MCM-505

ACCOUNTING THEORY & PRACTICES

UNIT-5 ACCOUNTING AND ECONOMIC CONCEPTS OF INCOME AND VALUE

(M. COM. SECOND SEMESTER)

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CONCEPT OF INCOME

- In common parlance, the term ‘Income’ means the reward or payment received in exchange for the production of goods and services. For example, the salary received by the clerk is his income, since it is the reward received by him for his services. Similarly, the rent received by the owner of a property is his income, it is the reward for the services rendered by him through his property. In case a craftsman earns some money by selling some of the articles made by him, the money so earned will be taken as his income. Income may be of different types, e.g., Personal Income, National Income, Business Income, Gross Income, Net Income, etc. The term Income, therefore, by itself cannot give any precise meaning unless it is used with some adjective.

ACCOUNTING CONCEPTS AND INCOME MEASUREMENT

- 1. Convention of Conservatism
- 2. Consistency
- 3. Accounting Period Concept
- 4. Accrual Concept
- 5. Going Concern Concept
- 6. Separate Entity Concept

EXPIRED COST AND INCOME MEASUREMENT

- The definition of business income as given by American Accounting Association states that the revenue has to be compared with the related expired cost (or expense) for the purpose or determination of business income. In other words, the expired cost or the expense has to be identified in some fashion or the other with one or more elements of revenue.
- In order to give a better idea about the real problem faced by the accountant in determining the real business income, the problem can be explained on the basis of different types of costs involved in the process of determination of business income. For the purpose of cost analysis, the business concerns can be divided into two categories:
- (i) Trading concerns (ii) Manufacturing concerns
- **Problems faced by the accountant in determination of these costs:**
- (i) Cost of Goods Sold/Purchased
- (ii) Inventory Cost
- (a) FIFO Method
- (b) LIFO Method
- (c) Weighted Average Price Method
- (iii) Intangible Cost
- (iv) Imputed Costs
- (v) Extraordinary Costs

REALIZATION PRINCIPLE AND INCOME MEASUREMENT

There are four distinct alternatives regarding recognition of the time, when the revenue/income could be taken as realized.

(i) Recognition at the time of sale.

(ii) Recognition at the time when sales value is collected.

(iii) Recognition when production is completed.

(iv) Recognition proportionately over the performance of the contract.

ACCOUNTANT'S AND ECONOMIST'S CONCEPT OF CAPITAL AND INCOME

- The Economists' concepts of capital and income are different from those of the Accountant. According to Economists, the term 'capital' refers to such assets which are used for producing goods and services. It comprises of tangible assets, viz., building, land, plant and machinery, furniture, equipment, etc., and intangible assets, viz., human skills, technology, etc. According to Accountants, the term 'capital' or capital employed' refers to all tangible and intangible assets owned and employed in the business for earning revenue. They include both fixed and current assets. Assets taken on lease are not included in the capital employed. Similarly, assets like human skills are also not included. As a matter of fact, the salaries paid for utilizing human resources are taken as a revenue expenditure and hence written off from profits.
- According to Economists, the term 'income' means 'the current flow of goods and services over a period of time'. For example, if the Economist says that the national income of India during 1997-98 was Rs.80,000 crores, he means, goods and services worth Rs.80,000 crores were produced during 1997-98. An Economist is mainly concerned with individual (per capita) or national income.

Ex-ante Income and Ex-post Income

- **Ex-ante Income:** The expectation about the cash flows at the end of the year (t_1) and the present values of the original cash flow (t_0) is termed as 'ex-post income'.
- **Ex-post Income:** The expected cash flows from the asset concerned may be different after the expiry of a period. In such a case, the revised cash flows from the asset will have to be calculated. The income computed on the basis of the difference between the present value of the revised cash flow (t_1)and the present values of the original cash flows (t_0) is termed as 'ex-post income'.

SUMMARY

- The Income Statement measures the income of a business during a particular period of time. Income may be of different types, e.g., Personal Income, National Income, Business Income, Gross Income, Net Income, etc. In accounting, one is mainly concerned with Business Income, a term which is synonymous with the term Business Profit. According to the American Accounting Association, the term Business Income includes realized net income and not income alone. It means, income will be considered to be business income only when it has been actually realized. National Income such as appreciation in the market value of the assets of the firm cannot be taken as business income unless the assets have really been disposed off. Measurement of the accounting income is subject to a number of accounting concepts and conventions. For the purpose of cost analysis, the business concerns are divided into two categories namely trading concerns and manufacturing concerns. Income determination requires in case of both manufacturing and trading concerns the cost of goods sold. In case of trading concerns, the job is comparatively easy since the cost of goods sold can be easily found out by taking into account the purchase cost of the goods.

References

- SILM developed by Uttarakhand Open University for MCM-505 (Accounting Theory and Practices), Year 2017,