

## First lecture: General introduction to the science of accounting

### 1- The origin and concept of accounting

#### 1-1- Definition and classification of entities

##### 1-1-1- Entity definition

It is a set of material, human and financial means aimed at producing, under the best economic conditions, goods and services tending to meet the material needs of man.

##### 1-1-2- Classification of entities

###### a) Classification according to activity criterion.

According to this criterion, **entities** can be classified into:

- Commercial entities;
- Industrial (or production) entities;
- service entities;
- Agricultural entities.

###### b) Classification according to the law criterion.

According to this criterion, **entities** can be classified into:

- Public entities ;
- Private entities (privately owned);
- Mixed institutions

###### c) Classification according to size criterion (capital and number of workers).

According to this criterion, organizations can be classified into:

- Large entities;
- Small entities;
- Medium entities.

##### 1-1-3-Objectives of entities

Among the objectives of the entities we mention:

- **Profit generation:** which allows it to continue in activity and is also used to measure its health and strength;
- **Rationalization of production:** rational use of production factors and avoiding bankruptcy ;
- **Ensuring an acceptable level of wages for workers:** allowing them to cover their necessary needs and improve their livelihood;
- **Providing insurance for workers:** such as insurance against work accidents, health insurance and retirement;

- **Fulfilling community requirements:** covering their requests and providing them with reasonable prices;
- **Achieving research and development:** by developing means and methods of production and creating new products.

### 1-2- The genesis of accounting

The need for accounting appeared in the Middle Ages as a result of the emergence of commercial transactions and the use of money as a means of measuring the values of these transactions. Solo projects were the dominant format at that time. Accounting was a tool to serve project owners by recording the many financial transactions in the books due to the need of the project owner to have a record that counts all the operations that he cannot be aware of in his memory, which helps him in measuring the responsibilities of the people managing his money and in defining the relationship of the project with others who deal with him.

After the 18th century, the industrial revolution appeared, which led to the emergence of joint-stock companies that require enormous capital to invest, accounting became a means at the service of the administration by providing it with data that help it to define various policies related to the entity's activity and to supervise and control their implementation, and it also provides suppliers, customers and potential investors with important information that helps them make the right decisions.

### 1-3- accounting concept

Accounting is linguistically a source of the verb calculate (count), and it means controlling and auditing accounts. The concept of accounting can also be explained by the process of recording transactions and financial procedures carried out by the entity. The financial data used in accounting summarizes all financial transactions that took place in a specific period of time and shows the financial position of the institution, its properties and cash flows.

There are several definitions of accounting, including:

**“It is an information system concerned with the operations carried out by the various economic agents, which can be expressed in money”.**

**Or “It is one of the quantitative techniques for data processing, such as statistics, econometrics, and operations research, as some specialists call it business science.”**

**Also, "Accounting is not an end in itself, but rather an information system concerned with measuring, processing and then communicating financial information to the concerned parties to help them make rational decisions."**

## 2- Types of accounting

There are 3 basic types of accounting:

### 2-1- National Accounting

It studies the real and financial flows between the various economic agents to obtain the gross national product (PNB), the gross domestic product (PIB), etc...

### 2-2- Public Accounting

It studies the real and financial flows at the level of the state, local authorities and all public bodies of a non-commercial and non-industrial administrative nature (revenues and expenditures);

### 2-3- Entity accounting

 It branches into:

- **Analytical accounting** (or cost accounting)
- **Estimated accounting**
- **General or financial accounting** (subject of this matter) is concerned with storing numerical baseline data, classifying, evaluating and recording them, and presenting financial statements that **faithfully reflect the financial position**, the entity's property, its efficiency and the status of its treasury at the end of the cycle or the end of the financial year.

## 3- Definition of financial accounting

To define financial accounting, we suffice with the definition contained in Article 03 of Law No. 07-11 of 11/25/2007, which includes the financial accounting system, issued in the Official Journal of the Republic of Algeria, No. 74 of 11/25/2007).

**“Financial accounting is a system for organizing financial information that allows storing numerical base data, classifying, evaluating and recording them, and presenting statements that reflect a true picture of the financial position and property of the entity, its efficiency, and the status of its treasury at the end of the financial year.”**

From the previous definition, it can be said that financial accounting is a system in the entity to organize financial information in the following way:

- Collect all financial information related to the operations of the entity;
- Translating this information into numerical base data;
- Classify these data according to their nature;
- Evaluate these data according to the applicable accounting rules and methods;
- Recording that information in its appropriate accounts according to the chronology of its occurrence;

-Processing these accounts and extracting them in the form of lists or financial statements that reflect a true picture of the entity's financial position and show the true values of all the entity's property, its performance and the status of its treasury at the end of each year or accounting cycle.

## **4- Objectives and Fields of application of financial accounting**

### **4-1- Financial accounting objectives**

Financial accounting aims to:

- Calculation of various results;
- Knowing the extent of the entity's financial disclosure;
- Providing analytical accounting and estimated accounting with the necessary data;
- It represents an important basis for financial analysis;
- Providing the necessary financial information to its users to make decisions.

### **4-2-Fields of application of financial accounting**

The financial accounting system stipulates that financial accounting must be applied in the following entities:

- Companies subject to commercial law;
- Cooperatives;
- Natural or moral persons producing commercial and non-commercial goods or services if they carry out economic activities based on repetitive operations;
- All natural or moral persons subject to this under a legal or regulatory text.

## **5- Assumptions and accounting principles**

The accounting assumptions and principles contained in the Financial Accounting System are:

two basic hypotheses of financial accounting, two accounting conventions, four qualitative characteristics of financial information, and eleven accounting principles.

### **5-1- Basic hypotheses of financial accounting**

The financial statements of the entities subject to the financial accounting system are adjusted on the basis of the following two hypotheses:

#### **5-1-1- Commitment accounting (or Accruals )**

The effects of commercial transactions and other events are accounted for on the basis of Commitment accounting when these transactions or events occur (and not when cash or its equivalent is paid or received). They are recorded in the accounting books and presented in the financial statements for the period in which they took place (or occurred).

### 5-1-2- Continuity of exploitation (or Going Concern )

The financial statements are prepared on the basis of continuity of exploitation, assuming that the entity continues its activities in an expected future, unless events or decisions occurred before the date of publication of the accounts, which may cause liquidation or cessation of activity in the near future.

And if the financial statements are not prepared on this basis, then doubts about the continuity of exploitation are clarified and justified, and the basis on which they are determined is specified in the appendix.

### 5-2- Accounting conventions

The financial statements are prepared on the basis of the following two conventions:

#### 5-2-1- Entity unit conventions

The entity should be considered as if it were an independent accounting unit separate from its owners, where financial accounting is based on the principle of separation between the assets, liabilities, expenses and income of the entity, and the assets, liabilities, expenses and income of participants in its own capital or shareholders.

Entity financial statements should only take into account the transactions of the entity and not the transactions of its owners.

#### 5-2-2- Monetary unit conventions

Each entity is obliged to respect the monetary unit conventions, where the Algerian dinar is the only unit of measurement for recording entity transactions, and it is also the unit of measurement for the information carried by the financial statements.

Only transactions and events that can be valued in cash are included in the accounts. However, it is possible to mention in the appendix to the financial statements information that cannot be quantified and that could have a financial impact.

### 5-3- Qualitative characteristics of financial information

The conceptual framework of financial accounting stipulates that information contained in financial statements must have the qualitative characteristics of relevance, reliability, comparability and understandability:

#### 5-3-1-Relevance

It is the quality of information when it can influence the economic decisions of users by helping them to estimate past, present, or future events, or to confirm or correct their previous estimates.

### 5-3-2- Reliability

The quality of information when it is free from error or significant prejudice and which users can trust to provide a true picture of what it is supposed to provide or can reasonably be expected to provide.

### 5-3-3- Comparability

The quality of information when it is prepared and presented in light of respecting the continuity of methods and allows its user to make significant comparisons in time and between entities.

### 5-3-4- Understandability

The quality of information when it is easy to understand by any user who has reasonable knowledge of business, economic activities, and accounting and has the will to study the information in a sufficiently serious manner.

## 5-4-Accounting principles

The financial accounting system stipulates that the financial statements are prepared on the basis of 11 accounting principles, which are:

### 5-4-1- Relative importance principle

According to the this principle:

- Financial statements should highlight every material piece of information that could influence the judgment of its users about the entity;
- Amounts not considered may be combined with amounts for items of similar nature or function;
- The true picture of the financial statements must reflect the managers' knowledge of the reality and the relative importance of the recorded events;
- Accounting standards may not be applied to elements of little importance.

### 5-4-2- Financial year independence principle

The result of each financial year is independent of the financial year which precedes it and of the financial year which follows it and, to determine it, only the related events and transactions must be attributed to it.

### 5-4-3- Events after the accounts closing date principle

An event must be linked to the closed financial year if it is directly and likely related to an existing situation at the closing date of the financial year's accounts and is known between this date and the date of approval of the accounts for this financial year.

No adjustment shall be made if an event occurred after the closing date of the financial year and did not affect the situation of the assets or liabilities of the period prior to the approval of the accounts. And this event must be notified in the appendix to

the financial statements if it is significant enough to influence the decisions of users of the financial statements.

#### **5-4-4- Prudence principle**

Accounting must comply with the principle of prudence, which leads to a reasonable estimate of the facts in the event of doubt, in order to avoid the risk of transferring existing doubts in the future which would increase whit debts the entity's assets or its results.

We must not overestimate the value of assets and income, nor underestimate the value of liabilities and expenses.

The application of this principle of prudence must not lead to the constitution of latent reserves or excessive provisions.

#### **5-4-5- Permanence of methods principle**

Consistency and comparability of accounting information during successive periods requires continuous application of rules and methods related to the evaluation of elements and presentation of information.

No exception to the principle of permanence of methods is justified except by a search for better information or a change in organization.

#### **5-4-6- Historical cost principle**

Assets, liabilities, income and expenses are recorded in the accounts and presented in the financial statements at their historical cost on the basis of their value on the date of their recognition without taking into account the effects of variations in price or changes in the purchasing power of money.

The elements of assets, liabilities, products and charges are recorded in accounting and presented in the financial statements at their historical cost on the basis of their value at the date of their inspection without taking into account the effects of price changes or the development of the purchasing power of the currency.

However, specific assets and liabilities such as biological assets or financial instruments are valued at fair value.

#### **5-4-7- Opening balance sheet intangibility principle**

The opening balance sheet for a financial year must be identical to the closing balance sheet for the previous financial year.

#### **5-4-8- Economic reality over legal appearance primacy principle**

Transactions are recorded in accounting and presented in financial statements according to their nature and their financial and economic reality without sticking only to their legal appearance.

#### **5-4-9- Faithful image principle**

The financial statements must, by their nature and their quality, and in compliance with accounting principles and rules, satisfy the objective of the faithful image by providing relevant information on the financial situation, performance and changes in the financial situation of the entity.

In the event that the application of an accounting rule proves to be unsuitable for giving a faithful image of the entity, the reasons must be mentioned in the appendix to the financial statements.

#### **5-4-10- No compensation principle**

No compensation may be made between an element of asset and an element of liability, nor between an element of expense and an element of income, unless such compensation takes place on legal or contractual bases or if these assets, liabilities, expenses and income were initially intended to be realized on a net basis.

#### **5-4-11- Double entry principle**

The accounting entries are drafted according to the so-called “double-entry principle” where each entry affects at least two accounts, one of which is a debtor and the other a creditor, respecting the chronological order in the recording of operations. The amount debited must equal the amount credited.