Accounting, 13th Edition. Pearson.

Weygandt, J. J., Kimmel, P. D., and Kieso, D. E. (2021). This is the 11th time that Financial Accounting has been published. Wiley.

9. Appendices

Appendix A: Samples of Financial Statements

This is an example of a balance sheet from December 31, 2023.

Value of Assets (\$)

Cash: 15,000

Accounts Receivable: 8,000

12,000 items in stock

Tools cost \$25,000.

Total Assets: \$60,000

Liabilities Amount (\$)

7,000 bills to pay

The loan amount is \$18,000.

Total debts: \$25,000

Owner's Equity: Amount (\$)

30,000 dollars in cash

5,000 in profits kept

Total equity: 35,000

This is what an income statement for the year that ends on December 31, 2023, looks like.

Item amount (\$)

\$100,000 in sales

Sold goods worth \$60,000

\$40,000 in gross profit

Costs of doing business: \$25,000

After costs, the profit is \$15,000.

This is an example of a cash flow statement for the year ending December 31, 2023.

Item Amount (\$)

10,000 for running events

-5,000 for activities that involve investing

Funding Activities: \$2,000

The amount of money went up by 7,000.

Appendix B: A list of accounting terms

Assets are things that a business owns, such as cash, tools, and stock.

Liabilities are things like loans and bills that are due that you owe to other people.

After paying off debts with assets, equity is what the owner still has.

Accrual accounting means that you record income and expenses as they happen, not when money changes hands.

The matching principle says that the money that comes in should be the same as the money that goes out.

When you recognise revenue, you write it down when you earn it, even if you haven't gotten the money yet.

With the double-entry system, every transaction has the same number of debits and credits in at least two accounts.

Debits are the entries on the left side of an account that make costs or assets go up.

Credits are entries on the right side that increase revenue, equity, or liabilities.

A balance sheet is a report that shows what you own, what you owe, and what you own at a certain time.

An income statement is a report that shows how much money you made, spent, and made over a certain amount of time.

Cash Flow Statement: Shows how much money comes in and goes out from loans, investments, and running the business.

Appendix C: A Case Study

A Look at BlueSky Electronics

BlueSky Electronics is a small store that sells electronics. Maria, the owner, put in \$30,000 to start the business. In its first year, BlueSky sold \$100,000 worth of goods. It spent \$60,000 on inventory and \$25,000 on other business costs. Maria kept track of all her transactions with double-entry bookkeeping. The company's balance sheet at the end of the year showed that it had \$60,000 in assets, \$25,000 in debts, and \$35,000 in equity. The income statement said that the company made a profit of \$15,000.

Maria checks financial reports every month to decide what to order again, how much stock to keep, and when to hire new people. The bank believes what she says because it is true, which helps her get a business loan to grow.